TAX CONSIDERATIONS IN DAMAGE AWARDS—IS *The Queen* v. *Jennings* THE FINAL RULE IN CANADA?

I. INTRODUCTION

Whether or not to consider taxation in evaluating the amount of damages a plaintiff should receive is an issue which has been the subject of much conjecture. The issue first peaked in 1955 in the House of Lords, in *British Transport Commission* v. *Gourley*[1] which held that the tax one would have paid if the award had actually been received as income is to be deducted from the gross quantum of that award. This proposition presupposes two conditions precedent to its operation: firstly, the award of damages must represent a sum of money received in lieu of lost income; and secondly, the award itself must not be liable to taxation when received by the plaintiff.

Under Canadian law damages received for personal injuries are not taxable; nor has the Department of National Revenue ever attempted to include them under any section of the Income Tax Act. This also applies to damages received in a breach of contract of employment action, or in lieu thereof, provided they are not paid voluntarily by the employer.[2] In other words if the employer is in some way compelled to make the compensatory payment, it will be a non-taxable capital receipt in the plaintiff's hands. However, if it can be construed in such a way as to amount to a retiring allowance[3] under the Income Tax Act, ss. 56(1)(a) and 248(1), or as representing salary arrears,[4] then the amount will be liable to assessment.[5] When damages for loss of business and breach of contract are paid as compensation for loss of profits, they are taxable; but they may be non-taxable capital receipts if paid to compensate for damage to or loss of one's income-producing structure.[6]

II. PRE-1966 HISTORY

In Canada the *Gourley* issue first appeared in 1945 in Ontario, where much of the later litigation on the matter was to occur. The Ontario High Court in *Fine* v. *Toronto Transportation Commission*[7] was confronted with a claim for the loss of both past and present wages, caused by a personal injury to the plaintiff. In refusing to consider the plaintiff's tax liability had he not been injured, Barlow J.[8] approved of the reasoning of du Parcq J. in *Fairholme* v. *Firth and Brown Ltd.,* [9] an early English decision that such a matter was a personal one between the taxpayer and the Crown and of no concern to the defendant. The following year in *Bowers* v. *J. Hollinger and Co.*[10] the same Court faced a similar claim for loss of earnings which resulted from injuries sustained by the plaintiff while riding on a bus. Urquhart J., in awarding gross earnings,

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[1] (1956) A.C. 185.

[2] *Brown* v. *M.N.R.* (1952) 52 D.T.C. 9, *Millman* v. *M.N.R.* (1951) 51 D.T.C. 305, *Hafenzi* v. *M.N.R.* (1961) 61 D.T.C. 357, *Larson* v. *M.N.R.* (1967) 67 D.T.C. 81, *Garneau* v. *M.N.R.* (1968) 68 D.T.C. 132, *Jones* v. *M.N.R.* (1969) 69 D.T.C. 4, *No. 45* v. *M.N.R.* (1952) 52 D.T.C. 72.

[3] *Estate of G. S. Cleet* (1969) 69 D.T.C. 135.

[4] *Gagnon* (1961) 61 D.T.C. 307.

[5] *See* McDonald, *Canadian Income Tax* (1970) 2395-2397.

[6] *Id.* at 2676-2682.

[7] [1945] O.W.N. 901.

[8] *Id.* at 902-903.

[9] (1933) 49 T.L.R. 470.

[10] [1946] O.R. 526.

followed the *Fairholme* and *Fine* decisions and emphatically stated: "I do not think that I can add anything to the reasoning therein to be found".[11]

Having faced the issue twice in personal injury cases, the High Court of Ontario next dealt with it in relation to loss of earnings caused by a breach of contract to purchase goods. In refusing to deduct the tax which the plaintiff company would have paid on the earnings, the Court in *Anderson* v. *International Waxes Ltd.*[12] applied the English Court of Appeal decision of *Billingham* v. *Hughes,*[13] where Tucker L.J. had applied the principle of *restitutio in integrum*, and Singleton L.J. had followed *Blackwood* v. *Andre.*[14] There Lord Keith had similarly refused to consider the tax implications in his judgment.

