Part 7 deductions, committeeship & management fees, tax grossups

TLABC Damages

15 February 08

Overview

- One point that reduces awards — deduction for the present value of Part 7 benefits
- Three that can increase them — grossup allowances for committeeship fees, management fees, and income taxes.

Legal basis

- Case law
- The former §55 of the *Insurance (Vehicle) Act*

Part 7 benefits

- CanLII — 545 BC judgments on Part 7 benefits.
- Benefits —medical, surgical, dental, hospital, ambulance or professional nursing services, or for necessary physical therapy, chiropractic, occupational therapy or speech therapy or for prosthesis or orthosis
- &, subject to ICBC's doctor's approval, for vocational training, attendant care, and other costs.

Part 7 deduction

- You all know the drill: after finding the damages for care and earnings loss, the present value of Part 7 benefits is deducted.
- That can be challenging when benefits are not being paid.

Survival-adjusted present value

- Get the deduction down to size — deduct *the survival-adjusted present value* of a stream of any ICBC Part 7 benefits, not the nominal lump sum.
- That reduces the nominal lump sum by a quarter to a half.

Part 7 elements

- The plaintiff's ***survival*** — tell me if it's not average — same as future damages
- the amount and timing of the ***benefits*** !!!
- the ***discount rate***.

Survival

- Normal or reduced life expectancy? The survival probabilities or life expectancy are implicit in the present values of future earning-capacity loss and care outlays.
- Reduced life expectancy — lower chance of being alive each future year, less weight for future losses, and lower present value.
- The same life expectancy or survival assumption applies to the plaintiff's losses as to the insurer's deduction & the grossups.

Benefits — amount and timing

- What benefits are being paid, or will be paid, or might be paid?
- Which care costs fall within Part 7?
- Besides the actuarial effects, the definiteness seems to affect the weight of the discount — more certain implies higher weight, etc.

Basic discount rate

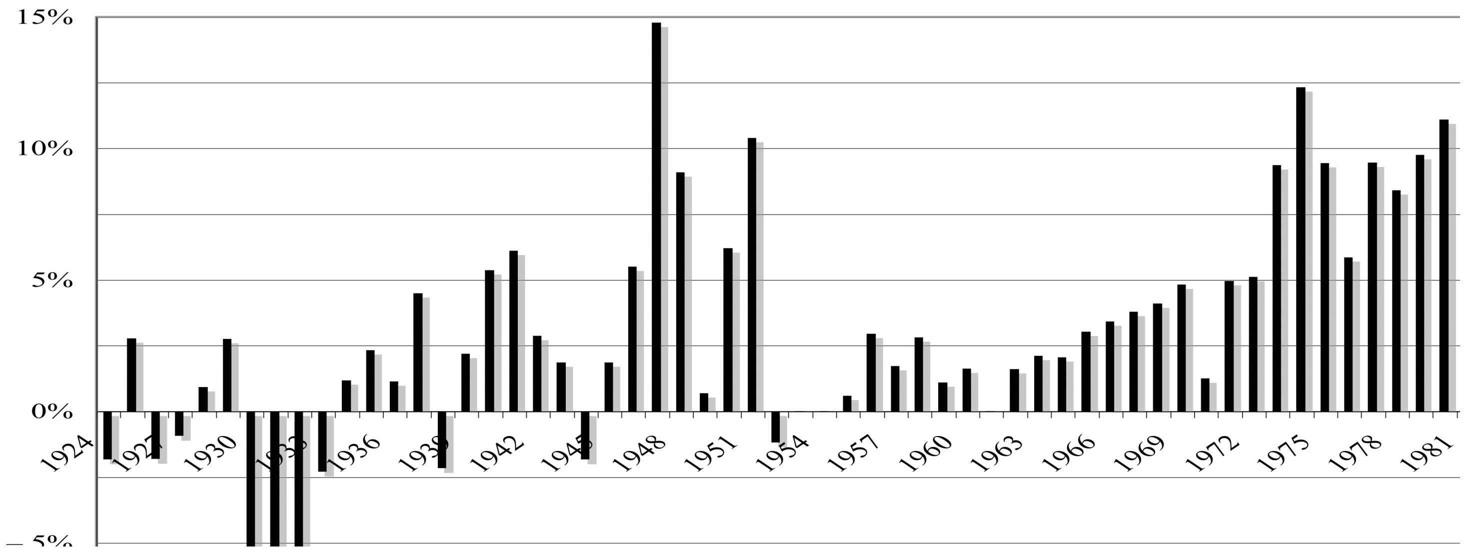
- Regulations under the *Law & Equity Act* — most future losses 3½%, *net of inflation*.
- This low 'real' rate implicitly adjusts for price inflation, presuming that invested assets would average 3½% more than the rate of inflation.
- **Future amounts that are specific goods or services, not a fixed number of dollars**, say five hours per year of physiotherapy when the future price will be paid.

