LAW REFORM COMMISSION OF BRITISH COLUMBIA
January 1994

LRC 134

TAXATION AND THE ASSESSMENT OF INCOME-RELATED AWARDS

In this Report the Commission recommends that a provision be added to the Law and Equity Act that rationalizes the calculation of damages in respect of lost earnings. Where a court makes an award of damages to an injured person to compensate for lost earnings, the damages are calculated and awarded as if that person's earnings attract no tax. This rule flows from a 1966 decision of the Supreme Court of Canada, R. v. Jennings, and reflects a theory that the injured party is to be compensated for a loss of income earning capacity rather than a loss of income itself. This approach leads to anomalous results including the overcompensation of injured parties in many cases. The Commission's recommendation, in effect, overrules R. v. Jennings.

Table of Contents

Page

I INTRODUCTION. 1

II TAXATION AND INCOME-RELATED AWARDS. 3
- A. The Current Position. 3
- B. Implications of the Jennings Principle. 5

III REFORM. 7
- A. The Need for Reform .7
- B. Prospects for Judicial Reform 7
- C. The Need for Legislation. 8
- D. Recommendation. 9

E. The Recommendation and the
Gross-up Guidelines 10
F. Relationship with the Work of
the Special Advisory Committee. 12

APPENDIX

RECOMMENDATIONS OF THE
SPECIAL ADVISORY COMMITTEE . . . .
13
A. General 13
B. The Guidelines. 13

1994

Province of
British Columbia

Report on Taxation and the Assessment of Income-Related Damage Awards

LAW REFORM COMMISSION OF BRITISH COLUMBIA

MINISTRY OF ATTORNEY GENERAL

LAW REFORM COMMISSION OF BRITISH COLUMBIA

REPORT ON

TAXATION AND THE ASSESSMENT OF INCOME-RELATED DAMAGE AWARDS

LRC 134 January, 1994

The Law Reform Commission of British Columbia was established by the *Law Reform Commission Act* in 1969 and began functioning in 1970.

The Commissioners are:

ARTHUR L. CLOSE, Q.C., *Chairman*
LYMAN R. ROBINSON, Q.C.
THOMAS G. ANDERSON

Gregory G. Blue is Legal Research Officer to the Commission.

Sharon St. Michael is Secretary to the Commission.

Linda Grant provides text processing and technical copy preparation.

The Commission offices are located at Suite 203, Chancery Place, 865 Hornby Street, Vancouver, B.C. V6Z 2G3.

The Law Reform Commission gratefully acknowledges the financial support of the Law Foundation of British Columbia in carrying out this project.

Canadian Cataloguing in Publication Data
Law Reform Commission of British Columbia.
Minor Report on taxation and the assessment of income-related damage awards

(LRC, ISSN 0843-6053 ; 134)

Includes bibliographical references: p.
ISBN 0-7726-2046-6

1. Damages - Taxation - British Columbia. 2. Compensation (Law) - British Columbia. 3. Income Tax - Law and legislation - British Columbia. 4. British Columbia. Law and Equity Act. I. Title. II. Series: Law Reform Commission of British Columbia. LRC ; 134.

KEB511.5.D35L38 1994 343.71105 C94-960068-7
KF6752.L38 1994

TO THE HONOURABLE COLIN GABELMANN
ATTORNEY GENERAL OF THE PROVINCE OF BRITISH COLUMBIA

Dear Mr. Attorney:

Re: Taxation and the Assessment of Income-Related Awards

(Minor Report, LRC 134)

Where a court makes an award of damages to an injured person to compensate for lost earnings, the damages are calculated and awarded as if that person's earnings attract no tax. This rule flows from a 1966 decision of the Supreme Court of Canada, *R.* v. *Jennings*, and reflects a theory that the injured party is to be compensated for a loss of income earning capacity rather than a loss of income itself.

This approach leads to anomalous results including the overcompensation of injured parties in many cases. In this Report the Commission recommends that a provision be added to the *Law and Equity Act* that rationalizes the calculation of damages in respect of lost earnings and, in effect, overrules *R.* v. *Jennings*.

Yours sincerely,

Arthur L. Close, Q.C.
Chairman

January 27, 1994

Table of Contents

PAGE

I INTRODUCTION 1

II TAXATION AND INCOME-RELATED AWARDS 3
A. The Current Position 3
B. Implications of the *Jennings* Principle 5

III REFORM 7
A. The Need for Reform 7
B. Prospects for Judicial Reform 7
C. The Need for Legislation 8
D. Recommendation 9
E. The Recommendation and the Gross-up Guidelines 10
F. Relationship with the Work of the Special Advisory Committee 12

APPENDIX

RECOMMENDATIONS OF THE SPECIAL ADVISORY COMMITTEE 13
A. General 13
B. The Guidelines 13

CHAPTER I INTRODUCTION

In mid-1992, a suggestion was received that the Law Reform Commission add to its program an examination of income tax gross-up and management fees. It was further suggested that if a series of standardized assumptions could be developed in relation to calculating these elements of a damage award, the result could be a significant saving in time and money for litigants and the justice system.

