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The Gourley Principle and The Income Tax Element in Awards of Damages: Some Tax Aspects in Singapore

Abstract

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Keywords

income, tax, damages, singapore, gourley

THE *GOURLEY* PRINCIPLE AND THE INCOME TAX ELEMENT IN AWARDS OF DAMAGES: SOME TAX ASPECTS IN SINGAPORE

TAN HOW TECK*

The adoption of the *Gourley* principle and its corollary, the *Gourley-in-reverse* principle, in the UK and Australia are first examined to set the context. The paper then discusses some practical tax difficulties of applying the *Gourley* principle in Singapore, and suggests how to reasonably estimate the plaintiff's tax liability in order to give effect to the principle. The paper finally comments that the approach in Singapore of simply ignoring taxation in cases where the lost profit and the damages are taxable is preferable to the alternative of adjusting the damages for any difference in tax liabilities on both sides.

INTRODUCTION

The purpose of damages in personal injury and death cases is to compensate the victim (plaintiff) and not to punish the tortfeasor (defendant) for his actions. This principle of compensation¹ is found in Lord Blackburn's statement in *Livingstone v Rawyards Coal Co*,² a Scottish case in which the defender mistakenly extracted coal from under the pursuer's land:

where any injury is to be compensated by damages, in settling the sum of money to be given for reparation of damages you should as nearly as possible get at that sum of money which will put the party who has been injured, or who has suffered, in the same position as he would have been if he had not sustained the wrong for which he is now getting his compensation or reparation.

This paper examines the celebrated case of *British Transport Commission v Gourley*,³ and reviews the adoption of the *Gourley* principle and its corollary, the *Gourley-in-reverse* principle, in the UK and Australia, before examining the Singapore context.

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¹ In exceptional cases such as an award of punitive damages, contemptuous damages or nominal damages, the courts may award a sum that does not represent a genuine quantification of the loss: M Rutter, *Handbook on Damages for Personal Injuries and Death in Singapore and Malaysia* (Singapore, Malayan Law Journal Pte Ltd, 1988) 75.

² (1880) 5 App Cas 25, 29 (HL).

³ [1956] AC 185.

THE GOURLEY PRINCIPLE IN SINGAPORE

The leading case in Singapore is *Teo Sing Keng*, in which Goh J (delivering the judgment of the Court of Appeal) said that the 'applicability of *Gourley's* case hinges not so much on the Income Tax Act as on the common law principles relating to assessment of damages'.⁴ Goh J held that the practical difficulties of applying the *Gourley* principle did not preclude its application in Singapore,⁵ and that in estimating the plaintiff's liability to income tax, the Singapore court 'must do its best to arrive at a reasonable figure, even though it cannot be said to be an exact one.'⁶ Subject to this formulation, the paper examines some tax aspects in Singapore and makes some suggestions: mathematical accuracy is not the objective (nor is it possible).

There have been calls for Singapore to adopt actuarial methods in assessing damages for personal injuries or death.⁷ The concept of 'structured settlements'⁸ has been mooted elsewhere. There are also matters of proof and other intricacies, but all these are outside the scope of the article.

THE GOURLEY PRINCIPLE REVISITED

In *Gourley*, the plaintiff was a senior partner in a firm of civil engineers who sustained serious injuries in a railway accident because of the defendant's negligence. The High Court assessed the plaintiff's loss of actual and prospective earnings at £37,720. The defendant disputed this, contending that as the plaintiff would have had to pay £31,025 in tax on those earnings, he ought only to be compensated for the after-tax amount of £6,695. By a 6-1 majority, the House of Lords held that the plaintiff should be awarded only £6,695.

It was the first time the House of Lords had to decide on the incidence of tax. Lord Jowitt opined that 'to ignore the tax element at the present day would be to act in a manner which is out of touch with reality'⁹ and that the tax element was not so

⁴ *Teo Sing Keng and Anor v Sim Ban Kiat* [1994] 1 SLR 634, 641.

⁵ [1994] 1 SLR 634, 645.

⁶ [1994] 1 SLR 634, 647 (endorsing Lord Goddard in *Gourley's* case, above n 3, 208)

⁷ Actuarial calculations incorporate mortality rates, which are omitted in the prevailing use of the multiplier-multiplicand approach in Singapore. See KC Tan, 'On Personal Injury Loss', in Anthony Chin and Alfred Choi (ed), *Law, Social Sciences and Public Policy: Towards a Unified Framework* (Singapore University Press, 1998) 73, 74-75; and WS Chan and Felix Chan, 'Lai Wee Lian Revisited – Should Actuarial Tables be Used for the Assessment of Damages in Personal Injury Litigation in Singapore? *Wells v Wells*' (2000) *Singapore Journal of Legal Studies* 364, 366-7.

