Insights and Strategies for Successfully Pursuing Damages
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Part 7 Deductions, Committeeship Fees, Management Fees, Tax Grossups

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Overview

This will highlight one point that reduces awards and three that can increase them, namely the deduction for the present value of Part 7 benefits and the grossup allowances for committeeship fees, management fees, and income taxes.[i] I won't presume to tell you about the law, keeping this more towards what your expert needs to know, but I have checked CanLII for cases on the points.

Part 7 benefits

CanLII showed some 545 BC judgments that mentioned Part 7 benefits when I tried to check my approach. Benefits "include all reasonable expenses incurred by the insured as a result of the injury for necessary medical, surgical, dental, hospital, ambulance or professional nursing services, or for necessary physical therapy, chiropractic treatment, occupational therapy or speech therapy or for prosthesis or orthosis," and, subject to ICBC's doctor's approval, for vocational training, attendant care, and other costs.

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.

To begin getting the deduction down to size, *the survival-adjusted present value* of a stream of any ICBC Part 7 benefits can be deducted, not the nominal lump sum. That reduces the nominal lump sum by a quarter to a half. The three elements in finding that present value are the plaintiff's *survival*, the amount and timing of the *benefits*, and the *discount rate*. The discount rate in turn depends on the future rate of price-level changes or *inflation* and how that effects the future benefits. Taking them in turn:

Survival — Does the plaintiff face a 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. The typical multiplier per $1,000 per year equals the result of adding up each year's value, and those values equal the $1,000 times the year's discount and survival factors. A reduced life expectancy means a lower probability 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.

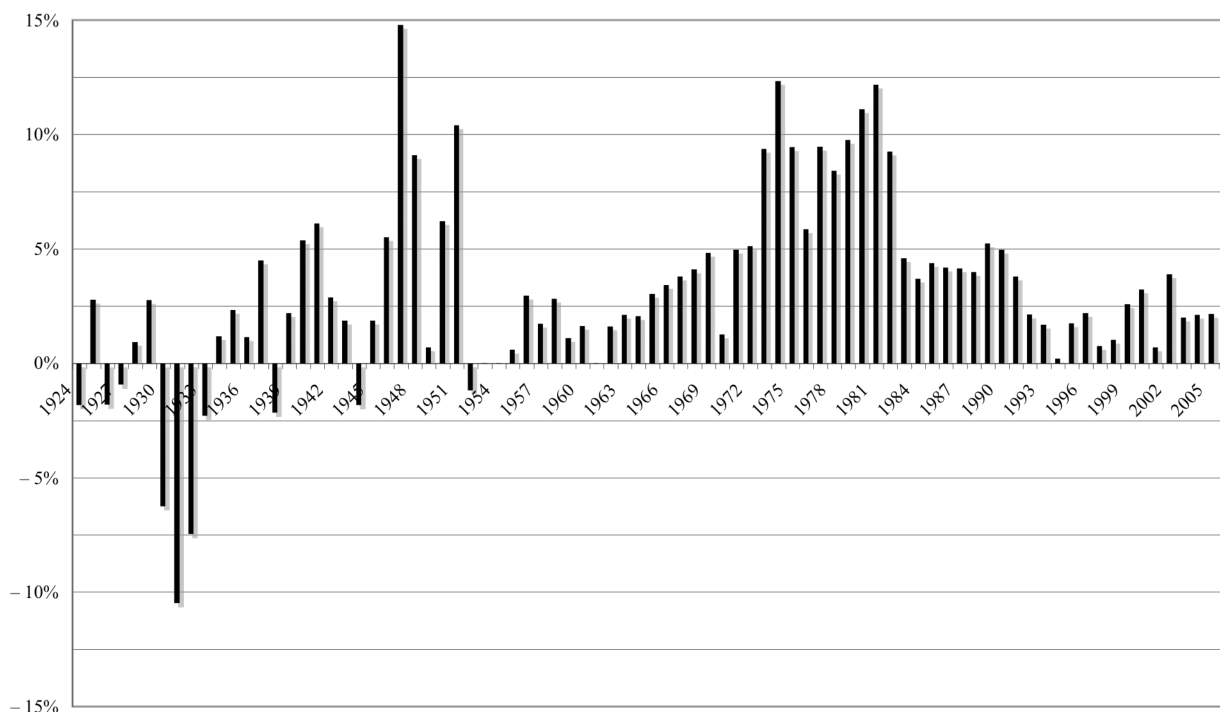
Amount and timing of the benefits — What benefits are being paid, or will be paid, or might be paid? Which of your care costs fall within Part 7? Are they specific amounts, say $300 per year for physiotherapy, or do they set out what will be paid upon presentation of a treatment plan or receipts with the future prices to be determined? Besides the actuarial effects, the definiteness seems to affect the weight of the discount — more certain implies higher weight, etc. And specific amounts, not adjusted for future inflation, attract a higher discount rate.

