GOURLEY REVISITED — TAXING DAMAGES

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ABSTRACT

For taxation purposes compensation payments assume the same character as the thing they replace — and they are then taxed accordingly. Compensation for lost income is therefore normally taxable in the hands of the recipient and, consequently, the operation of the 'compensation principle' requires that the award be made on a pre-tax basis. Where compensation is awarded not for lost income but for lost 'earning capacity' (a capital asset) the calculation of quantum becomes more complicated. The '*Gourley* principle' evolved to address that issue. In short it provides that in personal injuries and wrongful dismissal actions, the amount awarded for loss of earning capacity is to be calculated on a 'net of tax' basis, because those damages, not being on income account, are not themselves taxable. While there is much to commend the principle in the context of the compensation principle, it fails to take account of a number of issues that can affect the adequacy of compensation actually awarded and may therefore disadvantage the plaintiff. This paper considers areas in which a 'purist' application of the principle can produce 'unjust' results, examines the courts' responses to those problem areas and suggests options for possible legislative reform.

I INTRODUCTION

Damages can be awarded for a wide range of 'wrongs,' normally with the aim of compensating the plaintiff[1] by putting him or her 'in the same position as he or she would have been in if the contract had been performed or the tort had not been committed.'[2] That intent, referred to as the 'compensation principle,'[3] has been described as 'the cardinal concept',[4] 'the one principle that is absolutely firm, and which must control all else'[5] and 'cognate with … the rule, described … as universal, that a plaintiff cannot recover more than he or she has lost.'[6]

It is therefore perhaps not surprising that, for taxation purposes, compensation receipts have long been held to assume the same character as the things that they replace, and

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[1] The exceptions are 'exemplary damages', which are not normally awarded for breaches of contract (see *Butler v Fairclough* (1917) 23 CLR 78 at 89 and *Gray v Motor Accident Commission* (1998) 196 CLR 1 at 6), and 'additional damages' which may be awarded under specific statutory provisions to deter and punish wrongful behaviour (see *Hugo Boss Trade Mark Management GmbH & Co Kg v Sasalili Oxford Fia* [2014] FCA 1328 at [14] and, for examples, the intellectual property statutes).

[2] *British Transport Commission v Gourley* [1956] AC 185 at 197, 212; *Johnson v Perez* (1988) 166 CLR 351 at 355, 367, 371, 386; *Haines v Bendall* (1991) 172 CLR 60 at 63 and *Northern Territory v Griffiths (decd)* (2019) 364 ALR 208 at [337].

[3] *Livingstone v Rawyards Coal Co* (1880) 5 App Cas 25 at 29 per Lord Blackburn.

[4] *Haines v Bendall* (1991) 172 CLR 60 at 63.

[5] *Skelton v Collins* (1966) 115 CLR 94 at 128.

[6] *Haines v Bendall* (n 2) at 63 and *Northern Territory v Griffiths (decd)* (n 2) at [337].

that they are taxed accordingly.[7] As a result, in personal injuries and wrongful dismissal cases, compensation received for *lost earnings*, is regarded as income and, therefore, it is taxable.

This also has consequences for the calculation of quantum. Because lost earnings and compensation for their loss are both taxable, the effect of the 'compensation principle' is that the damages awarded to return the plaintiff to his or her pre-loss position are usually equal to the gross pre-tax earnings that the plaintiff would have received but for the injury or dismissal (because, following receipt, the compensation will be taxed exactly as the foregone earnings would have been so the net receipt should be, at least in theory, the same amount that the plaintiff's after-tax earnings would have been). Consequently, it has never been necessary to reduce the award by any notional taxation element to avoid over-compensation.[8]

However, where the lost earnings would have been taxable but the compensation receipt is not (as will be the case, for example, where the compensation is for loss of future earning *capacity* — a capital asset[9]), there is a question as to the proper basis upon which quantum should be calculated.

An uncritical consideration of the compensation principle might lead one to the conclusion that the proper amount should always be based simply on that part of the plaintiff's earnings which he or she was able to retain (ie his or her after-tax earnings) and that is indeed how the question of quantum has generally been resolved. However, there are a number of issues which affect the validity of that calculation and they are considered in this paper.

II Compensation for Personal Injuries — The *Gourley* Principle

In 1955 the House of Lords held in *British Transport Commission v Gourley*[10] ('*Gourley')* that, in personal injuries actions, the amount awarded for loss of *earning capacity* was to be calculated on an assessment of the plaintiff's likely future earnings, on a 'net of tax' basis. That was principally because those damages, not being on income account, were not themselves taxable.

The underlying principle was that which was referred to earlier — compensation should put plaintiffs in the same position they would have been in if they had not sustained the injuries.[11] If plaintiffs were awarded an amount equal to the pre-tax earnings foregone and were not then required to pay tax on it, they would be over-compensated. Three of their Lordships noted that the same principles would apply in wrongful dismissal actions where the award was not taxable. This, although obiter, was later accepted as

[7] *Commissioner of Taxation (NSW) v Meeks* (1915) 19 CLR 568 at 580 per Griffith CJ.
[8] *Gill v Australian Wheat Board* [1980] NSWLR 795 at 797. See also, *Stepanoski v Aslan (No 3)* [2019] NSWSC 1445 at [68].
[9] *Williamson v Commissioner for Railways* [1960] 60 SR (NSW) 252 at 281. Such receipts are also exempt from capital gains tax under *Income Tax Assessment Act 1997* (Cth), s 118-37.
[10] [1956] AC 185.
[11] Ibid at 197.

correct[12] and the principles have since been extended to any situation where the loss suffered would have been subject to tax had it been received but the award, for whatever reason, is not itself taxable.[13]

The *Gourley* decision departed radically from earlier United Kingdom decisions, commencing with *Fairholme v Firth & Brown Ltd*[14] in which it had been held that, in assessing damages in such cases, no regard should be had to the effect of taxation on the amount lost because, either, the servant's taxation liability was '*res inter alios acta*'[15] (something between others) or the incidence of taxation on the award was 'too remote' to be properly taken into account in the assessment of damages.

Fairholme v Firth & Brown Ltd was subsequently followed in *Jordan v Limmer & Trinidad Lake Asphalt Co Ltd*[16], *Blackwood v Andre*[17], *Billingham v Hughes*[18] and, in Australia, *Davies v Adelaide Chemical and Fertilizer Co Ltd.*[19] A similar result was reached in *W Rought Ltd v West Suffolk County Council*[20], which unlike the other cases, involved compensation for lost profit following an interruption of manufacturing operations (though this decision was overturned on appeal after *Gourley* was decided: see *West Suffolk County Council v W Rought Ltd*[21]).

The only dissenting view during this period was in *M'Daid v Clyde Navigation Trustees*[22] in which Lord Sorn held that damages awarded for personal injury should be calculated on a 'net of tax' basis — but he seems to have been reached that decision without considering the contrary views in *Fairholme v Firth & Brown Ltd* and it was later expressly disapproved by Lord Keith in *Blackwood v Andre.*[23]

III THE *GOURLEY* PRINCIPLE IN AUSTRALIA — *ATLAS TILES LTD v BRIERS*

In Australia, the practice prior to *Gourley* was the same as it had been in the United Kingdom — the tax effect was not taken into account in the assessment of damages and they were therefore awarded on a pre-tax basis. Thereafter, though, the *Gourley* principle was regularly applied by State courts when they were assessing damages for both personal injuries and wrongful dismissals.[24] It was not, however, considered by the High Court until *Atlas Tiles Ltd v Briers*[25] ('*Atlas Tiles*') in 1978.

[12] See *Parsons v BNM Laboratories* [1964] 1 QB 95 and *Lyndale Fashion Manufacturers v Rich* [1973] 1 WLR 73; [1973] 1 All ER 33.
[13] See, for example, *West Suffolk County Council v W Rought Ltd* [1957] AC 403.
[14] (1933) 149 LT 332.
[15] Ibid at 333 per du Pareq J.
[16] [1946] KB 356.
[17] 1947 SC 333.
[18] [1949] 1 KB 643.
[19] [1947] SASR 67.
[20] [1955] 2 QB 338.
[21] [1957] AC 403.
[22] 1946 SC 462.
[23] n 17 at 333-334.
[24] See, for example, *Groves v United Pacific Transport Pty Ltd* [1965] Qd R 62, *Robert v Collier's Bulk Liquid Transport Pty Ltd* [1959] VR 280 and *Williamson v Commissioner for Railways* [1960] SR (NSW) 252. .
[25] (1978) 144 CLR 202.

In that case the High Court held by a 3:2 majority that, contrary to the decision in *Gourley,* damages calculations (in that case for wrongful dismissal) should not involve a deduction for the income tax that would have been payable on the amounts that were lost as a result of the injury or wrongful dismissal.

The majority gave a number of reasons for reaching that decision. First, there was the problem of valuing the loss. As Barwick CJ pointed out, the compensation principle is fundamental but, '[i]t is for that of which the plaintiff has been deprived that the award of damages must compensate.'[26] He went on to say that what had to be kept in mind was that what was being compensated was loss of earning capacity, not loss of earnings (where the award would clearly be taxable). He then noted:

> [i]f the award of damages for such an injury destroying or diminishing his earning capacity were merely a matter of replacing those earnings, the amount of the award would be taxable: but it is not, for the reason that the award is for a capital loss.[27]

At the same time he did acknowledge that the quantum of lost future earnings would be a factor that should be taken into account in arriving at a valuation of the loss of the plaintiff's future earning capacity, perhaps even a major factor.[28] However, he then went on to draw an analogy with loss of a rental property, saying that the value of the property (and therefore the compensation that would be recoverable for any such loss) would not simply be a reflection of the lost rent that might have been earned from the property's continued use.[29]

On that basis he ultimately decided that the incidence of tax on the amount the plaintiff had lost as a result of the wrongful dismissal was too remote and that it should not be taken into account in calculating damages. He said:

> If … the correct statement is that compensation is to be given for destroyed or reduced earning capacity and not for the non-receipt of earnings, the liability to pay tax on taxable income to which the product of the earning capacity would contribute is not relevant to the valuation of the earning capacity destroyed or diminished: or it may equally be said that the liability is remote in a legal sense.[30]

His Honour also noted the problem of calculating the quantum of any reduction. If the tax that would have been payable if the award had been taxable was to be deducted when calculating the award, how was that reduction to be calculated? He suggested two possible options.[31]

The first (which seemed to him to accord with the compensation principle) was to look at how much the plaintiff's tax liability would be increased if the damages in their pre-tax form had been added to his or her taxable income and then take that amount away from the award (thus suggesting that the amount awarded would be regarded as the 'last

[26] Ibid at 208.
[27] Ibid at 209.
[28] Ibid.
[29] Ibid at 210-11, citing *Lim Foo Yong Ltd v Collector of Land Revenue* [1963] 1WLR 295; [1963] 1 All ER 186.
[30] Ibid at 218.
[31] Ibid at 205-6.

income' earned for the tax year and, therefore, that it be 'taxable' at the plaintiff's highest marginal tax rate, or rates).