A change of forum brought a change in reasoning as the Newfoundland Supreme Court in *Power* v. *Stoyles,*[15] a personal injury case, uncritically accepted the authority of the House of Lords decision in *Gourley*. Winter J. made no reference to the earlier Ontario authorities to the contrary, nor did he exercise his right to decide the matter independently of the English position, although Privy Council appeals had long been abolished.

Support for *Power* v. *Stoyles* came in *Walker* v. *Copp Clark Publishing Co. Ltd.*[16] when the issue returned to the Ontario High Court in 1962. The plaintiff had been wrongfully dismissed from his position as director and salesman of the defendant's predecessor company before the expiry of his five-year contract. Having then obtained a less remunerative employment the plaintiff was awarded only the difference between his former and present salaries, but on an after-tax basis. In so doing, Spence J. expressly applied *B.T.C.* v. *Gourley,* thereby reversing the trend of the previous Ontario decisions. One may argue that this case is distinguishable from the earlier ones, on the basis that it concerned a different cause of action. However, the fact remained that the former position was greatly weakened, if not reversed, by this decision.

In 1963, the *Gourley* problem went West for the first time in its Canadian history. In *Widrig* v. *Strazer and Gardiner*[17] the Alberta Appellate Division found the defendants liable for a breach of contract to deliver to the plaintiff certain shares representing company control. Among the damages was an amount for loss of wages which the plaintiff would have received had he held that control and employed himself as company aircraft pilot. Johnson J.A. for the Court stated:[18]

> No deduction for the payment of income tax on these damages for lost wages was made and on the authority of *British Transport Commission* v. *Gourley* . . . deductions for this tax should have been made.

This uncritical acceptance of *Gourley* was reminiscent of the approach taken in the *Power's* case.

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[11] *Id.* at 541; he also made reference to *Jordan* v. *Limmer and Trinidad Lake Asphalt Co.* [1946] 1 All E.R. 527.

[12] [1951] O.W.N. 113 per Ferguson J. (this was the last Canadian case in the matter before *Gourley*).

[13] [1949] 1 K.B. 643.

[14] [1947] S.C.R. 333.

[15] (1959) 17 D.L.R. (2d) 239.

[16] [1962] O.R. 622.

[17] (1963) 37 D.L.R. (2d) 629.

[18] *Id.* at 645.

The shift in support of the *Gourley* position in Canada was now well underway, and was enhanced by the Saskatchewan Queen's Bench that same year in *Smith* v. *C.P.R.*[19] Bence C.J.Q.B. awarded an injured school teacher only her loss of earnings after tax, expressly following the *Gourley* and *Widrig* cases.

However, in Manitoba, the last prairie province to deal with the issue, the pendulum swung again to the anti-*Gourley* side. In *Soltys* v. *Middup Moving and Storage Ltd.*,[20] Nitikman J. adopted the position that the injured plaintiff's tax situation was *res inter alios acta*, and the benefit of it should not go to the defendant.[21] Damages are to be awarded not "for actual loss of earnings, but for loss of earning capacity, *i.e.* loss of natural capital equipment and that while this is particularly applicable to general damages the same principle applies to special damages".[22] A similar result was reached the next year in *Buck* v. *Rostill*,[23] where Gregory J. also awarded gross wages lost to an injured waitress. He said that the general practice of that Court was to ignore one's income tax position (inveterate practice) and that this should not be altered until the Court of Appeal had given the matter consideration, or until the judges of the Court had agreed upon a uniform practice. Nor could he be sure that the Department of National Revenue would not tax the plaintiff on that part of the award representing lost income. In two subsequent personal injury cases, *Heltman* v. *Western Canada Greyhound Lines*[24] and *Curbello* v. *Thompson*,[25] the B.C. Supreme Court refused to make any deduction for income tax. In *Curbello* Aikins J., basing his decision upon the uncertainty that the Department of National Revenue would not tax the award, added that in principle he favoured the *Gourley* rule.[26] This statement no doubt somewhat weakened the anti-*Gourley* position of the B.C. Courts, just as *Walker* had done in the Ontario courts.