Future benefits — fixed dollars

- For specific amounts, say $300 per year for physiotherapy rather than future wrangling
- The Court prefers to order specified payments
- **=>** fixed dollar amounts
- **Specific amounts, not adjusted for future inflation, attract a higher discount rate.**

Historic inflation

Figure B–1
Annual changes in the CPI, 1924 ~



Stable, low inflation

- Price stability more likely now — independence of the Bank of Canada, the Bank's policy of holding the inflation rate at or below 2%, political consensus rejecting government deficits.
- This has mixed effects on future investment returns: it helps in that returns on all classes of assets tend to fall as the inflation rate rises, but it means that real returns on sound fixed-interest securities can fall below the 3½%.

Effective 6% discount rate

- **=> inflation** will approach **2½%** over a lifetime.
- **=> nominal rate of return =** real or inflation-adjusted rate of return of 3½% + nearly 2½% rate of inflation, would average **6% per year.**

Discount fixed benefits @ 6%

- ***Effective discount rate on any future fixed-dollar benefits*** $\approx$ ***6%.***
- Today's number of dollars buys less in future of the product or service whose price rises.
- It's plausible that medical and related costs rise at least as fast as the general price index, though I've not yet found good statistics on the point.

Grossup allowances

- **Need** — Future awards = survival-adjusted present value of the future losses or costs.
- Earnings accumulate in the fund to build it up in the early years, when earnings exceed withdrawals. Later, future benefits are drawn from income and capital as the fund (almost) exhausts over the plaintiff's lifetime.
- Income taxes and committeeship or management fees reduce the earnings, leaving the fund short.

Yeung case

- ***Yeung (Guardian* ad Litem *of)* v *Au*, 2007 BCSC 175, 7 February 2007**
- Joe Murphy
- Interaction of the three allowances — sought income tax +committeeship & management
- Got committeeship (only) + income tax

Structure?

- ***If*** you structure, no taxes, no fees
- Order
- Can allow growing & lump-sum payments
- Funds paid directly to insurance company
- ¿ Agree grossups, then structure?

What gets grossed up?

- Most straightforward — income taxes —on any future awards except the plaintiff's own earnings.
- Committeeship or management fees ***can*** apply even to the earning-capacity fund, but you must ***prove a degree of incompetence***, while still distancing, perhaps, your semicompetent client from the Public Guardian and Trustee.

Income-tax grossups

- See my Appendix B, Income-tax grossups
- All invested amounts that replace or compensate for future pecuniary losses that would not have been taxed — all but adult earning capacity
- Future care, domestic capacity, survivors' support, heightened divorce risk, or loss of marriageability — as well as future earning capacity until the plaintiff reaches 21.

Info needed

- Life expectancy
- Any wage or pension or investment income
- Any particular expenditure pattern
- The person's tax credits — personal, disability (or not), medical (which outlays qualify), age, pension, charitable, etc
- RRSP or other retirement saving.

Tax brackets

- The person would have earned income and paid taxes on it at his or her basic tax-rate brackets
- **=>** the grossed-up amounts occupy the higher brackets.

Exhaust the income fund?

- The income-replacement fund has to last a lifetime
- Doesn't wipe out if prudent or with professional management
- Allowing for any residual employment or pension income.
- That means that the income-replacement returns will never completely vacate the lower brackets.