The second option was to spread the tax ratably over all elements of taxable income to provide some form of 'average'.

He ultimately concluded, however, that arriving at an appropriate figure was a near impossibility. In particular, he noted that the solution that Lord Jowitt adopted in *Gourley* of arriving at one 'on broad lines,' even if that meant that the figure was 'rough and ready,' was not appropriate.[32] His final view, though, was that if damages awards were to be reduced to take the taxation effect into account, it would be better to leave it to the legislature to determine whether, and, if so, to what extent, that should occur.[33]

He did comment, however, that one impact of reducing the quantum of damages awarded was that the wrongdoer was the real beneficiary, making it cheaper to injure a taxpayer than a non-taxpayer, while also effectively denying the revenue the benefit of the tax that might otherwise have been paid.[34]

Jacobs J took much the same view saying that the *Gourley* principle required too many exceptions to be workable and that, accordingly, the pre-*Gourley* position was to be preferred.[35] He noted that this objection did not apply to lost earnings *pre-trial,* where both the amount of the loss and the tax payable on it could be calculated with precision, but that it did apply to the calculation of damages for loss of *future earning capacity*.[36]

Like Barwick CJ, he also noted that the sole beneficiary of the rule would be the wrongdoer and that there were significant reasons for the law not to offer a financial inducement to wrongdoing.[37]

Murphy J took a more activist view, noting that taking the plaintiff's notional tax liability into account was just one way in which damages in personal injury cases were underestimated (the other he identified was not taking inflation into account), and said that the difficulties of calculating a sum that would provide true compensation were 'so great that in general the calculation is not attempted.'[38] He also raised as an issue the difference between calculating past lost earnings, which is relatively simple, and determining the value of any future loss of earning capacity, which is not.[39]

Of the minority, Gibbs J accepted that precise calculation was problematic but said that, 'there is nothing in *Gourley's Case* that requires the court to proceed so mechanically as to fail to take these possibilities into account'.[40] He went on to say that calculating damages often requires making an estimate and that that should not preclude the

[32] Ibid at 212.
[33] Ibid.
[34] Ibid at 213 and 214-16.
[35] Ibid at 240.
[36] Ibid at 242-43.
[37] Ibid at 244.
[38] Ibid at 246-47.
[39] Ibid at 246.
[40] Ibid at 222.

compensation principle applying to prevent over-compensation, which would happen if tax was not taken into account.

On the question of benefiting the defendant by reducing the damages payable he said that the argument was 'fallacious' and that 'the question is what damages will compensate the plaintiff for his loss. It is not to the point that by reason of the circumstances of the case the damages are lower than they would have been if those circumstances did not exist'.[41]

Stephen J, also in the minority, after noting that, 'in considering economic loss, particularly future economic loss, [the courts] are entering an uncertain realm where the critical matter, what the future would have held for the plaintiff in terms of his earnings, depends upon a number of imponderables, some personal to the plaintiff, others affecting the community at large,'[42] went on to say:

> the objection taken to the principle in *Gourley's Case* seems to rest principally upon two grounds: that the incidence of income tax is too remote or is res inter alios acta, as it is sometimes put, and that if either party is to 'benefit' from the transmutation of taxable earnings into tax-free damages it should be the innocent plaintiff rather than the unworthy wrongdoer.[43]

As regards the first of those objections he said that remoteness was:

> inappropriate as a reason for inflating damages by excluding from consideration factors tending to reduce the measure of the plaintiff's loss … [and that] … res inter alios acta, is little more apposite. It is often employed, albeit inaccurately, to justify benefits which a plaintiff may derive from third parties being excluded from consideration… [but] … the decision whether or not the incidence of income tax is to be taken into account is essentially concerned with the aim of compensating the plaintiff and with matters of policy in achieving that aim.[44]

He then went on to say that *Gourley* was correct because take home pay is 'the true measure of the wage-earner's reward … [so] … there is no error in the policy decision so made'.[45]

He similarly dismissed the benefit argument saying that it:

> is to lose sight of the fact that the prime purpose of damages is that of compensating the injured party, no more and no less. It introduces instead a notion suitable only to some punitive theory of damages and seeks to convert awards of damages into *vehicles for the distribution of tax savings*. It also ignores reality in supposing that the financial interests of defendants in the great bulk of personal injuries cases are other than those of the premium-paying community at large.[46] (emphasis added)

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[41] Ibid at 223.
[42] Ibid at 231.
[43] Ibid.
[44] Ibid at 231-32.
[45] Ibid at 232.
[46] Ibid.

His Honour then went on to say that 'any abandonment of the now conventional post-*Gourley* basis for the assessment of financial loss due to impaired earning capacity would dramatically increase the general level of awards of damages, calling for a far-reaching and temporarily disruptive re-evaluation of the present basis *whereby loss has come to be distributed, by means of insurance*, throughout the community'.[47] (emphasis added)

Stephen J's tax savings issue is a valid point — though, clearly, it could be remedied by making such awards taxable. That would not, however, address the problem that Barwick CJ had identified: that there would then be the issue of the rate at which the awards should be taxed. That problem would only be compounded by the fact that the receipt would invariably occur entirely in a single tax year and would therefore be taxable in full in that year, unless there was some form of legislative averaging similar to that which formerly applied to the calculation of capital gains tax liability under Part IIIA of the *Income Tax Assessment Act* 1936 (Cth).[48]

His Honour's insurance point is also a valid consideration though, arguably, that should be something for government rather than the courts to consider when deciding, as a matter of policy, whether such awards should be taxable.

On the question of calculating quantum Stephen J rejected 'the "simple and blunt" process of doing no more than taking net-of-tax earnings, continuing them into the future and ascertaining their present value from appropriate tables'[49] and noted, instead, that 'special factors' could be taken into account — such as 'the higher rates that would apply to increased remuneration in the future, the possession of sources of income other than the income the loss of which reflects lost earning capacity and any likelihood that, whether by dramatic changes in marital status or otherwise, the plaintiff's allowable deductions and taxable income would have been subject to marked changes in the future … [and] … the effects of inflation and of income tax upon the income which capital sums of damages may produce.'[50] Despite that though, he then refused to consider how that might occur, saying that 'these are matters for another day and for a case that squarely raises the issue.'[51]

In that same context he also noted that the effects of inflation on the calculation of damages (which Murphy J had raised as an issue) might also be considered in some future case where that issue was squarely raised [52] (an issue with particular relevance

[47] Ibid.
[48] To recognise the inequity that could arise where a capital gain which may have accrued over a number of years was taxed at progressive rates in the year in which it was realised, the *Income Tax Rates Act 1986* (Cth) s 12 and Sch 7 provided that the tax payable by individual taxpayers on the gain was to be calculated by including only one-fifth of that gain in assessable income, calculating the tax on that amount at the taxpayer's marginal rates and then multiplying that amount of tax by five to determine the actual tax payable. The operation of the notional averaging provisions for net capital gains contained in the then Schedule 7 is detailed in Taxation Ruling TR92/12.
[49] *Atlas Tiles* at 230 (citing Taylor, 'The Element of Income Tax in Damages Awards for Personal Injuries', (1968-1970) 5 *Victoria University of Wellington Law Review* 208, 224.
[50] Ibid at 233.
[51] Ibid.
[52] Ibid

because, although he did not directly refer to the decision, the High Court had previously, and very clearly, rejected the use of inflation estimates when calculating quantum in *O'Brien v McKean*[53]).

IV RECONSIDERING *GOURLEY* — *CULLEN v TRAPPELL*

Interestingly, the decision in *Atlas Tiles* stood for less than 18 months before being overturned by *Cullen v Trappell,*[54] a case in which special leave to appeal from a decision of the NSW Court of Appeal (applying *Atlas Tiles*) was granted, specifically to allow the High Court to reconsider its earlier decision.

In a 4:3 decision the majority (Gibbs, Stephen, Mason and Wilson JJ) refused to follow *Atlas Tiles*, applied *Gourley* and held that, when assessing damages for personal injury (or unlawful dismissal), the court should take into account the income tax that the plaintiff would have had to pay on the earnings of which he or she had been deprived because of the injury (or dismissal).

Their Honours' reasoning was essentially that which the minority (Gibbs and Stephen JJ) had applied in *Atlas Tiles*. In brief, it was that (1) damages are compensatory in nature and should not be calculated on the norm that 'the wrongdoer should pay' (ie there should be no punitive element involved in either intent or result); and (2) (pragmatically) in nearly all cases any tax benefit does not attach to the wrongdoer but, because of insurance, to the public generally.

The majority specifically rejected the argument that following *Gourley* would lead to unacceptable difficulty and complication in the assessment of damages and said that, even if that were the case, 'there is no reason for departing from the fundamental principle on which that decision rests'.[55] (Gibbs J had earlier noted that: 'The method now usually adopted in assessing damages for economic loss to be suffered in the future is first to estimate what the loss will be, and over what period it is likely to occur, and then to estimate what sum, if paid *at the date of judgment*, would compensate the plaintiff for that future loss. This is usually done by applying actuarial tables which show the present value of a future loss, once an appropriate rate of interest has been applied')[56] (emphasis added).