The *Gourley* issue appeared again in *Posluns* v. *Toronto Stock Exchange*[27] for the final time before receiving the consideration of the Supreme Court of Canada. The defendants were sued for allegedly inducing the plaintiff's employer to breach his contract of employment. At trial Gale J. found no substantial basis for the claim. However, in dicta, he stated that even if the plaintiff had won, the *Gourley* rule would have applied to the award.[28] Of special interest is the way he distinguished between cases of personal injury and wrongful dismissal. With the former he said it was unclear whether the Department of National Revenue would or would not tax the award, the problem having never arisen because of the administrative policy of the Department. However, in cases of wrongful dismissal there is abundant authority that such damages would not be taxable, being awarded not in lieu of income, but as compensation for the destruction of a capital

[19] (1964) 41 D.L.R. (2d) 249.

[20] (1964) 41 D.L.R. (2d) 576 (Man. Q.B.).

[21] *Citing e.g.* (1956) 34 Can. Bar Rev. 940 per Philip F. Vineberg; *Law Society of Upper Canada, Special Lectures*, (1955) 126-129, per Stewart J.

[22] (1963) 41 D.L.R. (2d) 576 at 582.

[23] (1965) 51 W.W.R. 319.

[24] (1965) 23 The Advocate 78 per Verchere J.

[25] (1966) 58 D.L.R. (2d) 48, decided one day after *The Queen* v. *Jennings*.

[26] *Id.* at 51.

[27] [1964] 2 O.R. 547; *aff'd.* [1961] O.R. 285 (Ont. C.A.); *aff'd.* [1968] S.C.R. 330 (S.C.C.).

[28] [1964] 2 O.R. 547 at 679.

asset, that is, the right to serve and receive remuneration to the end of the contractual term.[29]

He added that in the corollary area of procuring a breach of contract,[30]

> . . . although the damages are payable not by the contracting party, as is the case in a wrongful dismissal action, but by a third party, [it] is closer in its nature to the breach of contract action than to a personal injury action.

Therefore such an action would also require the deduction of tax. This dichotomy, for the purposes of the *Gourley* rule, was a unique and novel approach for the Canadian courts to take, for previously they had always lumped them together, and applied the rule to all or none. This decision was later affirmed on appeal.[31] As will be discussed later, the approach of Gale J. may well represent the present state of the law in Canada, despite the anti-*Gourley* decision of the Supreme Court of Canada in the *Queen* v. *Jennings*.[32]

III. THE QUEEN *V.* JENNINGS *1966*

Most authorities view the 1966 decision of the *Queen* v. *Jennings*[33] as the *locus classicus* of the problem in this country. The writer submits that it is not.

The litigation began in Ontario after the plaintiff was so seriously injured in an automobile accident caused by the defendant's negligence, that his life expectancy was reduced from 22 to 5 years, during which time he would remain unconscious. On the basis of previous authority the trial judge, Ferguson J., applied the *Gourley* rule to the gross amount given for loss of earnings. The Court of Appeal of Ontario reversed the decision, but only by a two to one majority.[34] McGillivray J., in a strong dissent,[35] adopted the reasoning of both Earl Jowitt and Lord Goddard in *Gourley's* case. On the question of whether the Department of National Revenue would tax the award he stated:[36]

> . . . there is, I believe, no case on record of any attempt to assess income tax against any damage award for tortious injury whether for temporary loss of earnings or otherwise.

Although such awards are not specifically exempt under the Canadian Income Tax Act, "the Income Tax Appeal Board has not failed to distinguish between earned income and damages allowed for deprivation of earning capacity".[37] He then rejected the *ab convenieti* argument about the practical difficulties involved.

Although the other members of the Court did not apply the rule, their opinions point unequivocally to an acceptance of the rule in prin-

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[29] *Id.* at 681, *citing Chibbett* v. *Joseph Robinson and Sons* (1924) 9 T.C. 48; *Henley* v. *Murray* (1950) 1 All E.R. 908; and *Hafezi* v. *M.N.R.* (1961) 61 D.T.C. 357.

[30] *Id.* at 682.