Our approach to this topic involved the creation of a Special Advisory Committee[1] whose membership represented an appropriate blend of legal, actuarial, economic and taxation expertise. Its mandate was to consider the general feasibility of standardized assumptions for calculating income tax gross-up and management fees, to identify the elements of these awards which are amenable to standardized assumptions and to develop those assumptions.

The Committee has now finished its work and its conclusions and recommendations, endorsed by the Law Reform Commission, are being submitted in a Report issued contemporarily with this.[2] The core recommendation of the Committee is that legislation be enacted to enable the promulgation of "guidelines" to govern the calculation of income tax gross-ups and the awarding of management fees, along with recommendations as to the content of those guidelines.

In the course of considering the Committee's work we encountered an anomaly in the substantive law concerning the assessment of income loss that might be addressed by legislation at the same time the Committee's recommendations are implemented. The concern is that compensation tied to income loss is calculated without reference to income taxation. This results in overcompensation in many cases. This issue did not fall within the Committee's terms of reference and was not the subject of any recommendations in the Committee's Report.

We decided, therefore, to bring forward a separate report of the Law Reform Commission setting out our analysis and recommendations on this question. The balance of this Report is devoted to this task.

---

1. The *Law Reform Commission Act*, R.S.B.C. 1979, c. 225 contemplates the creation of such committees. S. 4 provides:

> **4.** The commission may appoint committees, the members of which need not be members of the commission, and may refer any matter to committees for consideration and report to the commission. The Lieutenant Governor in Council may authorize the payment of travelling and out of pocket expenses incurred by the members of a committee in carrying out their duties.

2. Law Reform Commission of British Columbia, *Report on Standardized Assumptions for Calculating Income Tax Gross-up and Management Fees in Assessing Damages* (LRC 133) (hereafter referred to as the "Gross-up Report"). The Committee's conclusions and recommendations are described in the Appendix to this Report.

CHAPTER II TAXATION AND INCOME-RELATED AWARDS

A. The Current Position

The role that income tax should play in the assessment of awards calculated with reference to income loss, both past and future, has been a matter of persistent controversy in Canada for the past 25 years.[1] A useful description of the Canadian position and the issues that surround it is set out by Cooper-Stephenson and Saunders:[2]

> There are three primary questions concerning the influence of taxation on damage awards for loss of earnings. The first two are questions of damage assessment; the third a question of tax liability. The questions are:
>
> 1. Is the award for loss of earnings (whether past or prospective) to be based on "gross" earnings, ignoring the fact that the plaintiff would have had to pay tax on those earnings; or is it to be based on "net" earnings after tax, so that compensation would, in effect, substitute take-home pay?
>
> 2. Is the award to be increased because the plaintiff will have to pay tax on any interest generated by the lump sum, such interest being recognized as taxable income under current tax laws?
>
> 3. Are damages for loss of earnings (whether past or prospective) taxable in the hands of the plaintiff, on the ground that they are paid as a substitute for lost earnings?
>
> It can be seen that these questions are interrelated. And a number of solutions to the problem of taxation can be reached. The first solution would follow if damages for loss of earnings were taxable in the hands of the plaintiff (question 3), whereupon the plaintiff would only be fully compensated if assessment were based on gross earnings (question 1). However, as the law presently stands, damages for personal injury are not taxable as such in the hands of the plaintiff. In light of this, a second solution is to award damages based on "net" earnings (question 1), and to award a sum to cover projected tax on interest generated by the lump sum (question 2). This is the solution adopted in England and Australia, and is, in effect, the solution used in Canada for fatal accident cases. The third solution is to ignore the effect of taxation altogether: to award damages based on "gross" earnings (question 1), but to make no allowance for tax which will be levied on interest generated by the lump sum (question 2). This is the solution currently adopted by Canadian courts in personal injury cases.

---

1. *See* Cooper-Stephenson and Saunders, *Personal Injury Damages in Canada*, (1984); McLachlin, "What Price Disability? A Perspective on the Law of Damages," (1981) 59 Can. B. Rev. 1; Waddams, *The Law of Damages* (1983) 242-6; Rea, "Inflation, Taxation and Damage Assessment," (1980) 58 Can. B. Rev. 280; Charles, "A New Handbook on the Assessment of Damages in Personal Injury Cases From the Supreme Court of Canada," (1977-78) 3 C.C.L.T. 344, 358; Krishna, "Tax Factors in Personal Injury and Fatal Accident Cases: A Plea for Reform," (1978) 16 Osgoode Hall L.J. 723.

2. *Ibid.* at 181.