Of the minority Barwick CJ adhered to the views he had expressed in *Atlas Tiles* and emphasised again that, in his view, *Gourley* wrongly confused replacement of the capacity to earn with replacement of the wages that might be expected to have been earned, while again acknowledging that the lost wages would be an element in the calculation, saying that, '[t]o attempt to assess damages on the basis of the benefit

[53] (1968) 118 CLR 540. See also n 66 below.
[54] (1980) 146 CLR 1.
[55] Ibid per Gibbs J at 17.
[56] Ibid at 12. It is clear that Gibbs J's calculation produced the plaintiff's current after tax loss of $66 a week – and did so without consideration of possible future pay rises or the effect of inflation.

which the recipient of salary or wages derives from its receipt, is to my mind to introduce remote and irrelevant considerations.'[57]

He then went on to illustrate that point by referring to the impact that other outgoings, including travel and clothing required for work and for other requirements of the employer, can have on disposable income, saying '[they] may significantly affect the benefit derived from the receipt of salary or wages'.[58]

He also noted that other matters could affect the plaintiff's tax liability, such as available rebates (and, presumably, things such as deductible losses from other income-earning endeavours), which would make arriving at an accurate assessment impossible. He said: 'No doubt, if *Gourley's Case* were accepted, due allowance could be made for those deductions to which the employee is presently entitled, but not for those to which he might become entitled in the future.'[59] He then went on to note the fact that tax rates are not stable either, and the obvious effect that that would have on the accuracy of any present calculation of future after-tax loss.[60]

Murphy J adopted the same approach he had taken in *Atlas Tiles*, departed from the key question before the Court and criticised the trial judge's assessment of damages because (1) they assumed that the plaintiff's earnings would remain constant over the ensuing 25 years of his working life; (2) they ignored the probable increases in real wages reflected throughout the Australian community (noting that these had averaged about 3% per year over the 25 years before the trial); and (3) they ignored increases due to normal age progression and promotion (and the fact that the trial judge's assessment had also reduced the plaintiff's likely available 30 years of working life to 25 years to 'allow for adverse contingencies').

His Honour then went on to note that:

> The injustice is compounded when the notional wage loss is discounted by 6 percent. That discount rate is a reflection of inflation. To ignore the probable effects of inflation on future earnings or expenses while taking it into account by adopting inflated interest rates when assessing the present value of those earnings or expenses is clearly an injustice to injured plaintiffs.[61]

In a similar vein Aickin J said about applying the *Gourley* principle:

> If… the general rule continues to be that no account is to be taken of increases in wages or other income due to promotion, changes in awards due to "indexation" or 'work value' or other matters in estimating loss of earning capacity, this practice, though realistic is anomalous.[62]

He then went on to describe the process for determining damages saying:

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[57] Ibid at 8.
[58] Ibid at 9.
[59] Ibid.
[60] Ibid.
[61] Ibid at 27.
[62] Ibid at 30-1.

> The law with respect to the mode of assessment of damages for personal injury has in recent years gone through a process of both refinement and elaboration which has however introduced what appear to me to be in principle serious anomalies. … The process now used is primarily to take a plaintiff's weekly or other periodic wage or salary as at the date of hearing, and to subtract from it in the case of partial incapacity the weekly amount which he is able to earn at the date of hearing. The next step is to calculate the total sum which would be received if that figure represented actual earnings for the balance of the working life of the plaintiff. From the total figure so calculated a reduction is made for what were originally called contingencies but which are now usually referred to as 'the vicissitudes of life' and then a chosen discount rate is applied in order to calculate from the appropriate tables the present value of that series of periodical payments. This exercise gives a figure which has, if I may say so a spurious air of precision.[63]

He then noted:

> To make as a matter of course an adjustment for unfavourable contingencies which may operate to reduce the estimate for the future, rather than to advert to both favourable and unfavourable contingencies is a departure from logic. However it is not customary to make allowance for the prospect of promotion to a more highly paid position, whether as a result of obtaining higher qualifications by reason of experience or of training ... and thereby obtaining new skills … These of course are imponderables, as are the risks of illness or redundancy. With due respect to those who have thought otherwise it appears to me that there is no sound basis for supposing that there is always a preponderance of bad luck over good luck.[64]

He also referred to the fact that the courts do not take inflation into account when assessing damages, saying merely: 'The decision of this Court in *O'Brien v McKean* excludes the effect of inflation from the calculation in so far as it relates to the period beyond the date of hearing'.[65]

What Barwick CJ had said in *O'Brien v McKean* (after noting that what was being compensated was loss of earning capacity not loss of earnings) was:

> ... changes in the amounts which would have been paid for the exercise of the lost or impaired earning capacity and which would be *due solely to changes in the purchasing power of money* ought not be considered as relevant to the assessment of compensation for the lost earning capacity … For the loss of a present capacity, with all its inherent probabilities, the injured person is to be presently compensated by an immediate payment of money. Upon the award being made, the successful plaintiff becomes entitled to that money free to do with it what he will. He can protect himself against the possibilities of continuing or increasing inflation to the same extent as any other citizen with an investible fund. The successful plaintiff has, as it were, exchanged an earning capacity for such a capital fund. In my opinion, neither possible nor probable changes in the purchasing power can be relevant to the assessment of the capital sum so to be paid.[66] (emphasis added)

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[63] Ibid at 32. See also the Windeyer J's more detailed discussion of the calculation of damages for personal injury in *Bresatz v Przibilla* (1962) 108 CLR 541 at 543.
[64] Ibid at 33. Windeyer J expressed similar reservations in *Bresatz v Przibilla* (1962) 108 CLR 541 at 543-44.
[65] Ibid at 34.
[66] *O'Brien v McKean* (n 55) at 546-47 per Barwick CJ. See also at 552 per McTiernan J, at 552-53 per Taylor and Menzies JJ and at 558-59 and 560 per Windeyer J. The principle was confirmed in *Pennant Hills Restaurants Pty Ltd v Barrell Insurances Pty Ltd* (1981) 145 CLR 625 at 634 and 635 per

Having noted the effect of that decision Aickin J went on to say: 'All these aspects indicate what appears to me to be a tendency to be selective in the factors which may affect future earnings and therefore enter into the calculation of the value to be attributed to the loss of earning capacity. … When one comes to consider the question of tax there will be many cases in which its estimation even at the rates prevailing at the date of the trial will present great difficulty'.[67] He then went on to discuss the various problems that had already been covered by others.

V AFTER *CULLEN V TRAPPELL*

A *The Gourley Solution Applied*

Since *Cullen v Trappell* the Australian courts have consistently applied the principle that the majority adopted, with perhaps the clearest exposition being found in cases such as *Traecey v Churchill*[68] (the first appeal to come before the New South Wales Court of Appeal after *Cullen v Trappell* was decided) and *Saul v Menon.*[69] Both involved situations where the trial was held before *Cullen v Trappell* but the appeal was heard after it. In both cases the court, at trial, had followed the decision in *Atlas Tiles* and ignored the effect of taxation but, on appeal, followed the principle accepted in *Cullen v Trappell*, and re-assessed quantum to take that effect into account. Explaining the change Moffitt ACJ noted in *Saul v Menon*, 'it has now been firmly decided that the incidence of taxation is to be brought to account in the computations and assessments [of damage for loss or diminution of earning capacity]'.[70]

There are, however, still a number of issues that have not been resolved, or even fully considered in the decisions to date and they can result in, as Murphy J said in *Cullen v Trappell,* an assessment of the loss of future earning capacity which is 'unrealistic.'[71]

For example, in *Cullen v Trappell* the plaintiff, a qualified print machinist who was no longer able to work in that trade had the quantum of his loss of future earning capacity assessed at $45,311. That was in 1980 when he still had an estimated 30 years of working life remaining. That sum was calculated by taking into account the then after-tax weekly earnings that a rotary printing press machinist would earn ($170 per week), deducting the amount that he was able to earn in a sheltered workshop ($104 per week) multiplying that by the 25 years of working life that was likely to remain to him (the 30

Barwick CJ, at 639 per Gibbs J, at 676 and 679 per Mason J (Wilson J agreeing) and at 685 per Murphy J. Stephen J (with whom Aicken J agreed), took a contrary position, noting (at 650-51) that 'the courts' treatment of future inflation involves no rule of law, only a rule of practice … [and] … "the measure of damages ought never to be governed by mere rules of practice" …' and (at 651-52) that, 'It seems clear that the conventional Australian basis of assessment, which substantially disregards the effect of future inflation, no longer provides a satisfactory means of compensating plaintiffs for future economic loss or liability'.

[67] (1980) 146 CLR 1 at 34.

[68] [1980] 1 NSWLR 442.

[69] [1980] 2 NSWLR 314. See also *Thiess Properties Pty Ltd v Page* [1980] 31 ALR 430 at 437 and 439 where the Full Court of the Federal Court dealt with the same issue in the same way.

[70] [1980] 2 NSWLR 314 at [11]. See also *Commissioner of Taxation v Sydney Refractive Surgery Centre Pty Ltd* (2008) 253 ALR 59 at [4].

[71] (1980) 146 CLR 1 at 27.

years of anticipated working life discounted for the effect of his injuries and the 'vicissitudes of life'), the resulting figure then being further discounted by 6% (the standard discount figure that the courts then used) to account for the effects of inflation on the returns of investment of the capital sum.

That further discount was imposed (and justified) on the assumption that the capital sum, appropriately invested, would produce a return which, with the capital sum itself, would be sufficient to replace the lost future earnings but would be exhausted at the end of the plaintiff's anticipated working life. That is, it would allow him to draw $66 per week for the whole of those 25 years — though not *$66 adjusted for inflation*.

Given that Mr Trappell was expected to have 25 years of remaining working life which would have to be funded from the award, the amount of $45,311 was clearly inadequate to provide him with real replacement earnings, even assuming that he continued to earn some supplementary income from the sheltered workshop or other similar employment.