[31] (1964) 41 D.L.R. (2d) 576. *See also* McDonald, *supra*, n. 5.

[32] [1966] S.C.R. 532, (1965) 51 D.L.R. (2d) 644.

[33] *Id.*

[34] [1965] 2 O.R. 285, *sub nom Jennings* v. *Cronsberry* (1965) 50 D.L.R. (2d) 385.

[35] [1965] 2 O.R. 285 at 300.

[36] *Id.* at 315.

[37] *Id. citing Millman* (1951) 51 D.T.C. 305; *G. M. Brown* (1952) 52 D.T.C. 9; *Hafenzi* (1961) 61 D.T.C. 357; and *Koller* (1963) 63 D.T.C. 994.

ciple, for they stressed that the "proper foundation" had not been laid. MacKay J.A. stated:[38]

> There is no agreement of counsel that the award is not taxable; there is no evidence as to the plaintiff's investment income, if any, so that in this case no proper foundation was laid for making such a deduction.

In the same vein, Kelly J.A. stated:[39]

> . . . the defendant failed totally to lay the foundation which, in my view, is necessary for the application of the principle. . . .

The writer submits that the majority of the Court would have applied the rule if they had been shown that the award would not have been taxable.

If this interpretation is correct, it would mean that of the four judges who heard the case before it reached the Supreme Court of Canada, all four accepted the *Gourley* rule in principle as being applicable in Ontario when the two conditions precedent were discharged.

Upon further appeal by the defendant Crown to the Supreme Court of Canada,[40] the entire five member bench concurred in rejecting the *Gourley* rule.[41] In delivering the Court's opinion, Judson J. stated:[42]

> For what it is worth, my opinion is that an award of damages for impairment of earning capacity would not be taxable under the Canadian Income Tax Act. To the extent that an award includes an identifiable sum for loss of earnings up to the date of judgment the result might well be different.

However, he knew of no decision where these issues had been dealt with, and because the Department of National Revenue was not a party to the present litigation, he felt that this issue was yet in doubt. This fact alone would have been sufficient for the Court to reject the *Gourley* rule. However, Judson J. was not content to base his repudiation upon that narrow ground only. Instead he adopted both the dissenting opinion of Lord Keith[43] in *Gourley* and the minority views of the *Seventh Report of the Law Reform Committee on the Effect of Tax Liability of Damages (1958).*[44] In brief summary those arguments were:

(a) the plaintiff must be compensated for the loss of his earning capacity (his capital equipment), and not merely for loss of earnings;
(b) the plaintiff's tax liabilities are irrelevant to the defendant (being both *res inter alios acta* and too remote). The defendant must make full restitution, as opposed to *Gourley's* requirement, for compensation;
(c) a net sum (after tax) is not an adequate compensation for the plaintiff's loss of being able to deal freely with his income; and
(d) the rule is contrary to public policy (*i.e.* in making it cheaper to break contracts of service than to fulfill them).

Judson J. would not concede that to reject *Gourley* would be to

[38] [1965] 2 O.R. 285 at 296-297.

[39] *Id.* at 320. However, MacKay J.A. expressed a personal preference for the dissenting views of Lord Keith in *Gourley*.

[40] [1966] S.C.R. 532.

[41] *Id.* at 534 per Cartwright J.; per Maitland, Judson, Ritchie and Spence J.J. at 543.

[42] *Id.* at 544.

[43] [1956] A.C. 185 at 216.

[44] Cmnd. 501, para. 8 per Donovan J., Mr. Parker and Professor Wade.

overcompensate the plaintiff, for the estimate of damage is merely a rough and ready amount, "usually a guess to the detriment of the plaintiff,"[45] and to deduct another uncertain amount (tax) would be an undue preference for the defendant or his insurer.

In calculating the loss of the plaintiff's capital asset, the Court must deduct expenses normally incurred in producing the income. However, Judson J. found that income tax is not such an expense. The fact that the award is not taxable only reflects the state's election not to do so, and it is not for the defendant to complain of that. This benefit should remain with the plaintiff until the law determines otherwise.