⁸ See, eg, Lewis R, 'Structured Settlements of Damages Awards in Britain and Canada', (1993) 42 *International and Comparative Law Quarterly* 780.

⁹ [1956] AC 185, 203.

remote it ought to be disregarded in assessing damages. He acknowledged the imprecision in estimating the amount of tax but cautioned against any 'elaborate assessment of tax liability':

It will no doubt become necessary for the tribunal assessing damages to form an estimate of what the tax would have been if the money had been earned, but such an estimate will be none the worse if it is formed on broad lines, even though it may be described as rough and ready.¹⁰

Lord Goddard considered that the assessment of special damages in respect of loss of earnings should be made taking into account the effective rate of income tax (and, if necessary, surtax). Lord Goddard envisaged the help of accountants in complicated cases to enable the parties to agree figures, but if this was not possible, 'the court must do its best to arrive at a reasonable figure, even though it cannot be said to be an exact one.'¹¹

Lord Keith, dissenting, considered it 'unreal' to fix damages on the basis of existing taxation without any knowledge of what the injured person's future commitments and obligations and personal status will be or would have been. Lord Keith warned of 'serious difficulties and complications' that would follow from the requirement to deduct tax, and cautioned that the matter was not confined to British income tax, noting that 'if a foreigner is injured in this country the courts will have to pay regard to the incidence of his foreign income tax, if any'.¹² Lord Keith's famous dissent was endorsed by the Supreme Court of Canada in *Jennings*¹³ ten years later.

The *Gourley* decision unequivocally established that taxation is not too remote to be recoverable as part of an award of damages for personal injury or death. It said little, however, by way of how the tax element was to be reflected in the assessment.

¹⁰ [1956] AC 185, 203-204.

¹¹ [1956] AC 185, 208.

¹² [1956] AC 185, 217-8.

¹³ *The Queen in the Right of the Province of Ontario v Jennings* 57 DLR (2d) 644. In his leading judgment, Judson J considered that unless the Minister of National Revenue was a party to the proceedings, 'any expression of opinion [as to whether an award of damages is for the impairment of earning capacity or whether it includes an identifiable sum for loss of earnings up to the date of judgment] must be insecure'. But while Judson J thought that this reason alone was perhaps sufficient for rejecting the *Gourley* principle, he placed his rejection upon broader grounds (at 655-656), noting that it is 'not open to the defendant to complain about this consequence of tax policy [of taxing the lost profit but not the damages] and the Courts should not transfer this benefit to the defendant or his insurance company.'

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As subsequently applied by the UK courts, two conditions must be satisfied for the *Gourley* principle to apply: the loss of profit is subject to tax if it has been earned, and the award of damages itself is not taxable. The *Gourley* principle has been applied in the UK to companies, among others, that received compensation for compulsory acquisition of land¹⁴ and for prohibition from working a mine,¹⁵ and to contractual claims including those for wrongful dismissal payments.¹⁶

It was common ground in *Gourley* that any damages found to be due were not taxable. Singapore cases that dealt with taxable damages, such as damages awarded for trespass¹⁷ and for breach of a lease agreement¹⁸ are therefore, strictly, not

¹⁴ *West Suffolk County Council v W Rought Ltd* [1957] AC 403. A local authority in the UK compulsorily acquired factory premises leased to and occupied by the company for manufacture. Nine months passed between the date the local authority took possession and the date the company was able to recommence its manufacturing operations in alternative accommodation. The company claimed compensation for loss of profit in respect of specific orders during the interruption. The House of Lords held that the Lands Tribunal, which assessed the compensation (not taxable), should have estimated to the best of their ability the amount of additional tax that the company would have had to bear if it had actually earned the amount that the interruption prevented it from earning, and should have reduced the award by that amount.

¹⁵ *Thomas McGhie & Sons Ltd v BTC* [1963] 1 QB 125. The UK High Court held that the compensation was paid to the company for the loss of profit (taxable) from working its mine, a capital asset, and not for the sterilisation of the capital asset (non-taxable). The damages, which were not taxable, were therefore reduced.

¹⁶ *Parsons v BNM Laboratories Ltd* [1963] 2 All ER 658. The plaintiff was a chemist who had been wrongfully dismissed. Damages were assessed for loss of salary and commission as £1,200. Under prevailing UK tax law, there was a tax-free threshold of £5,000 for wrongful dismissal payments. The issue was whether the award should be reduced by an agreed amount of income tax of £320 on the lost income (and an unemployment benefit of £59 2s. 6d. that the plaintiff had received, but this second amount is not germane to our discussion). The UK Court of Appeal, by a 2-1 majority, held that the damages should be reduced by both amounts.