The current legal position in Canada rests on a 1966 decision of the Supreme Court of Canada, R. v. *Jennings*.[3] The central principle of *Jennings* is that when an injured party receives compensation that is linked to a loss of earnings, the compensation is not to be characterized as "income" which would attract taxation. Rather, it is to be characterized as compensating the injured party for the loss of the capacity to earn income. Because this loss is identified as a capital asset rather than income, it carries no tax consequences. The principle in *Jennings*, or its application in particular circumstances, has been affirmed in numerous subsequent cases.[4]

The rationale underlying *Jennings* and the court's characterization of income related loss has been severely criticized as unconvincing[5] and out-of-step with the way in which the courts actually approach the evaluation of this loss:[6]

> Despite frequent judicial use of the term "loss of earning capacity", the overwhelming weight of authority supports the view that the primary basis for assessment under this head is an estimation of loss of earnings, in the sense that the plaintiff's damages reflect what he would have earned but for the accident, rather than what he had the capacity or ability to earn....
>
> Therefore, despite use of terminology such as "loss of ability to earn", "loss of earnings capacity" and "loss of time", it is clear that as a matter of practice general assessment in Canada is for what the plaintiff would probably have earned and not for what he could have earned.

B. Implications of the *Jennings* Principle

The effect of following *Jennings* and ignoring the impact of taxation is to overcompensate plaintiffs. This is clearest when an award is made with respect to income lost before judgment. The plaintiff will normally receive an amount equal to the before-tax salary or income that went unearned. No tax is payable on that award so the plaintiff is overcompensated by the amount of tax that would have been paid if the amounts had actually been earned. Calculating damages that would not involve over-compensation for pre-trial income loss is a relatively straightforward matter.

---

3. (1966) 57 D.L.R. (2d) 644.

4. *Andrews* v. *Grand & Toy Alberta Ltd.*, (1978) 83 D.L.R. (3d) 452; *Guy* v. *Trizec Equities Ltd.*, (1980) 99 D.L.R. (3d) 243; *Watkins* v. *Olafson*, [1989] 2 S.C.R. 750.

5. Cooper-Stephenson and Saunders, *supra,* n. 1 at 185. The *Jennings* case is extensively analyzed in terms of six broad reasons thought to underlie it. The authors find none of them persuasive.

6. *Ibid.* at 198.

Overcompensation can also result from the application of the *Jennings* principle to future income loss although here the issue has become somewhat subtler. The current method of calculating compensation for future income loss involves ascertaining the present value of the income stream which has been lost.[7] The income stream on which the calculation is based is the plaintiff's before tax income and the present value calculation is made using the statutory discount rate set out in section 51 of the *Law and Equity Act*.[8]

The overcompensation in this case may be less obvious because interest generated by the award is taxable in the hands of the plaintiff. This offsets, to a degree, the overcompensation that may result from calculating the plaintiff's income loss with reference to before tax income. In some cases, it may come close to achieving a balance, but the reality is that in almost every case the current method of calculation will result in some overcompensation to the plaintiff.

The intuitive correctness of this assertion becomes fairly clear when one considers an award that has to deliver compensation over a relatively short period of time - say to an individual who is seriously injured five years before the expected retirement date. In this case, the plaintiff's withdrawals from the fund would be tax free in the plaintiff's hands and only a trivial portion of those withdrawals would have been made up of interest generated by the fund on which the tax would have been paid.[9] As the award period becomes longer, the relative overcompensation diminishes.

A more accurate approach to calculating future income loss would be to do a present value calculation based on the plaintiff's projected net (after tax) income stream and then "gross-up" the resulting fund to adjust for the impact of taxation on revenue generated by the fund.

In the past this approach might have been regarded as unacceptable on the purely practical ground that it would add further complexity to the process of assessing damages to achieve gains that are not immediately

---

7. This process is described in greater detail in the Gross-up Report at pp. 4-9.

8. R.S.B.C. 1979, c. 224. The resulting fund is not "grossed-up" as would be the case if the fund were for future care.

9. An award to compensate for 5 years of lost future earnings of $60,000 per year would amount to approximately $280,000. The interest earned by this award before it was exhausted at the end of the 5 year period would attract income tax of approximately $10,000 (based on the 1992 tax rates and assumptions that the plaintiff has no other sources of income and is entitled to no deductions or credits other than the personal tax credit). If the $60,000 had actually been earned by the plaintiff each year over that period, it would have attracted income tax of about $100,000 in total. This represents a windfall to the plaintiff of $90,000.

obvious.[10] We believe that as the courts and the legal profession become increasingly comfortable with the procedure of grossing-up this objection loses much of its force. The recommendations of the Special Advisory Committee for standardized assumptions[11] should make this procedure even more palatable.

10. This is the argument adopted by Waddams, *supra,* n. 1 at 246.

11. *See* Appendix.

CHAPTER III REFORM

A. The Need for Reform

The current approach of the law in Canada may be criticized on the following bases.