For the Supreme Court, the practical difficulties involved in applying *Gourley* were also an important factor in its rejection. How can one's future tax liability be determined if the plaintiff is young, has a promising career, is newly married, has an income earning wife, has investment income, pays foreign tax, or could easily have moved to another province with differing tax rates?[46] Problems could also arise in litigation, where discoveries could be long and oppressive, and where problems as to onus of proof would arise. In conclusion, Mr. Justice Judson stated:[47]

> I think that we should say now that we reject the principle stated in *Gourley*.

IV. POST-JENNINGS ANALYSIS

To most people, the rejection of *Gourley* by the Supreme Court of Canada was a fatal blow to the application of that rule to any situation in Canada.[48] This reaction was confirmed in *Sabel* v. *Williamson*[49] when the Manitoba Court of Appeal unanimously followed *Jennings* and awarded an injured plaintiff gross wages for the term of his life expectancy. However, the *Jennings* case was distinguished in an action under the Nova Scotia Fatal Injuries Act in *Fuller* v. *Atlantic Trust Co.*[50] Cowan C.J.T.D. awarded the widow and dependent children of a deceased accident victim only the net income which would have been available for their support, after deducting the tax which the deceased would have paid.

It soon became obvious that the *Gourley* rule was not dead in Canada, especially when the Supreme Court of Canada again dealt with the issue in *Florence Realty Company Limited* v. *The Queen.*[51] Under a governmental order the appellant had lost the use of a private railway siding. The parties agreed that the compensation for the loss would be set by the Exchequer Court under one of two principles:

1. If the Court found that the appellant would have to relocate his business, the compensation was to equal the amount that a prudent owner would be forced to pay for the relocation;
2. If a relocation was unnecessary, then the compensation was to be that amount which a prudent owner would have paid rather than lose the rail service.

The Court favoured the latter principle, awarding $91,300, an after-tax

[45] [1966] S.C.R. 532 at 545.

[46] *Id.* at 547.

[47] *Id.*

[48] *E.g.* Bale, (1966) 44 Can. Bar Rev. 66; Dworkin, (1967) B.T.R. 315 at 377.

[49] (1967) 61 D.L.R. (2d) 234.

[50] (1967) 62 D.L.R. (2d) 109.

[51] [1968] S.C.R. 42.

award. On appeal the Supreme Court of Canada, sitting with four of the five judges in the *Jenning's* case,[52] unanimously upheld the Exchequer Court's decision. Spence J. for the Court stated that the *Jennings* case "held that in fixing compensation for personal injuries sustained by a plaintiff which affected his earning capacity there should not be any deduction made on account of income tax".[53] But he continued:[54]

> I am not of the opinion that the decision of this Court in *The Queen* v. *Jennings* is applicable to exclude the deduction of income tax liability from the compensation payable to the appellants herein.

Rather, the Court must decide what a prudent owner would have paid in order to retain the service, and any prudent executive would quickly realize that the additional profits to be earned because of the siding would be subject to taxation. To pay more than net after-tax profit in order to retain the siding would result in a loss to the company.

The writer submits that the *Florence* case restricts the ratio of *Jennings* to personal injuries. By finding that *Jennings* did not apply to the *Florence* situation, Spence J. and the Supreme Court of Canada have effectively limited that case to personal injuries resulting in a loss of past or future wages. The point is arguable that because the Court in *Florence* was dealing only with additional (future) profits, compensation for past loss still remains subject to *Jennings*. However, the overall wording of the *Florence* case suggests that if the company had lost profits between the time of the removal of the rail siding and the time of trial, these would have been subject to the *Gourley* rule as well.

Whether *Jennings* will be interpreted in this way in the future remains to be seen, although help may be gleaned from a more recent case heard in the Supreme Court of Canada—*Posluns* v. *Toronto Stock Exchange*.[55] The Court unanimously affirmed the lower decisions, including that of Gale J. whose dicta (discussed previously) contained an interesting distinction between cases of personal injury, where taxation of the award was uncertain (therefore excluding *Gourley*) and wrongful dismissal, where the damages are not taxable (thus allowing *Gourley* to apply). In *Posluns,* Ritchie J. for the Supreme Court of Canada stated:[56]

> For all these reasons, *as well as those contained in the reasons for judgment of the learned trial judge . . .*, I would dismiss this appeal. . . . (italics mine).