¹⁷ *Raja's Commercial College v Gian Singh & Co Ltd* [1972-1974] SLR 268. In this case, the appellants were tenants of premises in a large commercial building in Singapore for several years beginning from 1957. The respondents gave the appellants a notice to quit on 30 November 1967 determining the appellants' tenancy at 31 December 1967. The appellants claimed to be entitled to remain in occupation under the Control of Rent Ordinance, and the respondents sued them claiming possession of the premises and damages. The appellants finally vacated the premises on 30 November 1973 but went ahead with their appeal against the amount of damages awarded by the High Court. Their main ground of appeal was that the award should not have been the full amount of the respondents' loss of rent but rather that amount less the income tax payable on the rent. The Court of Appeal dismissed the appeal. The Privy Council upheld the decision and ruled that the mesne

applications of the *Gourley* principle. This viewpoint is supported by the Federal Court in Malaysia in a case of wrongful termination of a contract.¹⁹

The *Gourley-in-reverse* principle

A corollary of the *Gourley* principle, the 'Gourley-in-reverse' principle, was first adopted in the UK in *Taylor v O'Connor*.²⁰ In that case, the husband of the respondent widow died in a car collision caused solely by the appellant. The issue was whether the widow could have an award increased by the tax payable on the assumed investment of the damages she received. The House of Lords considered that the aim of a damages award was to replace a stream of earnings with a lump sum which, when invested, would yield income. This income, when added to gradual capital withdrawals, was intended to compensate for the loss during its currency. However, the investment income thus generated was taxable although the damages were not. The House of Lords therefore increased the award to take the notional tax into account. The later case of *Hodgson v Trapp*²¹ suggests, however, that a plaintiff in the

profits, being damages in place of lost income, fell to be treated as income, and declined to reduce the damages awarded.

¹⁸ *Klerk-Elias Liza v KT Chan Clinic Pte Ltd* [1993] 2 SLR 417. In this case, the appellant had breached a lease agreement. The Court of Appeal held that no deduction was to be made on the damages made to the lessor as any sum awarded as damages in lieu of rent were profits arising from property and therefore taxable.

¹⁹ Malaysia's adoption of the *Gourley* principle in personal injury cases is well-established: see eg *Yeap Cheng Hock v Kajima-Taisei Joint Venture* [1973] 1 MLJ 230. The *Gourley* principle was applied for the first time to a company in a contractual claim in *Daishowa (M) Wood Products Sdn Bhd v Kepong Wood Products Co Sdn Bhd* [1980] 2 MLJ 68. In that case, the appellant agreed for a period of five years to buy all wood chips produced by the respondent. The agreement was renewable at the option of either party giving two months' notice to the other. The trial judge found that the appellant was not entitled to terminate the agreement and awarded damages calculated as the gross amount of lost profit. The appellant contended that the trial judge ought to have deducted tax from the award. The Malaysian Federal Court ruled (at 70) that '[w]hether the damages are taxable or not is a matter for the court. If they are taxable then *Gourley's* case has no application. If they are not, the *Gourley's* case applies and a deduction would have to be made' (emphasis added). The Federal Court held that the damages were for the destruction of apparatus (and thus not taxable) because the appellant's termination caused the respondent's business to come to an end, and reduced the award.

²⁰ [1971] AC 115.

²¹ [1989] AC 807. In this case, a road accident caused by the first defendant's negligence severely injured the plaintiff. Lord Oliver, delivering the opinion of the House of Lords, questioned the propriety of the hitherto practice of expressly adjusting the award to account for the tax which might fall to be paid. For Lord Oliver, the most persuasive

UK must now show that extraordinary grounds exist if he or she is to be able to get an award increased for the notional tax payable.²²

The Australian experience

The High Court of Australia, by a 3-2 decision, at first rejected the *Gourley* principle in a case of wrongful dismissal in *Atlas Tiles Ltd v Briers*.²³ Barwick CJ, with whom Murphy J agreed, was of the view that the House of Lords erred in *Gourley's* case in failing to appreciate the distinction between compensation for loss of earning capacity (the nature of that which is being compensated) and the loss of earnings (the basis of calculating the amount of damages). The third member of the majority, Jacobs J, was of the view that tax was to be deducted in calculating past loss but not future loss (as taking tax into account in respect of loss of future earnings would give rise to complexities and uncertainties).²⁴

