

## The Taxation Of Damages In The Hands Of A Recipient

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Amounts received as special or general damages for personal injury or death are excluded from income. Such amounts may include damages for one or more of: past and future loss of income; pain and suffering; loss of amenities of life; reduced life expectancy; medical and rehabilitation expenses; and future attendant care costs.

In its Interpretation Bulletin IT-365R2 "Damages, Settlements and Similar Receipts" Revenue Canada confirmed that amounts received as compensation for personal injury or death are not subject to taxation. This is notwithstanding the fact that such damages may be determined by reference to past or future loss of income or earning capacity. However, where damages represent recovered income from employment or amounts recovered in respect of loss or termination of employment, they may be subject to taxation.

Pre judgement interest is considered to be part of the non taxable damages award and is thus not subject to taxation.

Post judgement interest, that which accrues subsequent to the date of an award, is income of the taxpayer.

In its advance ruling ATR 40 "Structured Settlements" Revenue Canada confirmed that payments, including the inherent interest element, pursuant to a structured settlement, where an insurer funds its obligation to pay personal injury damages through the purchase of an annuity contract issued by a life insurer, are generally not taxable in the hands of a recipient.

Pursuant to paragraphs 81(1)(g.1) and (g.2) of the Income Tax Act, interest income and capital gains earned on personal injury awards held by or on behalf of persons under 21 years of age are not taxable. This exemption applies:

- irrespective of whether the award is for personal injuries sustained directly by the minor, or received by him or her as compensation for loss of amenities of life,
- until the end of the year in which the person turns 21 years of age.

Disability benefits may be taxable or non taxable in the hands of a recipient, depending on whether:

- the employer paid or contributed to the premium cost, or
- the premiums were deducted for tax purposes by the insured.

Revenue Canada considers lump sum settlements of taxable disability benefits, net of any premiums paid by the recipient, to be fully taxable in the year of receipt. One way to defer immediate taxation is through the purchase of a term annuity, in which case payments would be taxable as received.

In IT-337R3 Revenue Canada states that amounts received for loss or termination of employment are generally taxable as a retiring allowance in the year of receipt. However that portion, if any, of a settlement or award representing damages for discrimination or other human rights violations may be considered non taxable. In a recent decision the Tax Court of Canada held that the portion of a settlement representing damages for mental distress did not fall within the definition of retiring allowance and was hence not taxable.

The 1999 budget has proposed that certain lump sum payments, pertaining to prior years, can at a taxpayer's election be taxed as though the amounts had been received in the relevant prior years. Eligible payments include those relating to: employment, former employment, superannuation and pension benefits.

While attendant care payments for services rendered by a professional care giver are taxable in the hands of the recipient, it is suggested that payments by an insurer to a parent, spouse or dependant for attendant care services constitute part of the insured's damages award, and are thus generally non taxable.

The above-noted article is neither a definitive analysis of the law nor a substitute for professional advice. Readers are cautioned against reliance on the information provided without first seeking detailed professional advice with respect to their or their client's unique situation.

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