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## **Income Taxes in Commercial Damage Calculations – Still a Grey Area**

For many business losses, damages are calculated on a “before tax basis”. However, there is some debate as to whether income taxes should be factored into the calculation of damages.

The logic behind calculating damages on a “before tax basis” is that the plaintiff will receive the judgment on a before tax basis, hence the effect of income taxes can be safely ignored.

However, in *Toronto-Dominion Bank v. Leigh Instruments Ltd. (Trustee of)* regarding the relevance of “the consequent tax treatment of the loan, ... and the amount of any tax benefit which may have accrued to the Bank [which it submits] go to the issues of mitigation and quantum of damages”. Winkler J. of the [then] Ontario Court (General Division) concluded, “Accordingly, it seems clear that the tax treatment of the loss in issue in an action may be relevant to the calculation of damages in some circumstances. In my view, in the circumstances before me, evidence as to any tax benefit received or receivable by the plaintiff, flowing directly from the accounting and tax treatment of the Leigh loan by the T-D Bank, is arguably relevant to the issues of mitigation and quantum of damages. The objection is therefore overruled”. Winkler J. later dismissed the Bank’s action, and the Court of Appeal for Ontario dismissed the appeal.

Including the effect of income taxes is consistent with the definition of damages: “That sum of money which will put the party who has been injured, or has suffered, in the same position as he would have been in if he had not sustained the wrong for which he is now getting his compensation or reparation”.

The net loss to the plaintiff is ultimately a loss of after tax income.

The dollar differences between damages calculations that include or exclude the effect of income taxes will generally not be large, unless one or more of the following factors applies:

- There are significant tax benefits caused by the matters in dispute;
- Effective tax rates change over time, or as a result of the matters in dispute;
- The calculation of damages runs over a number of years; and/or
- The relevant interest rates in the damages calculation are quite high.

The fact pattern of the specific case will determine the relevance and financial impact of income taxes on the quantum of damages.

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