Two years later, in the personal injury case of *Cullen v Trappell*,²⁵ a differently constituted High Court (by a 4-3 majority) endorsed the *Gourley* principle with regard to both future loss and past loss. The High Court also applied the *Gourley-in-reverse* principle, increasing the damages to take account of tax on the assumed return on the lump sum awarded. Gibbs J saw 'no justification for using a method of an actuarial or mathematical kind in assessing damages, without making the allowances that the method itself requires in order to give the correct result.'²⁶

authority against the *Gourley-in-reverse* principle was *Lim Poh Choo v Camden Health Authority* [1980] AC 174, in which Lord Scarman, delivering the opinion of the House, had made clear that inflation was to be countered by a prudent investment policy rather than a specific adjustment to the damages award. Although Lord Oliver conceded that the taxation point was not specifically answered by the disregard of inflation in *Lim Poh Choo*, he proceeded on the basis that the same two arguments for not taking into account inflation applied to future taxation: first, assessing future tax liability was inherently uncertain; and, second, the incidence of future taxation and inflation was counteracted by judicial policy in the UK of selecting multipliers on the assumption that the interest rates appropriate to a stable currency prevailed. See the commentary in Anderson L, 'Taxing Issues in Damages for Personal Injuries' (1989) 52 *Modern Law Review* 551, 552-3.

²² The effect of these decisions was numerically shown in Priscott C, 'Damages for Lost Earning Capacity: Should They be Based on Gross or Net Earnings?' (1999) 5 *New Zealand Journal of Taxation Law and Policy* 147, 150-3.

²³ (1978) 144 CLR 202.

²⁴ *Ibid*, 242-3.

²⁵ (1980) 146 CLR 1.

²⁶ *Ibid*, 13.

In *Todorovic v Waller*²⁷ (another personal injury case) the following year, the High Court, in a 4-3 decision, endorsed Gibbs J's approach of reflecting the Gourley-in-reverse principle by reducing the discount rate to take account of notional tax. The Australian position has since been that where there is a loss of earning capacity that is likely to lead to future financial loss, or where the plaintiff's injuries will necessitate future expenses for the plaintiff's health and comfort, the future loss is to be discounted at a rate of 3% in all cases, subject to any relevant statutory provision. No further allowance would be made for inflation, for future changes in rates of wages or prices, or for tax upon the notional investment income.

THE ASSESSMENT OF DAMAGES FOR PERSONAL INJURIES IN SINGAPORE

Judges in Singapore frequently assessed damages for personal injuries without explicit reference to the tax factor.²⁸ Rutter observed however that 'the mere absence of any mention of taxation in the law reports does not necessarily mean that taxation was not in fact taken into account.'²⁹ In *Muthan Sinnathambi v Puran Singh*,³⁰ the Singapore High Court alluded to the fact that, in previous cases, 'income tax is deducted in the calculation [of pre-trial loss of earnings] even if no evidence is given of this'.

In the leading case of *Teo Sing Keng*,³¹ Goh J (delivering the judgment of the Court of Appeal) said that the main criticisms levelled against *Gourley's* case were the practical difficulties³² of applying the *Gourley* principle; the criticisms did not however provide a sufficient basis for the Court to depart from the fundamental principle on which the *Gourley's* case rests, ie, that the injured party should be awarded such a sum of money as will put him in the same position as he would have been if he had not sustained the injuries. Income tax will be deducted in an award for loss of future

²⁷ (1981) 150 CLR 402, 424.

²⁸ See eg *Peh Diana & Anor v Tan Miang Lee* [1991] 3 MLJ 375.

²⁹ Above n 1, 313. The other leading text in Singapore on the topic is Audrey Lim et al, *Assessment of Damages: Personal Injuries and Fatal Accidents* (2001, Butterworths Asia and the Subordinate Courts of Singapore).

³⁰ [1992] 2 SLR 103, 107. In this case, the plaintiff was the father of the deceased, who had been a pillion rider on the motorcycle that the defendant was riding and that collided into a tree.

³¹ [1994] 1 SLR 634, 645.

³² For a Canadian perspective of some practical difficulties, see *Jennings* (above n 13, 657). For Australian and UK perspectives, see eg CW Pincus and S White, 'Taxation of Compensatory Payments and Judgments', (2001) 75 *Australian Law Journal* 378; Slater A, 'Tax on Damages: A Litigation Perspective' (June/July 1994) *CCH Journal of Australian Taxation* 60-65; and S Eden, C Tyre and A Barr, *Tax for Litigation Lawyers* (Edinburgh, W Green/Sweet & Maxwell, 2000).

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earnings as such damages represent compensation for non-receipt of a taxable income. On the other hand, deduction is not to be made for an award for loss of earning capacity as such damages are to compensate for loss of a capital asset, which is non-taxable.³³ Goh J said that an award for loss of earning capacity, as opposed to an award for loss of earnings, is generally made in the following cases:

- (1) where, at the time of trial, the plaintiff is in employment and has suffered no loss of earnings, but there is a risk that he may lose that employment at some time in the future, and may then, as a result of his injury, be at a disadvantage in getting another job or an equally well paid job;
- (2) where there is no available evidence of the plaintiff's earnings to enable the court to properly calculate future earnings, for example, young children who have no earnings on which to base an assessment for loss of future earnings.³⁴

In *Teo Sing Keng*, the plaintiff was earning at the time of the accident, and his earnings would have been taxable. By contrast, sums received as consolidated compensation for death or injuries are tax-exempt under section 13(1)(i) of Singapore's Income Tax Act. As the two conditions for applying the Gourley principle were met, tax was deducted in assessing damages for the plaintiff's loss of earnings.