1. It leads to an inconsistent treatment of damage assessment in personal injury cases and fatal accident cases that cannot be justified.

2. The approach is out of step with that followed by the courts in England, New Zealand and Australia.[12]

3. The approach is based on a legal characterization of loss of earnings that does not reflect the way judges actually assess these losses.

4. The approach is inconsistent with financial theory since the principal method for the valuation of a capital asset is to determine its after-tax cash flow.

5. Significant numbers of plaintiffs are overcompensated under the present approach.

The most serious concern arising out of the continued application of the *Jennings* principle is that of overcompensation to individual plaintiffs. In most cases, the cost of overcompensation is passed along to the general public in the form of increased insurance rates.

B. Prospects for Judicial Reform

It is possible that *Jennings* will yet be overruled but the record of the Supreme Court of Canada on this issue is not encouraging. It has had a number of opportunities to reconsider *Jennings* but it has not done so. In *Trizec Equities Ltd.* v. *Guy* Mr. Justice Macdonald of the Appeal Division of the Supreme Court of Nova Scotia made a plea for judicial reform of the rule:[13]

> I well appreciate the inherent problems that would be involved if income tax were to be taken into account in assessing damages for loss of future earnings,

---

12. In those jurisdictions damages for loss of earnings are awarded on an after-tax basis following *British Transport Commission* v. *Gourley*, [1956] A.C. 185 (H.L.).

13. (1978) 85 D.L.R. (3d) 634, 654.

> yet, with respect, it seems unrealistic to me not to make some allowance for it. In this day of high wages, high taxation and high damage awards, to make an assessment of damages for loss of future earnings without considering, as a factor, the incidence of taxation, is to cloak the award in a coat of artificiality which in many cases will result in over compensation. The law, however, is as stated in the *Jennings* case and I shall refrain from saying anything further on the subject except to express the hope that the Supreme Court of Canada will, in the opportune case, reconsider the *Jennings* principle.

The *Trizec* Case was itself appealed to the Supreme Court of Canada which declined the invitation to reconsider *Jennings*, reaffirming it instead.[14]

C. The Need for Legislation

A legislative solution is required. We are fortified in this view by observations recently made by Madam Justice Southin of the British Columbia Court of Appeal in *Cooper* v. *Miller*.[15] She com-mented:[16]

> I turn then to the final question on this appeal...the deductibility from Mr. Shank's award of the income he would have paid...
>
> I agree...that logically one should in assessing damages for past loss of earnings and loss of future earning capacity make some reduction because earnings are subject to income tax.
>
> For my part, I cannot understand how it is right to gross-up for the impact of income tax on an award for future care and not "gross-down" for income tax in making an award for past loss of earnings and loss of future earning capacity.
>
> A distinction can be drawn between past and future loss founded on the difficulty of determining what deduction ought to be made on the award for loss of future earning capacity. But on the past loss the impact of tax can easily be determined by the simple expedient of making an assessment founded on the plaintiff's past income tax obligations giving due weight to any changes made before the date of trial in the *Income Tax Act*.
>
> In gross-up cases, complex calculations are necessary which require expert assistance. In past loss cases, expert assistance ought only occasionally to be necessary.
>
> Such a computation would not be perfect - there are variables - but what is as certain as anything can be is that this plaintiff, for instance, would not have

---

14. (1980) 99 D.L.R. (3d) 243. At the time this Report was prepared, the issue had again come before the Supreme Court of Canada in *Miller* v. *Cooper* (No. 22860). The appeal was heard on Nov. 4, 1993 and the decision was reserved. *See* Supreme Court of Canada, Bulletin of Proceedings, Nov. 5, 1993 at 2025. As to the B.C. Court of Appeal decision in *Cooper* v. *Miller see infra* at n. 15.

15. (1992) 64 B.C.L.R. 62 (indexed as *Cunningham* v. *Wheeler*). *See also MacDonald* v. *Neufeld* (unreported B.C.C.A. Van. No. CA014815/CA015657; Sept. 3, 1993).

16. *Ibid.* at 82.

> taken home from work during the period of his pre-trial disability the amount which he has been awarded. He has, in fact, had a windfall.
>
> But we are bound by authority not to make any such reduction: see *Watkins* v. *Olafson*, (1989) 2 S.C.R. 750.
>
> If the law on this subject is to be changed it must be changed either by the Supreme Court of Canada or by the legislature. I point out that it would be a relatively simple matter for the legislature to add a clause to the *Law and Equity Act*...empowering the courts to take into account the effects of income tax on awards of both sorts.

D. Recommendation

We adopt the suggestion of Madam Justice Southin that an amendment to the *Law and Equity Act* is an appropriate way to proceed. What is required is a provision that will overrule *Jennings* by stating in positive terms the appropriate role of income tax in assessing damages for loss of earnings. Our version of such a provision is set out below.