B *Unresolved Problems with the Gourley Solution*

While it is clear that there is much to commend the *Gourley* solution in the context of the compensation principle, it is also clear that its application fails to take into account a number of issues which do affect the question of the adequacy of the quantum of the compensation awarded. Most of those issues were identified by Lord Keith in *Gourley* or by Barwick CJ and Jacob, Murphy and Aickin JJ in *Atlas Tiles* and/or *Cullen v Trappell.* In brief they may be summarised as follows:

1 *Determining What is Being Compensated*

As Barwick CJ pointed out in both *Atlas Tiles* and *Cullen v Trappell* it is difficult to escape the conclusion that the majority in *Gourley* did not really draw a distinction between a loss of earning capacity and loss of the proceeds of exercising that capacity in the future. The two are clearly related but, equally clearly, they are not the same thing and to value the former, effectively exclusively, by reference to the latter may not produce a just outcome. As all of the judges acknowledged, there is an element of estimation in determining the quantum of damages in many cases but, arguably, it should first be clear what exactly is being compensated.

2 *Calculation Problems*

As Lord Keith, Barwick CJ and Murphy, Jacob and Aickin JJ variously illustrated, the presently accepted method for calculating damages for loss of future earning capacity does not take into account a range of possible future occurrences that might affect its proper valuation, even where it is based solely on an assessment of future earnings. They include:

- the possibility of increases in real wages over time;
- the possibility of increases due to normal age progression and promotion;
- the possibility of increases achieved by education and changing occupation;
- the possibility of future deductions and offsets (for, for example, future dependents); and

- lifestyle choices (in particular, the impact of salary-sacrifice type decisions on both future taxable income and the consequential tax liability).

Despite comments by Gibbs and Stephen JJ (in particular) that there was nothing in *Gourley* that required courts 'to proceed so mechanically as to fail to take these possibilities into account'[72] there is still a real question about how exactly the courts would take those possibilities into account and what evidence of the plaintiff's probable future conduct they would require before they would depart from the formulaic calculation to which both Gibbs and Aickin JJ referred in *Cullen v Trappell.*[73]

Even if courts can get around that problem, there is still the issue of how the rate of tax that will determine the reduction in the quantum of damages should be calculated. As Barwick CJ asked in *Atlas Tiles*, should the courts assume that the income foregone (a significant part of the basis on which the compensation is calculated) would be taxed at the taxpayer's highest marginal rate (or rates) or should they adopt some other, perhaps average, rate determined, as Barwick CJ postulated in *Atlas Tiles*, by spreading the amount of tax ratably over all elements of the taxable income[74] — or should they effectively ignore the plaintiff's other income and reduce the award by the tax that would have been payable on the income foregone, on the assumption that it was the only income received by the taxpayer (an option that seems to have been impliedly discarded as a possibility by their Lordships in *Gourley*).

A third issue, given that damages awards do not take inflation into account (thereby effectively forcing the taxpayer to make excessive drawdowns of capital from which income was intended to be derived over the entire balance of the plaintiff's anticipated working life, with the result that it will produce ever-decreasing real returns), how can the courts be certain that the tax rates now applicable to that taxpayer's total income will continue to be the rates at which his or her total income will be susceptible to tax? Even assuming (somewhat unrealistically) that the applicable tax rates and thresholds will not change over the course of his or her notional remaining working life, how is that to be taken into account in determining probable future taxation liability?

Even if that were possible, how do the courts assess likely future tax liability anyway given the probability, not only of fluctuations in tax rates, but also of other relevant variables? Gibbs J noted in *Atlas Tiles* that 'it is said that it is impossible to foresee future changes in the level of tax, or in the tax laws, or in the situation of the plaintiff himself which may affect the extent to which the lost earnings would have borne tax,'[75] but he then went on, effectively, to disregard that as a legitimate concern saying:

> in the assessment of damages the court is constantly required to endeavor to predict the course of events in the future, and it does not abdicate a necessary function for

[72] (1978) 144 CLR 202 at 222 (per Gibbs J) and at 233 (per Stephen J).
[73] (1980) 146 CLR 1 at 12 (per Gibbs J) and at 32 (per Aickin J).
[74] (1978) 144 CLR 202 at 206.
[75] Ibid at 222.

> fear that its predictions may be falsified. To ignore tax altogether would be to assess damages on a basis that would be unreal and theoretical.[76]

The question could be asked however whether, if there is a risk of over-compensating a plaintiff or under-compensating him or her because of inherent uncertainties in the calculation methodology, justice might perhaps be better served if the courts were to err on the side of possible over-compensation.

Finally, even if all that could be resolved, what allowance, if any, should the courts legitimately make for other non-tax-related outgoings that affect after-tax disposable income? In *Cullen v Trappell* Barwick CJ instanced outgoings for travel and clothing required for work and other employer requirements that 'may significantly affect the benefit derived from the receipt of salary or wages'.[77] If the courts are to apply the compensation principle consistently and in line with their treatment of the impact of taxation then, logically, these expenses, which will no longer be incurred, should also be deducted from the gross compensation calculation to arrive at the plaintiff's true loss. At present, however, they are not considered, even though, arguably, they could be calculated at least as accurately as any likely future tax liability.

3 *Not Taking Inflation into Account*

As Aickin J noted in *Cullen v Trappell,* the effect of the High Court's decision in *O'Brien v McKean* is to exclude the impact of inflation from the calculation of damages beyond the date of hearing.[78] As damages for loss of future earning capacity under the *Gourley* principle are calculated on the basis of likely future earnings foregone this can produce an unrealistic representation of the true quantum of the plaintiff's loss, especially when that figure is itself reduced by a discount factor to give the net present value of estimated future loss of net earnings after taking into account the probable investment returns on the lump sum award.

While acknowledging that compensation is awarded for loss of earning capacity (a present loss), and the difficulties of accurately predicting the economic future — with the associated complexity that accounting for inflation would introduce into trials (together with the courts' acceptance that plaintiffs have the opportunity, through appropriate investment, to guard against the erosion of their awards by inflation), if a notional taxation factor built on assumptions as to future tax laws and the plaintiff's own taxation circumstances can be estimated and applied to reduce those awards it should be possible, in theory, to make similar assumptions about wage levels, based on historic data, to give a better estimate of probable loss.

That would better ensure that the damages awarded, together with the return generated through their investment, would provide a true replacement of loss over what would have been the plaintiff's remaining working life. It would also, incidentally, reduce the

[76] Ibid.
[77] (1980) 146 CLR 1 at 9.
[78] See also *Lim Poh Choo v Camden and Islington Area Health Authority* [1980] AC 174 and *Pennant Hills Restaurants Pty Ltd v Barrell Insurances Pty Ltd* (1981) 145 CLR 625.

probable future burden on the state's social security system if and when amounts awarded on current principles prove insufficient to provide adequate financial support over that period, as was patently the case in *Cullen v Trappell*. Given the decision in *O'Brien v McKean* that would however require legislative action.

4 *Benefitting the Wrongdoer*

It would seem to be an inescapable consequence of applying the compensation principle that the wrongdoer will, in most cases, receive a benefit, simply because the damages payable for the consequences of a wrongful act will almost invariably be reduced below what they would otherwise have been.

The judges in both *Atlas Tiles* and *Cullen v Trappell* were divided on the relevance of this issue, with some expressing concern at the injustice of providing that 'incentive'. The majority, however, thought that the compensation principle, as the 'dominant rule', was fundamental and that benefit to the wrongdoer was not a relevant consideration. More pragmatically they also acknowledged the insurance effect (through which the costs of compensation are distributed across the entire community) and the impact that increasing awards to remove the 'benefit' would have on future premiums.

Realistically the only way in which benefit to the wrongdoer can be fully removed while still adhering to the compensation principle would be to assess damages based on pre-tax earnings and then make the award itself taxable. This is not without its difficulties including, not least, the problem of the rate at which such awards should be taxed to ensure that the revenue does not receive a windfall at the expense of the plaintiff. Perhaps a possible solution would be for the legislature to set a rate of tax for such awards at the taxpayer's average rate of tax for, say, the three or five years prior to the injury, after excluding abnormal items, as is currently done when calculating the comparison rate of tax for the purpose of averaging primary producers' tax liability.[79]

That would, of course, increase both payments and insurance costs but one benefit might be to provide government with a revenue stream to cover the costs of disability and similar social security payments to plaintiffs whose awards prove to be insufficient to fund them through to the end of their notional working life. Either way there are a number of policy considerations which government would need to take into account when deciding whether legislative intervention could be justified.

C *Other Problems*

There are at least two other possible problems with the *Gourley* solution: first, what happens if the damages awarded are themselves taxable, but at a lower rate than that which the plaintiff would otherwise have paid? And, secondly, what happens where the correct taxation treatment of the award is unclear?

[79] *Income Tax Assessment Act 1997* (Cth), Div 392.

1 *The 'Lower Rate of Tax' Problem*

A major problem in determining whether (and how) tax should be taken into account when assessing damages arises because the underlying principle from *Gourley* is that, where the lost income would have been susceptible to tax but the damages are not, the damages should be calculated on an after-tax basis. But what happens if the damages or other compensation is taxed but tax is levied on some concessional basis? Should those awards be calculated on a pre-tax or post-tax (or some other) basis?

In *Atlas Tiles* Gibbs J considered how this might apply in the context of the then s 26(d) of the *Income Tax Assessment Act 1936* (Cth), which provided that:

> The assessable income of a taxpayer shall include-
>
> (d) 5% of the capital amount of any allowance, gratuity or compensation where that amount is paid (whether voluntarily, by agreement or by compulsion of law) in a lump sum in consequence of retirement from, or the termination of, any office or employment …

While accepting that the *Gourley* principle only applied where the damages awarded were not taxable, he held that, because the entire award in *Atlas Tiles* was not taxable, only five percent of it was, the *Gourley* principle should still apply and the award should therefore be calculated on a post-tax basis, subject to an adjustment for the tax that the plaintiff would pay on the five percent that would be included in his or her assessable income. He said:

> … the principle in *Gourley's Case* should be applied in assessing damages for wrongful dismissal in Australia, notwithstanding that five percent of the award will be taxable. … I consider that, *in general, the principle applies only where the damages are not taxable*, and this would be so *even if the tax payable on the award would be considerably less than the notional tax on the lost earnings*. But where only a *small fixed proportion* of the award is subject to tax, it would be manifest that a plaintiff would receive more than was necessary to compensate him for the loss caused by his wrongful dismissal if his damages were assessed on the footing of his gross earnings, when all of those earnings would have been subject to tax. The reasons underlying *Gourley's Case* in my opinion require that in such a case the court should assess damages on the basis of the net earnings which represented the plaintiff's real loss, but should adjust the result by taking account of the fact that a proportion of the award will bear tax.[80] (emphasis added)

Gibbs J's view was subsequently endorsed by the majority in *Cullen v Trappell* (which included himself)[81] and later decisions have interpreted the passage to be authority for the proposition that*, if only part of an award* is subject to tax, the basic proposition in *Gourley* continues to apply (subject to the adjustment to which Gibbs J alluded) — but that, if the *whole award* is taxable, albeit at a rate even considerably less than that which might have applied to the foregone income, then *Gourley* would not apply.