Rate of return 6%

- Inflation + basic 3 1/2% => 6%

Income mix for taxes

- Highest grossup — unsophisticated clients with only GICs
- But that's why there's management
- Can't have the common 60% interest & 40% dividends, no capital gains

Realistic income mix

- A typical portfolio — up to half equities
- That will yield ≈ 1/3 interest, 2/3 dividends + capital gains
- Investing in senior securities => 1/3 dividends, 1/3 gains

Actual real returns

Appendix Table B–a
Summary of CPI change and real or inflation-adjusted rates of return on investment and standard deviations of those rates of change or return

	80 years 1927 ~ 2006	50 years 1957 ~ 2006	25 years 1982 ~ 2006	15 years 1992 ~ 2006	10 years 1997 ~ 2006	5 years 2002 ~ 2006
Average inflation = rates of CPI change						
Consumer Price Index [CPI]	3.2%	4.1%	3.0%	1.9%	2.0%	2.4%
Average real rates of return						
Canadian stocks (S&P/TSX), mean	6.6%	5.6%	7.5%	9.2%	7.8%	10.5%
Fixed interest, mean						
Canada long bonds	2.9%	3.4%	8.9%	7.8%	6.3%	6.4%
91-day T-bills		2.5%	4.1%	2.7%	1.7%	0.7%
Pension-plan assets, median		† 4.7%	7.9%	7.8%	6.5%	6.1%
Standard deviations or measures of variability						
Consumer Price Index [CPI]	4.2%	3.2%	1.9%	1.0%	1.0%	0.9%
Canadian stocks (S&P/TSX)	18.4%	15.6%	15.3%	14.8%	16.2%	19.7%
Fixed interest						
Canada long bonds	9.7%	10.6%	10.8%	10.0%	7.4%	3.5%
91-day T-bills		2.8%	2.5%	2.0%	1.6%	1.7%
Pension-plan assets		† 12.9%	6.9%	6.9%	5.9%	7.1%

† "50 year" pension-plan return is for the 47 years 1960 ~ 2006.

Investment management, committee, or nothing?

– It depends, especially on the plaintiff's ability to manage an investment portfolio and realize at least the expected rate of return.

Nothing

- A sound plaintiff who can manage her own investments well would need no management services and so gets no fee allowance
- Especially if the total runs to tens of thousands.

Management or committee?

- In a middle ground, a manager can improve the odds of realizing the expected rate of return,
- and a trustee that also manages can solve long-term problems, especially with awards in the millions or hundreds of thousands.
- At the other pole, committeeship might be your client's default.

Investment-management or committeeship fees

- The entire future or invested proceeds will require protection against investment-management or committeeship fees
- Estimating — need life expectancy, other assets, income, and expenditures.

Which investment manager?

- Major financial institution like TD Canada Trust *v* pure investment manager?
- A trust company promises a greater probability of staying solvent and on the job
- An institution can more likely safeguard funds for future needs
- Both offer adaptation to unforeseen changes that a structure cannot.

Management fees — TD Canada Trust, eg

- No setup fee, no minimum
- Each year 0.6% on the market value of the assets up to $500,000, then 0.5% on the next $500,000, and 0.4% on amounts over $1,000,000
- **+** 6% of income received.
- **+** 2.5% of any final distribution.

Management & taxes

- No GST
- &
- Fees deductible for income taxes

Public Guardian and Trustee

- Paid directly to Public Guardian
- Hold funds in trust for a child (until 19).
- Adults — Committee of Estate, Committee of Person, Power of Attorney, Representative, Litigation Guardian and Pension Trustee; for most, Committee of Estate under the *Patients Property Act*.

Public Guardian fees

- One-time setup charge 5% of capital
- 0.4% of the principal each year
- 5% of the year's investment earnings.

Public Guardian & taxes

- GST applies
- Fees not deductible for income tax

If you get to choose

- Trust company perhaps more flexible
- Better tax treatment & no set-up fee
- But slightly higher annual fees

Enjoy the break

- The text and slides will be on my website, www.teasley.ca

- *Thanks!*