Use of the multiplicand-multiplier approach

The Singapore courts apply the multiplicand-multiplier approach, the use of which was first approved by the Privy Council in *Lai Wee Lian v Singapore Bus Services (1978) Ltd.*³⁵ Although no reported case in Singapore has likewise explicitly taken the *Gourley-in-reverse* principle into account in awarding damages, Rutter was of the view that the principle ought to apply, the success of its application depending on the plaintiff's ability to show actual figures and prove his tax burden.³⁶

The adoption of *Gourley* and the *Gourley-in-reverse* principles is reflected in Rutter's detailed three-step description of the approach - select the multiplicand, then the multiplier, and multiply the two amounts.³⁷ To summarise, the multiplicand takes into account loss of future earnings and consequential expenses; it is calculated on an

³³ [1994] 1 SLR 634, 645.

³⁴ [1994] 1 SLR 634, 646-7.

³⁵ [1984] 1 MLJ 325. In this case, the plaintiff sustained injuries when she was thrown off a bus on which she was travelling as a passenger.

³⁶ Above n 1, 321.

³⁷ Above n 1, 64-6.

annual basis, and after deductions for income tax.³⁸ As for determining the multiplier, the courts will consider the number of years or months of projected disability or incapacity during the plaintiff's remaining working life, the reduction in the number of years of his working life owing to the injury, and his future employment prospects. The number of years for which the plaintiff would suffer this reduction in earning capacity is assessed as a round figure, giving the multiplier. The multiplier is reduced to allow for the increased value of receiving a lump sum and for normal hazards and vicissitudes of life such as unemployment and sickness, and increased to take into account the tax that the plaintiff will have to pay on the investment income of the lump sum award itself.³⁹

It is submitted that the *Gourley*-in-reverse principle should logically be applied with the *Gourley* principle (or neither at all). The practical significance of all this appears small for individuals in Singapore, however, as local-source passive investment income (including interest but excluding rental) has been tax-exempt to an individual since 2004.⁴⁰ Applying the *Gourley*-in-reverse principle would not therefore affect the amount of damages to be awarded as there was no taxation on the assumed investment income.⁴¹

ISSUES IN APPLYING THE *GOURLEY* PRINCIPLE IN SINGAPORE

Although *Gourley* did not prescribe how the tax element was to be taken into account, some comments in that case are of great persuasive value. Thus, Lord Goddard cautioned that 'generally damages must be decided by the application of reasonable

³⁸ This was reflected in eg *Chan Heng Wah v Peh Thiam Choh* [1984-1985] SLR 728, 737 (use of after-tax probable earnings of the medical student who died in that accident); this aspect of the assessment was approved on appeal: [1987] SLR 132.

³⁹ The Singapore courts have also examined awards in other cases as a basis for arriving at the multiplicand and the multiplier. See, eg, *TV Media Pte Ltd v De Cruz Andrea Heidi* [2004] SGCA 29, which involved an artiste who suffered liver damage as a result of consuming slimming drugs.

⁴⁰ Section 13(1)(zd) and (ze), Singapore's *Income Tax Act*.

⁴¹ Under Singapore's Supreme Court of Judicature Act, the High Court of Singapore has the power to award provisional damages in any action for damages for personal injuries on the assumption that a contingency will not happen and further damages at a future date if the contingency happens. The High Court also has the power to order damages assessed in any action for personal injuries to be paid in periodic instalments instead of as a lump sum (First Schedule, paras 16 and 17). It appears, however, that the contingencies contemplate only complications (such as a deterioration in the plaintiff's physical or mental condition, or a serious disease) arising from the injuries, not the uncertainties that relate to tax matters.

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common sense'.⁴² It seems uncontroversial that an assessment of damages in Singapore should assume that tax rules and the plaintiff's circumstances prevailing on the date of assessment continue to apply. Where changes to these are known, however, such as where the Government has proposed a change to tax rates taking immediate effect, the new rates may be used instead.