[80] *Atlas Tiles* at 227. See also per Stephen J at 236.
[81] (1980) 146 CLR 1 at 11 per Gibbs J, at 24 per Stephen and Mason JJ and at 39 per Wilson J.

Whether this interpretation was entirely appropriate fell to be tested when s 26(d) was repealed in 1984 and a new set of provisions were introduced to tax 'eligible termination payments', a generic term covering retirement, termination and other similar payments made in consequence of the termination of a taxpayer's employment.[82]

The new provisions made eligible termination payments assessable in full (to the extent that they related to service after 30 June 1983) but subjected them to special rates of tax, up to a maximum of 30%, calculated on the basis of a number of variables including the age of the recipient, the source of the payment and whether it exceeded stipulated thresholds.

Given that the new provisions included the entire receipt in assessable income (rather than just five percent of it as had been the case under s 26(d)), did that mean that the *Gourley* principle could not apply to it and that compensation for, for example, unfair dismissal should be awarded on the basis of the pre-tax income that had been foregone because it would then be taxed in the recipient's hands, albeit at a lower tax rate than that which, in most cases, would have applied to the foregone income?

In *Kilburn v Enzed Precision Products (Aust) Pty Ltd*[83] that is exactly how the Court proceeded. O'Bryan J considered the impact of the 'eligible termination payment' provisions, found that their effect would be that '[t]he damages awarded to the plaintiff will probably attract tax' and therefore held that, 'the Court need no longer take taxation into account in calculating the damages for loss of earnings in a claim for wrongful dismissal.'[84]

To that extent, of course, there was a partial 'windfall' for the plaintiff because he received the full pre-tax amount of the income that had been foregone — but was taxed on it at a rate lower than that at which it would have been taxed if the same sum had been received as ordinary remuneration.

That decision was followed and its reasoning was applied in a number of subsequent cases including *Wheeler v Philip Morris Ltd,*[85] *Mills v Australian Card Services Pty Ltd,*[86] *Quinn v Jack Chia (Australia) Ltd,*[87] *Byrne v Australian Airlines Ltd,*[88] *Grout v*

[82] The former Subdiv AA of Div 2 (ss 27A-27J) of the *Income Tax Assessment Act 1936* (Cth).
[83] (1988) 5 VIR 31
[84] Ibid at 34. Interestingly, he made no reference to Gibbs J's judgment in *Atlas Tiles* but instead referred to an amendment to the UK *Finance Act* in 1960 (after *Gourley's Case*) which had made damages for loss of earnings for wrongful dismissal taxable, with the effect that the UK courts no longer reduced awards for the taxation effect. He then based his decision on a statement that the new Australian provisions had 'the same effect'.
[85] (1989) 97 ALR 282 at 312-13 where Gray J specifically referred to the above-quoted passage from Gibbs J's dissenting judgment in *Atlas Tiles* and applied it to distinguish *Cullen v Trappell*.
[86] Unreported, Supreme Court of Victoria. 21 March 1989, Kaye J at 20 and 24-25.
[87] [1992] 1 VR 567 at 581.
[88] (1992) 45 IR 178 at 203 (per Hill J); reversed in part on other grounds in *Byrne v Australian Airlines Ltd* (1994) 47 FCR 300.

Gunnedah Shire Council,[89] *Anderson v Geccu Trading Pty Ltd*,[90] *Guthrie v News Ltd*[91] and, to some extent, *Reilly v Praxa Ltd*.[92] Some additional support can also be found in *Bostik (Australia) Pty Ltd v Gorgevski (No 1)*[93] and *Walker v Citigroup.*[94]

A more 'purist' application of the *Gourley* principle, albeit not as articulated by Gibbs J in *Atlas Tiles* for cases where the entire award was taxable, was preferred in *New South Wales Cancer Council v Sarfaty.*[95] In that case the majority (Gleeson CJ and Handley JA) upheld the trial judge's calculation of damages, which the parties had both agreed would be taxable as an 'eligible termination payment', on the same basis that Gibbs and Stephen JJ had proposed in *Atlas Tiles* for payments taxed under the then s 26(d). That is, they assessed them on an after-tax basis and then added back the tax that would actually be payable on the award. In doing so they seemed to treat the two situations as analogous.

The same general reasoning can be seen, albeit not in an eligible termination payments scenario, in *CFMEU v Hail Creek Coal Pty Ltd*[96] where, having determined that the plaintiff was entitled to compensation for past and future loss of wages under s 545 of the *Fair Work Act 2009* (Cth), Reeves J turned to how best to deal with the tax impact. All parties had agreed that, as a lump sum, the full award would be taxed in the then current year — and that that would mean that the plaintiff would be liable to tax at higher marginal rates (he estimated that he would be subject to an average rate of 40% on his past loss of wages compared with the 30% average rate he had paid while working). His Honour held that 'it would be unfair to assess Mr Haylett's compensation without making an allowance for the additional tax he will have to pay'.[97] He therefore awarded damages for past lost wages on a 'post-tax' basis, but grossed them up to take account of the additional tax for which the plaintiff would be liable.

That approach is arguably a more faithful application of the 'compensation principle'. It is also one that could be extended to any situation where the tax rate applicable to the compensation differs from the tax rate that would have applied to the receipt that has been lost.

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[89] (1995) 129 ALR 372 at 373-74 where Moore J quoted in detail from Gray J's reference in *Wheeler v Philip Morris Ltd* to Gibbs J's dissenting judgment in *Atlas Tiles* to also distinguish *Cullen v Trappell*.
[90] [1999] VCC 46 at [90] and [99].
[91] (2010) 27 VR 196 at 235.
[92] [2004] ACTSC 41 at [33]. Gray J seemed to concede there that in some instances there could 'be a justification for discounting the difference in compensation for "grossed up" future earnings compared to receiving an eligible termination payment which is taxable at a lesser rate' but then noted: 'That is not the case here'.
[93] (1992) FCR 20 at 33.
[94] (2006) 226 ALR 114 at [131].
[95] (1992) 28 NSWLR 68.
[96] [2016] FCA 1032.
[97] Ibid at [64].

It could also extend to *McLaurin v FCT*[98] *and Allsop v FCT*[99] type situations where the award (or settlement) amount is an undissected lump sum that is not regarded as income and which, now, might only be subject to capital gains tax.[100]

It also seems to accord with the '*Gourley* in reverse' principle which was first adopted in the United Kingdom in *Taylor v O'Connor,*[101] a case involving a wife's loss of dependency on the death of her husband, where, in assessing damages Lord Reid said:

> damages for loss of dependency ought to be such that she will have available to spend each year, free of tax, a sum equal to the amount of the dependency. But if the damages are calculated without reference to income tax that will not be so. …The damages will therefore have to be increased by an amount necessary to counteract this short-fall.[102]

It also applies, in particular, in relation to the interest which it is assumed a plaintiff will earn when the capital sum awarded as compensation is invested to augment the capital and to provide an income stream for the balance of the plaintiff's notional working life.[103] Because that interest is itself subject to tax the total return will fall short of what is needed to properly compensate the plaintiff unless the interest is 'grossed up' by the amount of tax — which, therefore, is what occurs.[104]

More recent examples of the *Sarfaty* approach can be found in *Tomasetti v Brailey*[105] (where damages for negligent financial advice were not awarded but the court noted that, if they had been, they would have been an assessable recoupment under s 20-20 of the *Income Tax Assessment Act 1997* (Cth), and would therefore have had to have been 'grossed-up' for the tax that would have been payable on them),[106] and *Jamieson*

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[98] (1961) 104 CLR 381.
[99] (1965) 113 CLR 341.
[100] In *McLauren v FCT* and *Allsop v FCT,* both of which pre-dated CGT, the settlement had a mixed but unapportionable capital and income character. The entire amount was therefore held to be capital and not assessable. Now, where compensation payments are received as an undissected lump sum they are treated as having been received for disposing of the right to seek compensation and, unless they are covered by an exemption (as would be the case for compensation for an injury), are subject to capital gains tax, with the concessional treatment that that involves. See Taxation Ruling TR 95/35.
[101] [1971] AC 115.
[102] Ibid at 128-29. See also per Lord Morris of Borth-y-Gest at 133-34, per Lord Guest at 135, per Viscount Dilhorne at 138-39 and per Lord Pearson at 143. Unlike in Australia, damages in the United Kingdom are determined by ascertaining the amount of a single year's loss and applying an appropriate 'multiplier'. The increase required to negate the effect of taxation on the income produced by investing the award is therefore accommodated simply by selecting an appropriate 'multiplier'. In *Hodgson v Trapp* [1989] AC 807 the House of Lords noted that 'the incidence of taxation … should ordinarily be assumed to be satisfactorily taken care of in the conventional assumption of an interest rate applicable to a stable currency and the selection of a multiplier appropriate to that rate': per Lord Oliver of Aylmerton (with whom the other members of the House agreed) at 835.
[103] It can also apply to the income component of an annuity and to other similar receipts of a mixed capital and income nature.
[104] See, for example, *Cullen v Trappell* at 14-17 (per Gibbs J with whom Stephen, Mason and Wilson JJ agreed) and *Pennant Hills Restaurants Pty Ltd v Barrell Insurances Pty Ltd* (1981) 145 CLR 625 at 641-42 (per Gibbs J) at 663-65 (per Stephen J), at 681 (per Mason J). An actuarial example of the gross up required, at the then applicable rates of tax and available interest rates, can be found at (1966) 40 ALJ at 135-137.
[105] (2012) 274 FLR 248.
[106] Ibid at [149].