The Commission recommends:

The *Law and Equity Act* should be amended by adding a provision comparable to the following:

51.X. (1) In this section

"future income award" means the portion of a judgment for personal injuries that is intended to compensate for, or is determined with reference to, a loss of future earnings because of partial or total loss of income earning capacity,

"past income award" means the portion of a judgment for personal injuries that is intended to compensate for, or is determined with reference to, a loss of earnings incurred before trial.

(2) Where a claim is made for compensation based on loss of earnings arising out of a personal injury

(a) in the case of a past income award, the award must be assessed taking into account the income tax that would have been paid on the money in issue had it in fact been earned before trial, and

(b) in the case of a future income award, the assessment of the award must be based on
   (i) the present value of the claimant's projected loss of earnings, net of income tax, plus
   (ii) an additional amount to adjust for the impact of taxation of income generated by the amount described in subclause (i).

E. The Recommendation and the Gross-up Guidelines

Sub-clause 51.X(2)(b)(ii) of our recommended provision refers to "an additional amount to adjust for the impact of taxation ..." This is the income tax gross-up that is the subject matter of the Report of our Special Advisory Committee. The work of the Committee was carried out on the basis that gross-up issues arose only with respect to awards for future care and awards for loss of dependency under the *Family Compensation Act*.[17] The effect of our recommendation is to expand the domain of income tax gross-up to embrace awards for lost future earnings. This raises the question whether the Committee's recommended guidelines will require any additional provisions to clarify their application to the gross-up of an award for lost earnings.

For the most part, the application of the guidelines to the gross-up of an award in respect of future earnings raises no special issues. Most of the provisions are of general application and raise no special issues in this context.[18] Only one provision of the guidelines may require further consideration.

Paragraph 6 stipulates the tax rate to be used in carrying out a gross-up calculation. Paragraph 6(1) provides:

> 6. (1) A gross-up for a care award or a dependency award must be calculated on the basis that the taxable portion of the earnings of the award is taxed at the marginal rate or rates applicable after the taxation of all of a plaintiff's first dollar income amounts.

17. R.S.B.C. 1979, c. 120.

18. Some of the guidelines, *e.g.* para. 5(1), apply to "an award for future loss" which, by definition, includes an "income award." *See* Appendix. Other guidelines, *e.g.* para. 7, apply expressly to an "income award."

Paragraph 6(2) goes on to define what constitutes a plaintiff's "first dollar income amounts."[19] This rule represents the income "stacking" approach sanctioned in the cases.[20] It embodies an assumption that investment income earned by an award for future care or in respect of dependency will attract tax at the plaintiff's highest marginal rate and the gross-up must be calculated with reference to that rate. This formulation leaves at large the question of the tax rate to be assumed when calculating the gross-up of an income award.

There are a number of possible answers to this question. One might also adopt the "stacking" approach in this context and assume that investment income earned by an award to replace lost future earnings attracts tax at the plaintiff's highest marginal rate. To do this, however, might require some reconsideration of what constitutes "first dollar income" in the light of the meaning given to that expression in the guidelines.[21] Alternatively, this investment income might be assumed to attract tax at the same rate as the plaintiff's first dollar income.

This issue is new to Canada. It has not yet been addressed by the courts nor has there been any opportunity for any kind of consensus to develop among professional advisers concerned with the calculation of income tax gross-ups. In the circumstances, therefore, we believe it would be premature of the Commission to attempt to lay down any views or recommendations about the way in which the gross-up guidelines should address this particular issue.

We note that the review mechanism provided in the guide-lines contemplates their modification and the creation of new guidelines as experience and circumstances may require. While we do not doubt the desirability of clarifying, in the guidelines, the tax rate to be assumed when calculating the gross-up of an income award, we believe that would best be done through the mechanism provided for revising the guidelines and after there has been some local experience with gross-up of this kind. Accordingly, we make no recommendations concerning possible additions to the guidelines.

---

19. For the purpose of a gross-up calculation with respect to a care award or dependency award, the expression "first dollar income amounts" includes investment income that is assumed to be generated by an award for lost future earnings.

20. *See* the Gross-up Report at p. 20.

21. *See* Appendix A, paragraph 6(2), Rule B(a).

F. Relationship with the Work of the Special Advisory Committee

We wish to stress in conclusion that although the recommendations made in this Report were stimulated by the work of our Special Advisory Committee, they are the Law Reform Commission's own. While individual Committee members have assisted us in addressing particular issues, the Committee, as such, has not considered the issues and recommendations set out in this Report.

APPENDIX

RECOMMENDATIONS OF THE SPECIAL ADVISORY COMMITTEE

A. General

The Special Advisory Committee recommended that enabling legislation be enacted to permit the creation of guidelines that would provide standardized assumptions in relation to income tax gross-ups and to rationalize the awarding of management fees. The guidelines are set out below.