The lost earnings of the plaintiff in *Gourley* would have been taxed under Schedule D in the UK, which included Cases for profits of a trade, and for profits of a profession or vocation. In *Gourley*, Lord Jowitt and Lord Goddard took the view that no distinction was to be drawn between cases involving Schedule D (in which the tax was payable only after the money had been received) and other cases where tax fell to be assessed under the P.A.Y.E. system or Schedule E (pursuant to which the money was deducted before the tax was paid).⁴³ The manner by which the tax is collected in Singapore, whether by withholding, direct assessment, or the appointment of an agent, has no bearing on the plaintiff's tax liability itself, and ought not therefore to affect the amount of tax to be deducted.

The plaintiffs in most of the local personal injury cases surveyed were employees with low income. Any deduction of tax required by the *Gourley* principle was thus likely to have been small.⁴⁴ Graduated tax rates for resident individuals in Singapore have fallen over the years, and many no longer pay any income tax: for year of assessment 2007, the tax-free bracket for a resident individual applies to chargeable income of up to \$20,000. Where the plaintiff is an employee who is not tax-paying, taking the tax element into account in damages will not affect the amount to be awarded.

This paper now briefly examines a few tax aspects in a scenario where the plaintiff is carrying on a substantial trade or business (whether as a sole proprietor or a partner), and, separately, where he is tax-paying and subject to foreign taxation. Any deduction of tax from the damages may become significant in either or both of these scenarios, and skilled evidence may enable the parties to agree figures⁴⁵ or may serve as 'a check or a guide'⁴⁶ to the courts to arrive at a reasonable estimate of the plaintiff's tax liability.

⁴² [1956] AC 185, 210.

⁴³ [1956] AC 185, 198 and 207.

⁴⁴ See *Peh Diana & Anor v Tan Miang Lee* [1991] SLR 341, 350.

⁴⁵ Above n 11.

⁴⁶ *Taylor v O'Connor* [1971] AC 115, 134 (per Lord Morris, who cautioned that skilled evidence could not resolve matters that in the nature of things are uncertain or decide issues that require judgment).

FIRST SCENARIO - INDIVIDUAL CARRYING ON A TRADE OR BUSINESS IN SINGAPORE

Two tax aspects are examined: first, how the plaintiff's unabsorbed trading losses and/or capital allowances, if any, should be dealt with; and second, whether and, if so, how other sources of income the plaintiff has should affect the assessment of damages.

AVAILABILITY OF UNABSORBED TRADING LOSSES AND CAPITAL ALLOWANCES

Where the plaintiff has sustained trading losses and has not been tax-paying, then provided that there is a prospect of the plaintiff's business turning in a profit during the period of his incapacity owing to the injury, the losses may be assumed to be carried forward in estimating the loss of his profit over that period. If such a prospect of profit is absent, the damages would not be reduced to allow for the tax deduction of the trading losses. The Australian case of *Bateman v Slatyer*⁴⁷ is persuasive authority on this point.

Where the plaintiff is unlikely to resume his trade because of the injury, the 'business continuity' condition for the carry forward of unutilised capital allowances will not be satisfied,⁴⁸ and this tax consequence should be reflected in the calculations.

Where the plaintiff was tax-paying before the date of injury but he expected to incur trading losses during the period of incapacity, then if he satisfies the conditions for carry back relief,⁴⁹ it seems appropriate to assume that he elected the relief. The election would result in tax refundable to him and reduce the tax liability that might otherwise attach to his lost profit for the year of loss immediately following the tax-paying year. It is suggested that the damages to be awarded in such a case should be reduced by the amount of tax refund, as the dollar value of the lost profit will be correspondingly smaller.

⁴⁷ (1987) 71 ALR 553. In this case, the applicants were awarded damages for misrepresentations inducing them to take up an unprofitable franchise. They had sustained trading losses but, as they had no prospect of profit, Burchett J declined to reduce the damages to allow for the tax deduction of the losses.

⁴⁸ Section 23(1), Singapore's *Income Tax Act*.

⁴⁹ Section 37E, Singapore's *Income Tax Act*. The carry back regime is intended to improve the cash-flow position of small businesses. Carry back of the unabsorbed trading loss or capital allowance is allowed for one year only, and the total amount to be set off against the plaintiff's assessable income is capped at \$100,000.

Other sources of income

If the plaintiff has taxable income besides that from his trade or business, one tax aspect is whether and how those sources of income should be taken into account in assessing the damages.

One approach is to ignore them.⁵⁰

An alternative approach is to treat the lost profit as the top slice of the plaintiff's income and to deduct tax based on the marginal rate or rates applicable for that slice.⁵¹ Other income (without distinction between passive and active sources) would in effect be taken into account to calculate the tax liability on the trading profit he could have earned.