The writer suggests that in the light of the *Florence* case only two years earlier, if the dicta of Gale J. had been wrong, the Supreme Court would have so stated in order to remove any misapprehension as to the true meaning of *Jennings*. By adopting the decision of Gale J., the Court has tacitly accepted his view of the applicability of *Gourley* in areas other than personal injuries. In other words the Supreme Court is now restricting *Jennings* to its facts (personal injury cases), and allowing *Gourley* to apply in other areas of damage.

There is no doubt that all Courts are following *Jennings* in personal

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[52] Maitland, Judson, Ritchie and Spence J.J. were common to both benches. Cartwright J. in *Jennings* was replaced in *Florence* by Abbott J.

[53] [1968] S.C.R. 42 at 52.

[54] *Id.*

[55] [1968] S.C.R. 330.

[56] *Id.* at 341 per Ritchie J.

injury cases. This is clearly illustrated by *Caco* v. *Maple Lodge Farms Ltd.*[57] and *Saccardo* v. *City of Hamilton,*[58] two Ontario cases where the High Court awarded gross wages without any reference to either *Gourley* or *Jennings*. In fact, the British Columbia Supreme Court recently applied *Jennings* to an action for lost wages occasioned by a wrongful dismissal.[59] However, in other areas the *Gourley* rule is often applied. In *Alexandroff* v. *The Queen*[60] an injured doctor claimed damages for loss of profits suffered by his drug company, of which he had been the principal customer. The Ontario Court of Appeal threw out his claim on the grounds that he had submitted statistics showing only gross profits and had made no allowance for income or other corporate taxes, thereby falling far short of the judicial standard of proof required.

Recent fatal accident cases have not found the *Jennings* case to be applicable either. The Ontario High Court in *May* v. *Municipality of Metro Toronto*[61] approved of the earlier *Fuller* v. *Atlantic Trust Co.*[62] decision. Addy J. agreed that *Jennings* settled the law regarding personal injury awards, but it did not cover a fatal accident claim. The plaintiff was not the person who would have earned the income, but only the person who would have received the benefit of the net after-tax income. The *May* case has recently been followed in *MacDonald* v. *Deson*[63] and *Krause* v. *Davey.*[64]

From the cases we can determine that there are areas of our law to which *The Queen* v. *Jennings* has no application. However, in others, such as wrongful dismissal, the law is confusing, to say the least. Lower Courts may apply the rule in strict adherence to the *Jennings* decision,[65] while the indications from the Supreme Court itself, in later cases[66] are that the *ratio decidendi* of *Jennings* is to be limited to its facts. For this reason, we must have a definitive statement from our highest court, enunciating the exact scope and application of that case. Because we have not yet received such a declaration we cannot say that *The Queen* v. *Jennings* is the true *locus classicus* of the *Gourley* issue in Canada, or that the tax factor no longer has any relevance to the assessment of damages in Canada.

—ROBERT J. IVERACH*

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[57] [1968] 1 O.R. 217 per Wilson J.

[58] (1971) 18 D.L.R. (3d) 271.

[59] *Harte* v. *Amfa Products Ltd.* (1970) 73 W.W.R. 561 per Ruttan J.

[60] [1968] 2 O.R. 597, unanimous judgment delivered by Aylesworth J.A.

[61] [1969] 1 O.R. 419. (There is a misprint at 423. The report places the word "not" incorrectly in the sentence "Therefore in coming to the conclusion that income tax should not be deducted. . . .")

[62] (1967) 62 D.L.R. (2d) 109 at 125-126.

[63] (1971) 13 D.L.R. (3d) 722.

[64] (1971) 18 D.L.R. (3d) 674.

[65] *Supra*, n. 59.

[66] *Florence Realty* v. *The Queen* [1968] S.C.R. 42; and *Posluns* v. *Toronto Stock Exchange* [1964] 2 O.R. 547.

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