B. The Guidelines

INCOME TAX GROSS-UP AND MANAGEMENT FEE GUIDELINES

Part 1 – General

Definitions

1. In these guidelines:

"award for future loss" means every element of an award

(a) based on a personal injury claim, or
(b) made under the *Family Compensation Act*

except

(c) the portion of an award intended to compensate for non-pecuniary losses,
(d) the portion of an award intended to compensate for pecuniary loss arising before trial, including past income loss, or
(e) the portion of an award that is a **management fee**,

"award value" means the amount of an **award for future loss** plus the amount of any **gross-up** added to the award.

"Canada life tables" means the most recent life tables for Canada published by Statistics Canada,

"care award" means the portion of a judgment for personal injuries that is intended to compensate for expenses of future care,

"dependency award" means the portion of a judgment made under the *Family Compensation Act* that is intended to compensate for loss of dependency,

"gross-up" means an amount added to an **award for future loss** to adjust for the impact of taxation of income generated by the award,

“income award” means the portion of a judgment for personal injuries that is intended to compensate for, or is determined with reference to, a loss of future earnings because of partial or total loss of income earning capacity,

“management fee” means an amount described in paragraph 11(1),

“plaintiff” means the party to be compensated.

Application

2. (1) Subject to subparagraph (3) and any directions given under subparagraph (6), an expert report concerning a **gross-up** that is submitted to the court must conform to these guidelines.

(2) Subject to subparagraph (3), an award of a **management fee** must conform to these guidelines.

(3) Parties may agree to vary or exclude these guidelines.

(4) Subject to subparagraph (5), the assumptions and rules set out in these guidelines, to the extent that they address matters that would otherwise require findings of fact by the court, constitute irrebuttable presumptions.

(5) The assumptions set out in paragraphs 4(3), 7 and 10(4) constitute presumptions that may be rebutted by evidence, but any party that intends to lead such evidence must give notice of that intention not less than 60 days before trial unless the court otherwise orders.

(6) Where the calculation of a **gross-up** involves a consideration of the taxation laws of a jurisdiction other than Canada or a province or territory of Canada, the court may, on application by a party, give directions respecting the application of these guidelines as the facts of the case may require.

Part 2 – Income Tax Gross-up

Form of gross-up

3. A **gross-up** must be expressed as a dollar amount.

Future tax laws

4. (1) Subject to subparagraphs (2) and (3), income tax laws applicable in the future are assumed to be the same as those in force at the time of trial.

(2) All fixed dollar amounts in the income tax laws are assumed to change annually at the rate of future inflation established under paragraph 8.

(3) A change in the income tax laws that, at the time of trial, has been introduced or announced in a budget speech in the Parliament of Canada or a provincial legislature, although not yet implemented or in force, is assumed to be part of the income tax laws applicable in the future.

(4) The presumption in subparagraph (3) may be rebutted by proving that the unimplemented change no longer represents taxation policy of the government of Canada or a province.

Investment income

5. (1) An **award for future loss** is assumed to generate investment income at a rate determined by the following formula:

$$J=((1+K) \times (1+R))-1$$

where

"**J**" means the assumed rate of investment income,
"**K**" means the assumed rate of future inflation established by paragraph 8,
"**R**" means the discount rate prescribed under section 51(2)(b) of the *Law and Equity Act*, and
"**J**", "**K**" and "**R**" are all expressed as decimal amounts.

(2) The investment income generated by an **award for future loss** is assumed to be derived from interest and dividends of Canadian corporations. The proportion of the income that is assumed to be derived from interest must be determined with reference to the following rules:

Rule A: In these Rules:
"**I**" means the proportion of income that is assumed to be interest, expressed as a percentage and rounded to the nearest whole number,
"**A**" means the total value of the **award for future loss**,

Rule B: Where **A** is $200,000 or less, **I = 100%,**

Rule C: Where **A** is between $200,000 and $800,000,

$$I = 100 - ((A - \$200{,}000)/\$15{,}000)$$

Rule D: Where **A** is $800,000 or greater, **I = 60%.**

Tax rate

6. (1) A **gross-up** for a **care award** or a **dependency award** must be calculated on the basis that the taxable portion of the earnings of the award is taxed at the marginal rate or rates applicable after the taxation of all of a **plaintiff's** first dollar income amounts.