Basic discount rate — Regulations pursuant to the *Law & Equity Act* set the discount rate for most future losses at 3½%, *net of inflation*. This low 'real' rate implicitly adjusts for price inflation, presuming that invested assets would earn, on average, 3½% more than the rate of inflation. This applies to future amounts that are not a fixed number of dollars, say five hours per year of physiotherapy when the current price is $60 per hour but the future price will be paid.

Inflation

This Figure B–1 shows the history of the Consumer Price Index [CPI], which increased at an average rate of 4.1% for the past 50 years and 3.2% for the past 80 years but has stabilized in the range of 2% ~ 2½%. Standard deviation, or volatility, which had averaged 3.2% and 4.2%, respectively, has settled into the 1% range. The highest rates occurred in 1947 ~ 1951, after the end of the restrictions of World War II, and in the years 1973 ~ 1982, which included the first and second oil-price shocks. Falling fuel prices drove the annual rate down to 0.1% in the 12 months to September 2006 before those prices began their recent climb.[ii]

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



The likelihood of continuing such price stability increased in the 1990s due to several political or institutional factors, especially strengthening the independence of the Bank of Canada, the Bank's policy of holding the inflation rate at or below 2%, and the 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%. Thus:

Expected inflation — That history suggests that inflation will approach 2½% over a lifetime. Thus nominal earnings, at the prescribed real or inflation-adjusted rate of return of 3½% and the nearly 2½% rate of inflation, would average 6% per year.[iii]

Discount on fixed-dollar future benefits — ***The effective discount rate on any future benefits that are not indexed or otherwise adjusted for inflation thus approximates 6%.*** Today's number of dollars buys less in future of the product or service whose price rises. And 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

Future awards are set as the contingency- or 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. You can see the basic problem, and the need for allowances, as either reducing the effective rate of return on investment or as eroding the fund, but either way the fund expires before the plaintiff — making the present value of her future needs or losses less than the total of the eventual amounts.

A recent case, *Yeung (Guardian* ad Litem *of)* v *Au*, 2007 BCSC 175, 7 February 2007 sets out the three grossup allowances and their interaction. It found total grossup of $1,750,000 on future losses of $4,000,000 for a teenager, or 44% — probably the highest now possible. It also demonstrated the current low investment returns: the proffered structure couldn't be used because it didn't reach the 3½% per year.

The most straightforward is the allowance for income taxes, since it applies to any future awards except the plaintiff's own earnings. The allowance for 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. (You might wish you could get the grossups and then structure the grossed-up total.)

Income-tax grossups

Appendix B, Income-tax grossups, is attached as a pdf. It explains the need for such an allowance, namely that future losses are discounted at the rate of return on investment, and that taxing that return would exhaust the fund prematurely. It also describes the applicability of a grossup, namely to invested amounts that replace or compensate for future pecuniary losses that would not have been taxed — future care, domestic capacity, survivors' support, heightened divorce risk, or loss of marriageability — as well as future earning capacity until the plaintiff reaches 21. Domestic capacity does not enter taxable income, and the support that would have been enjoyed in a family or marriage comes from aftertax income.

Estimating the allowance requires the life expectancy, any wage or pension or investment income, any particular expenditure pattern, and the person's tax credits — personal, disability (or not), medical (which outlays qualify), age, pension, charitable, etc — as well as RRSP or other retirement saving.

Since the person would have earned that income and paid taxes on it at his or her basic tax-rate brackets, the grossed-up amounts occupy the higher brackets. A prudent plaintiff, or one with professional investment management, would tend to make his or her income-replacement fund last a lifetime, allowing for any residual employment or pension income. That means that the income-replacement returns will never completely vacate the lower brackets.

As above, the appendix notes the effect of inflation, namely that the nominal-dollar return is taxed, rather than the real or inflation-adjusted, prescribed discount rate. It reviews the inflation data since the 1920s to estimate an expected rate approaching 2½% per year. That makes the typical rate of return 6% per year.