v Westpac[107] where damages were sought for interest payments to a bank that the plaintiffs had claimed as a deduction. The bank argued that the damages should be limited to the after-tax loss (ie the total loss less the tax benefit the plaintiffs had received because of the deduction). In both cases the Courts noted that where damages are themselves taxable they have to be 'grossed up' to take into account the tax that would be payable to ensure that the amount awarded does compensate the plaintiff for the losses that were actually sustained.[108]

The problem with *Sarfaty* is that, in reaching their determination, Gleeson CJ and Handley JA specifically (and erroneously) noted that '[t]here is no Australian decision since *Cullen v Trappell* which determines how, if at all, the tax on an award of damages for wrongful dismissal should be reflected in the assessment of those damages'.[109]

It was therefore perhaps not surprising that in *Grout v Gunnedah Shire Council (No 3),*[110] a case also concerning how damages for wrongful dismissal on which tax would be payable under the new 'eligible termination payments' provisions should be calculated, Moore J declined to follow *Sarfaty* preferring, instead, the reasoning in the earlier cases, saying:

> It is clear, in my opinion, that unlike in *Wheeler* and *Byrne* their Honours did not address the antecedent question of whether damages should be calculated by reference to gross or net income because the parties seem to have assumed that the net income was the relevant amount. The trial and appeal were conducted on that basis.[111]

He therefore awarded damages representing salary for the notice period 'assessed by reference to the applicant's gross income'.[112]

His Honour's decision was, however, almost immediately not followed by the Court in *Patterson v Middle Harbour Yacht Club,*[113] yet another case involving damages that the parties had agreed would be taxable as an 'eligible termination payment'. Having had the decision in *Grout v Gunnedah Shire Council (No 3)* brought to his attention[114]

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[107] (2014) 283 FLR 286; upheld on appeal: *Westpac Banking Corp v Jamieson* [2016] 1 Qd R 495 at [4]-[7], [10] and [195]-[199].
[108] *Tomasetti v Brailey* (2012) 274 FLR 248 at [149] per McFarlan JA, cited with approval by Jackson J in *Jamieson v Westpac* (2014) 283 FLR 286 at [229].
[109] Ibid at 79. Neither *Kilburn v Enzed Precision Products (Aust) Pty Ltd* nor *Wheeler v Philip Morris Ltd* were cited in the judgment and it appears that they were not referred to in either argument or the submissions — though that appears to have been a consequence of the parties having agreed at first instance that the plaintiff's damages were to be assessed on the basis of his lost post-tax earnings: see *Sarfaty v New South Wales Cancer Council* (Unreported, Supreme Court of New South Wales. 28 August 1991, Bruce A-J) BC9103662, at 11-12.
[110] (1995) 129 ALR 372, a decision later reversed on other grounds (see *Gunnedah Shire Council v Grout* (n 89)).
[111] Ibid at 374.
[112] Ibid at 375.
[113] (1996) 64 FCR 405. This case was later distinguished in *Reilly v Praxa Ltd* (n 92 above) but its methodology was subsequently applied in *Hockey v WIN Corporation Pty Ltd* ('*Hockey*') [2013] FCA 921 at [15]-[20].
[114] The parties had originally agreed that damages should be assessed in accordance with the decision in *Sarfaty's Case* but, after judgment was reserved, counsel for the applicant drew the Court's attention to the then recent decision in *Grout* (n 89) which had declined to follow that approach.

Whitlam J noted the then recent decision of the New South Wales Court of Appeal in *Daniels v Anderson*[115] where Clarke and Sheller JJA had set out four propositions governing the operation of the *Gourley* principle. Quoting the third and fourth of those propositions[116] he went on to say:

> In the present case I propose to apply the method used in *Sarfaty*. It would, in my opinion, be unjust not to do so. The damages award will be taxable as an eligible termination payment. It is agreed that the tax rate (including Medicare levy) on such a judgment will be 31.4 per cent. If I 'gross up' the relevant part of the damages by that percentage, that should provide just compensation to Mr Patterson for his loss of earnings and the value of his lost benefits. (I realise that, as noted in *Sarfaty* by Mahoney JA at 96, the method is not perfect.) The alternative approach, which is to ignore the impact of taxation on the damages awarded, requires that loss of earnings be calculated by reference to gross wages. This would result in an unnecessary windfall for Mr Patterson, since the loss in his gross annual earnings exceeds $60,000 and the vast bulk of this amount would have been taxed at a marginal rate of 47 per cent.[117]

Grout v Gunnedah Shire Council (No 3) was also criticised in *Slifka v JW Saunders Pty Limited*[118] where North J, having taken the view that in *Wheeler v Philip Morris Ltd*[119] Gray J had not considered the question whether damages should be awarded on a pre-tax basis 'where the tax on the award is very much less that the income tax on the lost earnings',[120] interpreted that judgment restrictively to mean 'that where the lost earnings and the award are both taxable *and nothing in the evidence reveals any difference in the rate of tax applicable*, the appropriate basis for the award of compensation is gross earnings'[121] (emphasis added). He then went on to say:

> Thus, in my view, *Wheeler* and *Sarfaty* are not inconsistent. *Wheeler* deals with the situation where there is no evidence that the award will be taxed at a lesser rate than lost earnings. *Sarfaty* deals with the situation where the tax liability on the lost earnings would have been much greater than the tax liability on the award of damages. The objective of compensating an applicant for actual loss is achieved in the former situation by assessing damages by reference to loss of gross earnings, and in the latter by reference to net earnings plus an allowance for tax payable on the award.[122]

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[115] (1995) 37 NSWLR 438.
[116] Ibid at 585. The two propositions were: '(3) If a comparison between taxable receipts for which damages are recoverable and the taxability of the compensatory verdict are so uncertain and depend upon such imponderables as the degree to which the plaintiff can for example carry forward losses from previous years the appropriate course is to ignore taxation considerations. (4) If on the other hand it is unjust not to take account of identifiable and quantifiable taxation impacts both on the lost receipts and the compensatory damages then these may be taken into account in assessing damages.'
[117] (1996) 64 FCR 405 at 408. This approach was implicitly endorsed (both counsel having agreed to it) in *Simakoff v Federation of Ethnic Communities' Councils of Australia Inc* (Unreported, Supreme Court of the Australian Capital Territory. 26 May 1999, Connolly M) BC9909213, at [11].
[118] (1995) 67 IR 316.
[119] *Wheeler v Philip Morris Ltd* (n 85).
[120] (1995) 67 IR 316 at 331.
[121] Ibid at 332.
[122] Ibid at 332.

He therefore adopted the *Sarfaty* methodology and awarded the applicant compensation for his unlawful dismissal based on his after-tax wages, grossed up for the tax that would be paid on that amount.

On its face, the reasoning in *New South Wales Cancer Council v Sarfaty, Patterson v Middle Harbour Yacht Club* and *Slifka v JW Sanders Pty Limited* seems to be consistent with what might be regarded as a concern to ensure that plaintiffs are not over-compensated which appears to underlie the majority judgments in both *Gourley* and *Cullen v Trappell.* However, it is clearly inconsistent with the principle that Gibbs J articulated in *Atlas Tiles*: if the full amount of compensation is taxable, '*even if the tax payable on the award would be considerably less than the notional tax on the lost earnings'* (emphasis added) then the award is to be calculated on the basis of the plaintiff's pre-tax loss, a principle that has been accepted and applied, at least in all other cases involving 'eligible termination payments', ever since.

2 *What Happens when the Taxation Consequences are Unclear?*

The problem of reconciling the conflicting approaches adopted in the cases that followed the reasoning in *Kilburn v Enzed Precision Products (Aust) Pty Ltd* from those that followed the reasoning in *Sarfaty* was considered in a different context in *Davinski Nominees Pty Ltd v I & A Bowler Pty Ltd.*[123]

In that case tenants in a shopping centre sought damages for income they lost following a wrongful interruption to their leases when relocation notices served by their landlord were subsequently held to be invalid. At issue was whether the compensation that VCAT awarded, on a pre-tax basis, should have been calculated on that basis. The complicating factor was that accountants giving expert evidence on behalf of the parties provided diametrically opposed views about whether the ATO would treat the compensation as income or as a capital gain (with the concessional treatment that the latter would involve).

The tenants, whose accountant gave evidence to the effect that the compensation would be for lost income, so would be fully taxable as income, argued that the compensation should therefore be awarded on a pre-tax basis. The landlord, whose accountant contended that any award would only be taxable as a capital gain, argued that the damages should be restricted to the net (after-tax) earnings that the tenants had lost increased by an amount to cover the capital gains tax payable on the award, thereby effectively applying the '*Gourley* in reverse' principle that seemed to underlie the decision in *Sarfaty.*

Kaye J canvassed the various decisions supporting the two rival methodologies, noted that they had their origins in the distinction that Gibbs J had drawn in *Atlas Tiles* between the effect of taxing part only of an award and taxing the entire amount, albeit at a reduced rate and held that:

[123] [2011] VSC 220.

> … the preponderance of the authorities support the proposition that, in an action for wrongful dismissal, damages should be assessed on the basis of the plaintiff's lost pre-tax earnings.[124]

However, in the context of the case before him his Honour then went on to find that, while that proposition, involving as he put it, 'a rather strict application of the dictum of Gibbs J in *Atlas Tiles v Briers,*'[125] was well established in wrongful dismissal cases, it should not 'be regarded as an inflexible statutory formula' in other cases.