It is suggested that a better approach would be to distinguish passive and active sources of income. Where the other sources of taxable income are passive (e.g., rental income received by the plaintiff as a mere landlord), they should be ignored in assessing damages because the incapacity owing to the injury does not affect the amounts of passive income earned. On the other hand, income from active sources, such as a part-time employment the plaintiff is concurrently engaged in, is directly affected by the incapacity and should therefore be taken into account. This approach is in line with the criterion of remoteness postulated by Simpson.⁵²

SECOND SCENARIO - INDIVIDUAL WHO IS SUBJECT TO FOREIGN TAXATION

Illegally employed workers

A foreign worker who sustains injuries while illegally employed in Singapore would still be able to qualify for damages. In *Ooi Han Sun*, a Malaysian working in Singapore without a work permit sustained injuries when the pick-up truck he was in overturned. The High Court considered that the maxim *ex turpi causa non oritur actio* (no cause of action arises out of a base cause) 'has only very limited application in tort and, in general, the fact that the plaintiff is involved in some wrongdoing does not of itself provide the defendant with a good defence'.⁵³ However, to compensate

⁵⁰ In *Taylor v O'Connor* [1971] AC 115, Lord Reid (at 129) opined that 'it will not be proper to take the widow's private income into account, which might increase the damages substantially.' Similarly, Lord Dilhorne (at 139) said that 'were the respondent a rich woman, it would not be right, in my opinion, to increase the provision for tax on account of her increased liability to tax on account of her personal income'.

⁵¹ Luntz H, *Assessment of Damages for Personal Injury and Death* (3rd ed, 1990, Butterworths) 351-2.

⁵² Simpson P, 'Loss, Tax, Tax Losses and Lost Tax' [2001] 3 *British Tax Review* 174, 182.

⁵³ *Ooi Han Sun v Bee Hua Meng* [1991] SLR 824, 830.

the plaintiff on the basis of what he might have earned by illegally working in Singapore without a valid work permit 'would be against public policy and wholly improper'. The High Court therefore held that the assessment of the loss of earnings 'should be based on an estimate, however difficult and imprecise this might be, of what he would have earned in [his home country] had there been no accident to him'.⁵⁴ Damages may however be assessed based on income earned in Singapore where the plaintiff could prove that he had worked in Singapore for a long period of time, intended to continue to work in Singapore, and would be able to resume his former employment and secure a work permit.⁵⁵

It is suggested that the above principle extends to a plaintiff who is illegally trading in Singapore. Moreover, where the damages are to be assessed based on trading or employment income (as the case may be) in the home country, a reasonable estimate of home country tax should logically be deducted in giving effect to the *Gourley* principle.

Legally employed workers

For a foreign worker who is legally employed in Singapore on the date of his injury, damages would be assessed as if he were a Singaporean worker, provided that his work permit or employment pass is likely to be renewed. This condition will be satisfied if, for example, the industry the plaintiff was working in has depended on foreign workers for many years, and such a situation was going to continue in the foreseeable future.⁵⁶

THE TAX POSITION IN SINGAPORE WHERE THE DAMAGES AND THE LOST PROFIT ARE BOTH TAXABLE

Where a dispute relates to a contract that governs the business profit-making apparatus and the termination of the contract causes the business to come to an end, the damages awarded will be a capital receipt even though they may be calculated based on estimated lost profit. The same tax result arises where the damages are to

⁵⁴ [1991] SLR 824, 833.

⁵⁵ *Ling Kee Ling v Leow Leng Siong* [1995] 2 SLR 189. The deceased had three jobs during the year before the accident, one of which was done without the proper work permit. He had worked illegally as a lorry attendant.

⁵⁶ In *Wee Sia Tian v Long Thik Boon* [1996] 3 SLR 513, the plaintiff was a Malaysian construction worker legally employed by a Singapore company at the time he sustained injuries. Prakash J declined, for the reasons given, to reduce the multiplier to take account of the possibility that he may have a shorter working life than his Singaporean counterpart because his work permit may not be renewed.

THE GOURLEY PRINCIPLE IN SINGAPORE

compensate for the sterilisation of a capital asset.⁵⁷ The *Gourley* principle has been applied in other countries to companies and to contractual claims,⁵⁸ but it has not been applied in any commercial cases in Singapore,⁵⁹ which suggests that the scenario in which lost profit is taxable but the damages are not taxable is rare. Where damages are taxable,⁶⁰ local courts appear to simply leave their taxability as a matter to be resolved by the recipient with its tax advisors and the tax authorities. In the UK, where 'the damages awarded will be subject to tax, the court inquires no further and does not consider whether the tax liability on the damages would be heavier or lighter than the tax liability on the lost income.'⁶¹

The UK position, as exemplified by *Parsons*, would be to leave the two taxes to set off each other,⁶² and 'it is no part of, at any rate, the normal functions of a court of law to increase the amount of an award of damages so as to protect the plaintiff at the expense of the defendant against the incidence of taxation which the legislature has thought fit to impose.'⁶³ On the other hand, the current Australian position, as exemplified by *Gill v Australian Wheat Board*, would be that in the exceptional situation where the difference in the taxation of the damages and the lost profit 'is likely to be marked' and where the parties are in agreement on what matters will affect the

⁵⁷ See, eg, *The Glenboig Union Fireclay Co Ltd v IRC* (1922) 12 TC 427, and generally Chase G, *Tax Treatment of Compensation and Damages* (London, Butterworths, 1994).