The tax rate depends on the type of investment income, with both dividends and capital gains taxed more lightly than interest. Plaintiff counsel would sometimes like me to assume that their unsophisticated client can handle only fixed-interest assets — but investment management takes care of that (except for the fairly old) and attracts its own grossup allowance. Reviewing the data for actual rates of return shows that equities so far outperform fixed-interest, over a period of years, that income tends to divide fairly evenly among the three types, interest, dividends, and capital gains.

I sometimes see implausible assumptions. One sees receiving interest and dividends but no capital gains: no such traded asset exists. The other assumes that the individual burns through his income-replacement fund by withdrawing his notional income each year while it lasts: a rational person would reduce expenditures to sustain him through old age.

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. A sound plaintiff who can manage her own investments well would need no management services and so no fee allowance, especially if the total runs to tens of thousands. 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. Presuming that this part hasn't been repealed, the *Insurance (Vehicle) Act* [RSBC 1996] Chapter 231 provides that:

> Payment to minor [or incompetent adult]
>
> 92 (1) A payment of insurance money for or on behalf of a minor, or a person with a mental disorder as defined under the Mental Health Act, who does not have a committee, must be made to the Public Guardian and Trustee, to be administered as he or she considers advisable, and the Public Guardian and Trustee may make arrangements with other persons, societies or agencies for this purpose.
>
> (2) *Subsection (1) applies also in respect of an adult who is incapable* of making decisions about his or her financial affairs, business or assets and does not have a representative authorized under the Representation Agreement Act or an attorney appointed by an enduring power of attorney under section 8 of the Power of Attorney Act to make those decisions.

In *Leung*, the girl's mother was the committee, obtained professional management, and sought the management cost as well as half the Guardian's committeeship fees. The Court awarded just one fee at the Guardian's rates.

Investment-management fees

The entire future or invested proceeds will require protection against investment-management fees, as noted, while the portion of the award that compensates for reduced earning capacity does not warrant protection against income taxes. I prefer to assume the use of a major financial institution like TD Canada Trust. Compared to a pure investment manager, it promises a greater probability of staying solvent and on the job, and an institution can more likely safeguard funds for future needs, while offering adaptation to unforeseen changes that a structure cannot.

A typical fund manager — the TD Canada Trust — would charge 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, as well as 6% of income received. It would also charge 2.5% of any final distribution.[iv] Fees are deductible for income taxes and no GST applies.

Estimating this requires the life expectancy, again, and other assets, income, and expenditures.

Trusteeship or committeeship fees — The Public Guardian and Trustee of British Columbia

The Public Guardian and Trustee (PGT) is authorized to hold funds in trust for a child (until the age of 19). This may be under a will, a trust agreement, or a court order; a child may also be entitled to money as compensation for injuries from an insurance policy or from monies left to them by a family member. The Trustee may also act for adults as Committee of Estate, Committee of Person, Power of Attorney, Representative, Litigation Guardian and Pension Trustee; for the majority of adult clients, the PGT is Committee of Estate under the *Patients Property Act*.

Money is paid to the PGT in trust for the person where it is invested and administered on the person's behalf. They use professionally-managed, balanced funds. If the Public Guardian and Trustee manages her invested funds, it would charge a one-time capital charge of 5% to set up the account on receipt, 5% against each year's income, and 0.4% of the principal each year, and 5% of the year's investment earnings. GST applies to those fees, and unlike the fees of commercial investment managers, they are not tax-deductible for income taxes.

Notes

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i *Standard approaches, assumptions, and appendices* — This generally follows the "Standards" section of my website, www.teasley.ca. In my work, trying not to be reminded of what I said another time induces consistency. Besides keeping the technicalities consistent from report to report, I like to keep them outside the body of the report, so it can focus on the facts. Thus, to the extent that they fit the evidence in the case, I use standard approaches, appendices, and endnotes like these.

ii *Inflation rates* — This section comes from the attached Appendix B, Income-tax grossups. The data come from the *Report on Canadian Economic Statistics, 1923 ~ 2006* [Ottawa: Canadian Institute of Actuaries, 2006, and prior annual issues, cited as *CIA Report*], Table 2A, Basic variables — changes for various subperiods, and Standard deviations of nominal annual percentage rates of change/return. Current figures from Statistics Canada.

iii *The implicit projected inflation rate* — The exact projected inflation rate is 2.42%: (1.0350) X (1.0242) – 1 = .06 = 6%.

iv *Inflation and investment-management fees* — Because the fee schedule does not reflect price-level changes, these fees and the required allowance are estimated without regard to price-level changes.