(2) For the purposes of subparagraph (1) a **plaintiff's** "first dollar income amounts" must be ascertained with reference to the following rules:

Rule A: subject to Rules C and D, an amount derived from any source that attracts income tax in the hands of the **plaintiff** forms part of the **plaintiff's** first dollar income amounts,

Rule B: without limiting Rule A and for greater certainty, the following amounts form part of the **plaintiff's** first dollar income:

(a) investment income that is assumed to be generated under paragraph 5(1) on the **income award** portion of the judgment,
(b) taxable income from capital and investments owned before the **plaintiff's** injury or dependency loss,
(c) a stream of payments attracting tax that is received after or as a result of the injury or dependency loss,
(d) the **plaintiff's** likely future income from employment,

Rule C: the following amounts do not form part of the **plaintiff's** first dollar income amounts:

(a) investment income assumed to be generated by the **care award** or **dependency award** portion of the judgment,
(b) potential income from a capital amount acquired by the **plaintiff** after or as a result of the injury or dependency loss including
    (i) insurance proceeds paid as a lump sum, and
    (ii) the portion of an award intended to compensate for non-pecuniary losses,

Rule D: Whether or not an amount forms part of a **plaintiff's** first dollar income must be determined without reference to section 3(7) of the *Family Compensation Act* or the principles concerning the deduction of collateral benefits in personal injury cases.

Withdrawals

7. It is assumed that withdrawals from the fund created by a **care award**, **dependency award** or **income award** will occur in equal real amounts.

Future inflation

8. The rate of general price inflation predicted to occur over the period for which an **award for future loss** is intended to provide compensation is assumed to be 4.0% per annum.

Calculation of gross-up

9. (1) A **gross-up** calculation must be carried out using the actuarial style of calculation known as the **survival probability method** in conjunction with the **Canada life tables**.

(2) In subparagraph (1) "**survival probability method**" means the method under which:

(a) the projected withdrawals from a fund in each future year are discounted to reflect the probability of survival to that year of
    (i) in the case of a claim under the *Family Compensation Act*, the plaintiff and the deceased, and
    (ii) in any other case, the plaintiff, and
(b) the withdrawals, discounted for survival prospects, exhaust the **award value** (adjusted for investment income on the declining balance and taxes on that income) over the period for which the costs of future care, lost dependency, or other loss could potentially endure.

(3) Where an award is to be reduced because of contributory fault attributable to the **plaintiff** or, in the case of a claim under the *Family Compensation Act*, to the deceased, any **gross-up** of the award must be calculated with reference to the reduced amount.

Tax benefits

10. (1) Where any part of an **award for future loss** is based on a projected expenditure for goods or services that would result in an income tax benefit to the **plaintiff** in the form of a deduction or credit (including a credit arising under section 118.2 of the *Income Tax Act* (Canada)) the value of that benefit, adjusted for the actuarial survival probability, must be taken into account in calculating the **gross-up**.

(2) An expert report respecting a **gross-up** of an **award for future loss** must set out a list that expressly identifies the items which, for the purposes of the calculations, have been treated as attracting an income tax benefit described in subparagraph (1).

(3) The list of items identified, in an expert report prepared for the **plaintiff**, as those which attract an income tax benefit described in sub-paragraph (1) is deemed to be accepted by all parties as exhaustive and conclusive unless a party who is adverse in interest

(a) submits an expert report that embodies a different list of items, or

(b) otherwise notifies the **plaintiff** that the list is disputed along with particulars of the dispute

no later than 30 days after receiving the **plaintiff's** expert report unless the court otherwise orders.

(4) Where an **award for future loss** is intended to compensate for items that attract a tax benefit described in subparagraph (1) but the award is reduced because of the **plaintiff's** contributory fault, for the purposes of calculating the **gross-up** it is assumed that the portion of the award that will be spent on items that attract an income tax benefit is proportionally reduced.

(5) Where the value of income tax benefits described in subparagraph (1) exceeds tax otherwise payable on the investment income that is assumed to be generated under paragraph 5(1) on the award, the excess may be regarded as reducing the **plaintiff's** tax liability on first dollar income amounts and taken into account in calculating the **gross-up**, but the **gross-up** may not be reduced to a negative value through the operation of this subparagraph.

Part 3 – Management Fees

Management fee

11. (1) Where a court considers it necessary or appropriate in the circumstances, the court may include in an **award for future loss** an additional amount for the purpose of enabling the **plaintiff** to obtain advice and assistance in the investment and management of the award over the **management period**.

(2) In this Part **"management period"** means the time from the trial of a proceeding to

(a) in the case of an **award for future loss** that includes an award intended to provide compensation throughout the lifetime of the **plaintiff**, the end of the predicted life of the **plaintiff**, determined with reference to the **Canada life tables**.

(b) in the case of a **dependency award**, the time at which the dependency would have been expected to cease if the facts giving rise to the claim for compensation had not occurred, and
(c) in any other case, the time on which calculations are based within which the fund created by the award is intended to be exhausted,

or such earlier time as the facts of the case may require,

Levels of management fee

12. (1) An award of a **management fee** must be stated in terms of a level described in subparagraph (2).

(2) There are four levels of **management fee** as follows:

Level 1: an amount sufficient to purchase a single session of counselling and the preparation of an investment plan by a professional investment counsellor at the commencement of the **management period**.

Level 2: an amount sufficient to purchase a session of counselling, and the preparation of an investment plan by a professional investment counsellor at the commencement of the **management period** and for its periodic review during the **management period**.