Instead, he said that the principles to be applied in such cases were to be found in the four propositions set out by Clark and Sheller JJA in *Daniels v Anderson*[126] to which Whitlam J had referred in *Grout v Gunnedah Shire Council (No 3)*.[127] Applying the third and fourth of those principles he went on to say that:

> The question, which then arises, is whether, on the materials before me on this appeal, it is possible to conclude that there was sufficient certainty as to the taxation implications of an award of compensation to the defendants, to lead to the conclusion that the Deputy President ought to have assessed the compensation to the defendants on the basis of their lost post-tax earnings.[128]

His answer to that question was that, given the particular issues he was required to consider (including the uncertainty over whether the compensation payments would be taxable as income or as a capital gain, complicated further by the fact that they had been calculated by reference to the first defendant's lost profits but then split equally between all three defendants), and the reality that the Commissioner of Taxation would not be bound by whatever decision he arrived at, it was not possible to determine with any reasonable degree of certainty what the taxation implications of the award would be for the three defendants.

Accordingly, he determined that 'it would not be possible to cater for the liability of the award to taxation, by adding to the award an amount to compensate the defendants in respect of that potential liability.'[129] Therefore, although he held that the Tribunal had not been bound by *Kilburn's Case,* he found that its overall decision that compensation should be awarded on a pre-tax basis was correct. The end result then was that, because of uncertainty about the tax consequences, the award was not reduced — at all.

3 *Other Options to Avoid Over-Compensation*

Clearly the decision in *Davinski* gave the tenants a windfall gain, and to avoid that outcome, counsel for the shopping centre owner had suggested in the course of argument that the issue of uncertainty over the taxation consequences could be resolved

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[124] Ibid at [46].
[125] Ibid at [61].
[126] *Daniels* (n 115).
[127] *Grout* (n 89).
[128] [2011] VSC 220 at [63].
[129] Ibid at [75]. Interestingly, in this passage and also at [70] he indicates that, if he had been able to determine the taxation consequences with sufficient certainty he would have used the calculation methodology used in *Sarfaty's Case*, reinforcing his earlier determination that a strict application of Gibbs J's dictum in *Atlas Tiles* should be restricted to wrongful dismissal cases.

by awarding an after-tax amount but also declaring that his client be required to indemnify the defendants for any tax liability they did incur in relation to it.

Kaye J rejected that suggestion on the grounds that 'it cuts across the basic common law principle that damages are awarded once and for all'.[130] That generally applicable principle was stated in *Todorovic v Waller* as, 'damages for one cause of action must be recovered once and forever, and (in the absence of any statutory exception) must be awarded as a lump sum; the court cannot order a defendant to make periodic payments to the plaintiff'.[131]

In applying that principle to reject the centre owner's argument regarding the uncertain taxation consequences in the case before him Kaye J cited, as specific authority, *Namol v AW Balderstone (No 2)*[132] where Davies J, in rejecting a similar proposition, had said:

> It is inconsistent with common law principles to make a conditional order either providing for an additional award should a certain event occur or reducing or providing for a reduction of an award should an expected event not come to pass.[133]

Interestingly, Kaye J also referenced *PM Sulcs & Associates Pty Ltd v Daihatsu Australia Pty Ltd ('Sulcs')*[134] even though in that case, having first noted that it was 'desirable that all damages should be assessed at the one time and the matter disposed of completely,'[135] Kirby J went on to give the plaintiff leave to apply for 'additional damages referable to Income Tax should it be assessed'[136] because of the uncertainty surrounding whether the award would be taxable.

In reaching that determination Kirby J considered a number of other cases where the 'once and for all' rule had not been applied. They included *Provan v HCL Real Estate Ltd ('Provan')*[137] where Rolfe J covered the possibility that the plaintiff might be found liable to pay capital gains tax on the amount awarded by declaring that, if that occurred,

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130 Ibid at [71].
131 (1981) 150 CLR 402 at 412 (per Gibbs CJ and Wilson J).
132 (1993) 47 FCR 388 ('*Namol*'). See also *Carborundum Realty Pty Ltd v RAIA Archicentre Pty Ltd* 93 ATC 4,418 at 4,428-29.
133 Ibid at 391. *Namol* was also followed in *Osric Investments Pty Ltd v Woburn Downs Pastoral Pty Ltd* ('*Osric Investments*') (2001) 48 ATR 184 though it appears that this was mainly because, as in *Namol*, there was no evidence to support a finding that the applicant would have a CGT or GST liability rather than because of concern that ordering an indemnity, as had been sought, would necessarily offend the once and for all rule: see at [193]-[199]. This approach was consistent with that taken by Hutley JA in *Pennant Hills Restaurants Pty Ltd v Barrell Insurances Pty Ltd* [1977] 2 NSWLR 827 (at 852) and the majority in *Akron Securities Ltd v Iliffe* [1997] 41 NSWLR 353 (at 360, 370 and 371).
134 [2001] NSWSC 798.
135 Ibid at [119].
136 Ibid. The wording, though not the overall effect of Order 6 giving effect to that determination, was subsequently amended to recognise a private ruling that the plaintiff received to the effect that the damages were assessable as ordinary income: see *PM Sulcs & Associates Pty Ltd v Daihatsu Australia Pty Ltd* [2008] NSWSC 683.
137 (1992) 24 ATR 238; 92 ATC 4,644.

he was entitled to be indemnified by the defendants,[138] *Tuite v Exelby*[139] where Shepherdson J, having formed the view that it was 'more likely than not' that the plaintiffs would be assessed to capital gains tax on damages for reduction in the value of their shares, increased the award by the estimated amount of that tax, but also required the plaintiffs to give an undertaking that, in the event that tax was not assessed, either at all or in a sum less than the amount awarded, they would repay the appropriate amount to the defendants[140] and *Rabelais Pty Ltd v Cameron ('Rabelais')*[141] where Hodgson J, having found that there was a potential capital gains tax liability, but one which he could not assess, resolved the matter as Kaye J later did in *Sulcs*, by reserving leave to the plaintiff to apply for additional damages if a taxation liability eventuated.[142]

The *Provan* approach was also endorsed in *Duke Group Ltd (in liq) v Pilmer ('Duke Group')*[143] where the Full Court of the Supreme Court of South Australia was asked to consider the validity of a similar order made by the trial judge to cover the possibility that the plaintiff would be called upon to pay capital gains tax on the damages awarded for the reduced value of shares it had acquired. In upholding the order the Full Court commented:

> Close consideration must be given to the suggestion that the order breaches the once and for all rule. However it is our view that the order does not offend against the principle behind that rule, namely, that there should be finality to litigation. The trial judge determined liability and assessed damages. In relation to this particular head of damages the quantum to be paid in respect of the tax was stated to be the amount of the tax, so that certainty was achieved to that extent. The trial judge simply identified the event on which that component of damages would become payable. The order is an indemnity for an amount which will be precisely defined *in the event of the collection of tax*. The order might give rise to some practical problems but they are not such as to outweigh the central consideration of arriving at a just award of damages. On the other hand there is no scope

[138] Ibid at 259; at 4,656. In reaching this determination Rolfe J acknowledged the 'once and for all' principle but went on to note that his proposed approach did not affront it because '[t]hat principle is subject to the qualification that liability may be considered in proceedings separate from those that quantify damages': at 241; at 4,647. In *Vickers v Taccone* [2005] NSWSC 578 however Hamilton J refused to make an order in relation to potential capital gains tax liability saying (at [4]) 'no material has been laid before me as to the likelihood of that liability arising, and I am far from certain that any liability could possibly arise. In those circumstances, I am not prepared to make any order in relationship to the payment of capital gains tax'.

[139] 93 ATC 4,293.

[140] Ibid at 4,301 – though this approach was rejected in in *Carborundum Realty Pty Ltd v RAIA Archicentre Pty Ltd* 93 ATC 4,418 with Harper J noting (at 4,428) 'it is not clear what the position would be were the undertaking refused'. Despite that, a similar ruling can be found in *Peet Ltd v Richmond (No 1)* (2009) 76 ATR 644 (at [82]) where Hollingworth J, in an action for a quantum meruit, grossed the award up by the GST that the plaintiff would be liable to pay but then ordered that, if a lesser amount was actually paid to the Commissioner, the plaintiff would refund the difference to the defendant.

[141] 95 ATC 4,552.

[142] Ibid at 4,553, noting that while it was 'desirable that all aspects of damages be disposed of in one hearing' as it was not possible for him to make any assessment of any income tax or capital gains tax loss he was prepared to reserve leave 'because there is the possibility of substantial loss'.

[143] (1999) 73 SASR 64.

> for injustice to the defendants. If the tax is not payable that is an end to the matter; if it is payable it should be taken into account in the award of damages.[144] (emphasis added)

The *Provan* approach was also followed in *BestCare Foods v Origin Energy ('Bestcare').*[145] In that case the plaintiff's factory was destroyed by an explosion and fire following a gas leak which, it was held, was caused by the defendant's breach of contract and negligence. The plaintiff, whose business failed and was ultimately sold by administrators, sued for, inter alia, damages for loss of the opportunity to make profits into the future. Among the issues before the Court was whether any award for lost future profits should be grossed up for tax.

Noting that 'for the Court to allow, as a component of damages, a sum representing BestCare's potential tax liability on the net receipts, the Court would be required to consider in detail each element of the assessment, and its possible tax treatment',[146] McDougall J then went on to hold that he would not make a specific award for the taxation component (to which Origin conceded BestCare was entitled) but would, instead, declare that Origin was liable to indemnify BestCare for any taxation liability it incurred in relation to the award. This he said would be just, because Origin's liability would then be 'only such liability as is actually brought home to BestCare, and not some liability determined by the Court as the *likely amount of any taxation impost*'[147] (emphasis added). It also gave the parties the opportunity to agree upon 'a regime governing the steps to be taken in determining the amount of the tax liability … [including] providing Origin with the opportunity to object, at its own expense but in the name of BestCare, to any assessment of tax that might be made'.[148] In the end result the parties accepted this solution and brought in an agreed form of orders to implement it. McDougall's decision was subsequently reversed on appeal — though not on that point.[149]

A somewhat similar approach can be seen in *Peet v Richmond (No 2)*[150] where the problem of a potential GST liability on a quantum meruit award was dealt with by the Court ordering that the plaintiff provide the defendant with a tax invoice. The defendant was then to pay the plaintiff one-tenth of the quantum meruit amount within 30 days and the plaintiff, upon paying the relevant GST to the Commissioner, would, within 30 days thereafter, provide the defendant with documentary proof of the amount remitted — and refund any balance.