⁵⁸ See, eg, *West Suffolk County Council v W Rought Ltd* [1957] AC 403 (above n 14); *Parsons v B.N.M. Laboratories Ltd* [1963] 2 All ER 658 (above n 16); and the Malaysian case of *Daishowa* (above n 19).

⁵⁹ Similarly, a *Gourley* reduction is 'little evident in commercial cases' in the UK: Eden S, 'An Unlucky Configuration' [2006] *British Tax Review* 150, 152-3.

⁶⁰ The general tax principle, sometimes called the 'replacement' principle, is that compensation in lieu of trading profit is itself income: see, eg, *London and Thames Haven Oil v Attwooll* (1967) 43 TC 491.

⁶¹ *Julien Praet et Cie SA v HG Poland Ltd* [1962] 1 Lloyd's Rep 566, 595 (per Mocatta J). In that case, damages had to be assessed for wrongful termination of an agency agreement relating to Belgian motor insurance. The defendant contended that Belgian tax payable by the plaintiff on the damages was negligible, whereas the tax on the lost profit would have been much higher. The defendant therefore argued that tax should be deducted from the gross lost profit, and that the resulting figure then increased by the estimated Belgian tax liability on the damages. The plaintiff contended that *Gourley*, as interpreted in subsequent cases, simply required that tax be ignored where, as here, the damages were taxable. Mocatta J agreed with him. Mocatta J's approach was endorsed by Pearson LJ (who, with Harman LJ, comprised the majority) in *Parsons* (above n 16, 679).

⁶² Above n 16, 675D (per Harman LJ, noting that 'there may be some roughness in this justice but it does at least make an end of the matter.').

⁶³ Above n 16, 680H (per Pearson LJ, who nevertheless envisaged 'exceptional cases' in which a departure from this practice may be appropriate).

amount of taxation, the award may be adjusted for that difference.⁶⁴ The *Gill's* decision may be confined to its specific facts, and it is suggested that the Singapore approach is simpler and thus preferable.

The scenario in which lost profit is not taxable but damages are taxable is implausible and has therefore little significance.

CONCLUSION

Based on the various cases surveyed, the following summary may serve as 'check or a guide' in arriving at a reasonable estimate of the plaintiff's income tax liability in an assessment of damages in Singapore where the two conditions for *Gourley* principle are satisfied.

The method of collection of the tax would not affect the amount of the damages to be awarded. The assessment should be based on tax rates prevailing on the date the award was made, but new tax rates or rules may be used instead where they have been announced by the Government and already taken effect. Where the plaintiff has sustained trading losses up to the date of injury, then if there is a reasonable prospect of his business making a profit during the period of incapacity owing to the injury, the damages would be reduced to reflect the value of the tax deduction the plaintiff could get for his losses; conversely, damages would be awarded gross if such a prospect is absent. Where the plaintiff has other sources of taxable income besides the employment or trading income he is posited to be earning, only active sources should be taken into account as only they are affected by the incapacity owing to the injury. The principle that an illegally employed worker in Singapore is to be awarded damages based on what he would have earned in his home country should apply also to an individual illegally trading in Singapore and, in either case, home country tax should be deducted in assessing the damages. For an individual who was trading before the injury, provided that the respective conditions are met, the assessment of

⁶⁴ 81 ATC 4217 (Supreme Court of NSW). The Australian Wheat Board was liable to compensate the plaintiff, a primary producer, for losses he suffered because of the presence of excessive amounts of pesticide in wheat dust sold to him by the Board. The plaintiff had mixed the wheat dust in the mash he fed to his poultry. Many of the flock fell sick or died, egg production and fertility were reduced, and he suffered damage for the five years of income, 1972 to 1976. The parties were agreed on the net loss figures for those five years of income and on the matters to be taken into account for the purpose of determining what, if any, amount should be added to the amount of compensation (to be paid in one lump sum in 1981) to allow for the imposition of tax in the financial year ended 30 June 1981. Rogers adjusted the award after reviewing the majority decision in *Parsons* and the dissenting decision of Stephen J in *Atlas Tiles Ltd v Briars* (which was subsequently adopted in *Cullen v Trappell*).

damages may assume that he had elected carry back relief and, if a prospect of profit exists during the period of incapacity, carry forward relief should be applied also.