Level 3: an amount sufficient to provide the **plaintiff**, on a continuing basis throughout the **management period**, with management services in relation to the custody of and accounting for investment of the **award value**.

Level 4: an amount sufficient to provide the **plaintiff**, on a continuing basis throughout the **management period**, with full investment management services in relation to the **award value** including custody and accounting services and delegated responsibility for making and carrying out investment decisions.

(3) Where the court makes an award of a **management fee** at level 3 it may make an additional award of a **management fee** at level 1 or level 2.

(4) Where the court determines that an award of a **management fee** at level 4 is appropriate for only a portion of the **management period**, the court may make an award of **management fees** that incorporates such elements of levels 1 to 4 as the facts of the case may require.

(5) Where the Public Trustee will be responsible for the management of the **award value** for any part of the **management period**,

(a) the **management fee** for that part must be determined with reference to the scale of fees for the services of the Public Trustee that is in force at the time of trial, and
(b) for the balance of the **management period**, the court may make an award of **management fees** that incorporates such elements of levels 1 to 4 as the facts of the case may require.

Amount of management fee

13. The amount of a **management fee** must be determined in accordance with the following rules:

Level 1: the amount of a level 1 **management fee** is $1,000.

Level 2: the amount of a level 2 **management fee** is the amount set out in Table A in the Schedule to these guidelines for the applicable **management period**.

Level 3 and Level 4:

Rule 1: the **management fee** is a percentage of the **award value**.

Rule 2: the percentage of the award applicable in a particular case is the percentage set out in Table B or Table C in the Schedule where the row and column referable to the **award value** and the **management period** intersect.

Rule 3: Table B must be used for Level 3 **management fees** and Table C must be used for Level 4 **management fees**.

Rule 4: Interpolation is permitted where the **award value** or the **management period** falls between two values in Table B or Table C.

Rule 5: Where the intersection of the **award value** and the **management period** falls outside the range of values provided in Table B or Table C, the amount of the **management fee** must be the subject of individual valuation.

Criteria

14. In determining whether or not, and at what level, a **management fee** should be awarded the court must consider all relevant factors including:

(a) the **award value**,
(b) the duration of the **management period**,
(c) the age of the **plaintiff**,
(d) the money-management and investment skills possessed by the **plaintiff**, and
(e) the extent to which the **plaintiff** may be impaired in the management of his or her affairs.

Part 4 – Review

Review of guidelines

15. (1) The Chief Justice of the Supreme Court will establish an advisory committee with respect to these guidelines.

(2) The advisory committee will be chaired by the Chief Justice or the nominee of the Chief Justice and, subject to subparagraph (4), will meet at the call of its chair.

(3) It is the function of the advisory committee to monitor the operation and application of the guidelines and to make recommendations for any changes or additions to them that may improve their operation or better achieve their aims.

(4) In May of each year the advisory committee must meet

(a) to evaluate the behaviour of the economic monitoring factor and, if, appropriate, conduct a review of the predicted rate of general price inflation established under paragraph 8 with recommendations for a revised rate if required, and

(b) consider the values expressed as dollar amounts in paragraph 5(2) in the light of price inflation that has occurred since they were last established, with recommendations for revised values if required.

(c) consider the scales and amounts of **management fees** established under paragraph 13 and the Schedule with recommendations for revisions if required.

(5) The economic monitoring factor referred to in subparagraphs (4)(a) and (6) is derived as follows:

$$EMF = ((1 + B)/(1+I) \times (1 + r)) - 1$$

where

"**EMF**" means the economic monitoring factor,
"**I**" means the assumed rate of future inflation established under paragraph 8,
"**B**" means the yield rate, as published in the most recent issue of the quarterly Bank of Canada Review, for Government of Canada marketable bonds that mature no earlier than 10 years from the date of publication,
"**r**" means the discount rate prescribed under section 51(2)(b) of the *Law and Equity Act,*
"**I**","**B**","**r**" and "**EMF**" are all expressed as decimal amounts.

(6) The behaviour of the economic monitoring factor is evaluated according to the following rules:

Rule 1: Where the **EMF** has, for 3 or more consecutive years, had a positive value of an absolute magnitude greater than 0.10 it is appropriate to consider recommending an upward adjustment of **I**.

Rule 2: Where the **EMF** has, for 3 or more consecutive years, had a negative value of an absolute magnitude greater than 0.10 it is appropriate to consider recommending a downward adjustment of **I**.

Rule 3: In any case not within Rule 1 or Rule 2, no adjustment of **I** is indicated.

(7) Any recommendations made by the advisory committee, whether pursuant to subparagraph (4) or otherwise must be transmitted by the Chief Justice of the Supreme Court to the Attorney General along with the Chief Justice's personal recommendations concerning action on them.

[The Schedule to the Guidelines has not been reproduced]