This divergence in opinion regarding how the 'once and for rule' should apply in cases where there is uncertainty about the plaintiff's potential tax liability (whether it be to

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[144] Ibid at [562].
[145] [2012] NSWSC 574.
[146] Ibid at [115].
[147] Ibid at [116].
[148] Ibid at [117].
[149] See *Origin Energy LPG Ltd v BestCare Foods Ltd* [2013] NSWCA 90, which was later varied, but not on this point, by *Origin Energy LPG Ltd v BestCare Foods Ltd* [2013] NSWCA 229.
[150] (2009) 76 ATR 644.

income tax, capital gains tax or even GST), was subsequently discussed in *Millington v Waste Wise Environmental Pty Ltd* (*'Millington'*),[151] with Croft J noting that:

> In many ways, a review of the authorities only muddies the already-opaque waters. While the 'once-and-for-all' rule is rightly seen as a long-standing common law rule, clearly there are numerous examples where courts have been prepared to make an award of damages in a manner that provides, as accurately as possible, an appropriate amount to compensate a party for the loss suffered, even if a lack of certainty as to the actual amount has led to the orders being at odds with any 'requirement' to provide a once-off, lump sum payment for damages.[152]

That case was an appeal from an order of a magistrate awarding compensation for damage to the respondent's garbage truck following a collision which, it was admitted, was the appellant's fault. The respondent sued for the cost of repairs, including GST. The magistrate, having found that the respondent would be entitled to claim an input tax credit for the GST, awarded a GST inclusive amount but then ordered that the respondent repay the GST component to the appellant once it became entitled to recover the credit (ie after it lodged its quarterly BAS).[153]

Noting that the compensatory principle and the 'once and for all' rule were both relevant on the facts, Croft J went on to say that 'by the very nature of these two principles they can at times be at odds in their application'.[154] The key, he said, was in the underlying requirement for 'certainty'. The compensatory principle requires that plaintiffs be awarded an amount of damages sufficient to place them in the same position they would have been in if the wrong for which they are being compensated had not occurred — but not to 'profit' by receiving compensation for losses that were not suffered.[155] Where their loss can be accurately calculated (or reasonably estimated) the compensatory principle is relatively simple to apply.[156] However, where there is uncertainty surrounding quantum, especially if the 'once and for all' rule is strictly applied, there is a real risk that plaintiffs will be either over or under-compensated. In such cases, he said:

> … it would be reasonable to suggest that orders of the nature made in *Provan* do provide a mechanism for a court to achieve certainty and accuracy in the calculation of damages in an expeditious, cost effective and convenient manner.[157]

He then went on to find that there was no uncertainty about the taxation implications in the case before him, that cases such as *Provan* were therefore distinguishable, that it

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[151] (2015) 295 FLR 301.
[152] Ibid at [52].
[153] While there were no written reasons for the Magistrate's decision it appears that the order was intended to ensure that Waste Wise was not deprived of the use of the money it would pay as GST between the date it paid for the repairs and when it subsequently received the input tax credit.
[154] *Millington* (n 151) at [57].
[155] Ibid at [26] citing *Wertheim v Chicoutimi Pulp Company* [1911] AC 301 at 308-09 and *McCrohon v Harith* [2010] NSWCA 67 at [53].
[156] Ibid at [40].
[157] Ibid at [59].

was appropriate to apply the 'once and for all' rule and that the magistrate should not have included a component for GST (or ordered its repayment).[158]

The same outcome had earlier been reached on similar reasoning in *Gagner Pty Ltd v Canturi Corporation Pty Ltd ('Gagner').*[159] In that case the damages that were awarded for the cost of rectifying premises included GST on those repairs, even though the plaintiff, which was registered for GST, was entitled to an input tax credit for that GST. On appeal it was held that the damages should not have included a GST component. Campbell JA (with whom Macfarlan JA and Sackville AJA agreed) explained his reasons, saying:

> I accept that the consequence of these provisions is that, even though the Respondent might pay out an amount of GST in connection with the goods and services which it acquired for the purpose of making good the damage to its premises, it would be able to recover that amount back, either in the form of a reduction of the net amount it must remit to the Commissioner for the quarter in which the payment was made, or as a refund. Thus the amount of GST component of any payments it made for making good the premises would not ultimately be a loss that it suffered. Given the compensatory purpose of the damages award, it was wrong to include that component in the award of damages.[160]

The critical difference between those two cases and the cases that followed the *Provan* approach was the question of 'certainty'. In both *Millington* and *Gagner* the GST liability and the potential input credit were known quantities; there was no uncertainty about their quantum.[161] That was quite different from the situations in *Provan, Sulcs, Tuite v Exelby, Rabelais* and *Duke Group* where there was clear uncertainty about the taxation liability that might attach to the damages being awarded. Consequently, there was no difficulty in applying the 'once and for all' rule in either *Millington* or *Gagner*, or in other similar cases.[162]

It therefore appears that the compensatory principle and the 'once and for all rule' can be reconciled. The courts seem to have adopted as their basic premise that there is no general rule that awards of compensation or damages necessarily attract tax[163] and that adjustments for the effect of taxation will only be made where the plaintiff has been able to demonstrate that the award will be subject to tax (of whatever nature) or, at least that that is 'more likely than not'.

In such cases the courts will do what they can to ensure that a single, final award is made and it is only in those rare cases where it is not possible to ascertain with certainty what the taxation position will be, that the courts will depart from the 'once and for all rule' and provide for some subsequent adjustment of the damages that have been

[158] As regards the problem of the respondent being 'out of its money' between it paying and recovering the GST Croft J noted at [37] that the appropriate solution was to include an amount of interest in the overall award.
[159] (2009) 262 ALR 691.
[160] Ibid at [147].
[161] See also *Hockey* (n 113) at [14].
[162] See, for example, *Dual Homes Victoria Pty Ltd v Moores Legal Pty Ltd* (2016) 306 FLR 277 at [289].
[163] *Namol* (n 132) at 391-92 per Davies J and *Osric Investments* (n 132) at [197] per Drummond J.

awarded. Even in those cases there is, in reality, 'finality' in that the question of liability will have been determined. By allowing subsequent adjustments to the amounts due, the courts are merely providing for the proper quantification of the damages awards they have made.[164]

VI POSSIBLE SOLUTIONS

There is no obvious easy solution to the *Gourley* problem. The uncertainties involved in arriving at an accurate valuation of loss of future earning capacity mean that awards will be, at best, an estimate, not of that loss but of the probable proceeds of that loss which, even then, will be informed not by fact but by assumptions about future behaviour by both the plaintiff and government.

Many of those difficulties concerning future behaviour would still remain if the loss was valued on the basis of pre-tax loss but at least the uncertainties about the effect of the future structure of the tax system would be removed.

How then should the compensation principle be applied to ensure, as far as possible, that the amount of any award approximates reality? The '*Gourley* in reverse' principle goes some way to achieving that outcome but it too relies on a number of assumptions about the future in relation to both financial markets and the taxation regime.

Legislating to require courts to take inflation into account when calculating loss of future earning capacity would seem to accord with the thinking underlying the '*Gourley* in reverse' principle and would also produce a more realistic estimate of probable lifetime loss (especially if calculated on a post-tax basis) but it, too, would require a considerable amount of 'guesswork' on the part of judges.

Reforming the compensation system to remove lump sum awards, at least for loss of future earning capacity, and to replace them with indexed annuities (or to require that any lump sum awards be used to purchase an indexed annuity) would also assist.

Those annuities would approximate the lost income and, as taxable receipts, could be taxed on essentially the same basis, with the same general after-tax outcome[165] (which should vary only to the extent of work-related deductions, which would no longer be applicable, and the other non-deductible but work-related outgoings to which Barwick CJ referred in *Cullen v Trappell*).

This need not mean that defendants would thereby incur an ongoing financial and administrative burden. They could still be required to pay a lump sum, but now to an annuity provider, based on a calculation such as that which superannuation funds and other annuity providers routinely undertake.

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[164] *Millington* (n 151) at [56] and [62].

[165] Though that would not be the case if plaintiffs were awarded lump sum compensation which they were then required to apply to the purchase of an annuity. In such cases the effect of *Income Tax Assessment Act 1936* (Cth), s 27H is, currently, to exclude the 'return of capital' component from the taxpayer's assessable income.

There would, however, still be taxation issues because of the present tax treatment of non-superannuation annuities under *Income Tax Assessment Act 1936* (Cth) s 27H (which excludes the 'capital' portion of any such payments) but that could be resolved, at least for 'compensation annuities', by legislating to remove that exclusion (thereby effectively reinstating the traditional practice of disregarding the annuity's capital origins and treating annuity payments as income).

There is also a problem with the exemption that can apply to 'structured settlement payments' under *Income Tax Assessment Act 1997* (Cth), Div 54, where some or all of compensation or damages payments for personal injury are used to purchase an annuity, but that too could be considered as part of an overall legislative package aimed at better applying the 'compensation principle' to ensure more appropriate plaintiff support over the remainder of their lives.

Moving from lump sum payments to annuities that would better approximate pre-tax income would also remove the 'benefit to the wrongdoer' problem and ensure that the revenue was not adversely affected, as is arguably the case now.

This would of course increase awards and have an impact on both insurance premiums and the insuring public but it might also reduce the reliance by plaintiffs, later in life, on social security payments to augment their depleting capital pool. In both respects there are policy issues which government would need to consider.

VII CONCLUSION

The *Gourley* principle has arguably been shown to be, in many respects, a 'blunt instrument' for resolving a difficult problem. It provides a degree of certainty in the assessment of damages but it does not reflect the complexities of modern taxation law in all of its manifestations. As a result, it can produce significant injustice to parties on both sides of the equation. It clearly needs to be applied with much more flexibility than the original formulation allowed and it is to the courts' credit that they have evolved variations that take some of those considerations into account.

It is arguable though that there is still some way to go before a set of universally workable principles are put in place. Perhaps at the end of the day the one guiding principle should simply be where it all started — compensation for actual loss, but with the overriding qualification that, in cases of uncertainty, awards should err on the side of the plaintiff.