Docket: 2008-1102(IT)I

BETWEEN:

GERALDINE M. FRIZZLE,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on November 6, 2008, at Sydney, Nova Scotia
Before: The Honourable Justice Wyman W. Webb

Appearances:

Agent for the Appellant: George Beverly Frizzle
Counsel for the Respondent: Kendrick Douglas

JUDGMENT

The appeal from the assessment made under the *Income Tax Act* for the Appellant's 2006 taxation year is allowed, without costs, and the matter is referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that the amount to be included in the income of the Appellant for 2006 pursuant to paragraph 6 (1)(f) of the *Income Tax Act* is to be reduced by $10 and in the event that the Appellant has not been allowed to claim a deduction for legal fees of $8,488, that the Appellant be allowed a deduction for this amount in computing her income for 2006.

Signed at Vancouver, British Columbia, this 27th day of November 2008.

"Wyman W. Webb"

Webb J.

Citation: 2008TCC651
Date: 20081127
Docket: 2008-1102(IT)I

BETWEEN:

GERALDINE M. FRIZZLE,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Webb J.

[1] The issue in this appeal is whether a lump sum payment received by the Appellant in 2006, as a settlement of an action brought by the Appellant against her former employer and the insurance company contracted by her former employer to provide an Income Protection Long Term Plan (the "wage loss plan"), should be included in the income of the Appellant in 2006 pursuant to paragraph 6 (1)(f) of the *Income Tax Act*. The wage loss plan would be a disability insurance plan for the purposes of subparagraph 6(1)(f)(ii) of the *Income Tax Act*. Paragraph 6 (1)(f) of the *Income Tax Act* provides, in part, as follows:

> 6. (1) There shall be included in computing the income of a taxpayer for a taxation year as income from an office or employment such of the following amounts as are applicable:
>
> …
>
> (f) the total of all amounts received by the taxpayer in the year that were payable to the taxpayer on a periodic basis in respect of the loss of all or any part of the taxpayer's income from an office or employment, pursuant to

(i) a sickness or accident insurance plan,

(ii) a disability insurance plan, or

(iii) an income maintenance insurance plan

to or under which the taxpayer's employer has made a contribution,…

[2] The Appellant had been employed as a bank teller at the Canadian Imperial Bank of Commerce ("CIBC"). She became disabled, and was unable to work. Her employer had paid the premiums under the wage loss plan and she started receiving periodic payments under this plan in the amount of $1,055 per month, commencing September 27, 2001. In early 2002, the insurance company stopped making payments. There is no dispute that the amounts that the Appellant received as payments under this plan in 2001 and 2002 were taxable to her.

[3] The Appellant commenced an action against her former employer and the insurance company. The Appellant and her spouse attended a settlement conference in early 2006. The defendants in the action made a settlement offer of $20,500 to settle all claims that the Appellant had against them. The Appellant accepted this offer and this amount was paid to her in 2006.

[4] The Appellant submitted copies of the T4A slips issued for 2001 and 2002 by the insurance company. In each case the T4A slip stated the amount of income (which was the amount that was paid to the Appellant under the wage loss plan) and the amount of income tax deducted. The Appellant also submitted a copy of the T4A slip issued for 2006, which showed that the lump sum payment amount of $20,500 was income but also indicated that no income tax had been deducted from such payment. While the Appellant argued that the failure to deduct income tax from the $20,500 lump sum payment was significant, the failure to deduct income tax does not, in and of itself, make the payment non-taxable. It is the nature of the payment and what it was intended to replace that will determine whether the amount should be included in the Appellant's income, not whether an amount of income tax was deducted by the payer from the payment.

[5] The Appellant also relied on a decision of this Court in *Landry v. The Queen* 98 DTC 1416, [1998] 2 C.T.C. 2712. However, that decision was rendered in 1998, which was before the Supreme Court of Canada rendered its decision in *Tsiaprailis v. The Queen*, 2005 SCC 8, 2005 DTC 5119, [2005] 2 C.T.C. 1, 248. The majority of the Justices of the Supreme Court of Canada in that case determined that the portion of a payment for a settlement of a claim under a disability insurance plan that relates

to the arrears of payments that should have been made periodically will be included in the income of the recipient, if the payment of the periodic payments would have been included in the income of the recipient. The part of the settlement amount that extinguishes the claim for future benefits would not be taxable. In part, Justice Charron of the Supreme Court of Canada stated as follows:

> 11 When the reasoning in Armstrong is applied to the present case, it is clear that monies paid in settlement of any future liability under the disability insurance plan were not paid "pursuant to" the plan because there is no obligation to make such a lump sum payment under the terms of the plan. The part of the settlement for future benefits is in the nature of a capital payment and is not taxable under s. 6(1)(f) of the Act.
>
> …
>
> 15 The determinative questions are: (1) what was the payment intended to replace? And, if the answer to that question is sufficiently clear, (2) would the replaced amount have been taxable in the recipient's hands? In this case, the evidence of what the amount was intended to replace is clear and cogent. As my colleague noted, the evidence established that the negotiated lump sum was "based on three aspects of liability under the policy: an amount to extinguish Ms. Tsiaprailis' claim for accumulated arrears, an amount to extinguish her claim for future benefits, and an amount to extinguish her claim for costs" (para. 54 (emphasis added)). Hence, it cannot be disputed on the evidence that part of the settlement monies was intended to replace past disability payments. It is also not disputed that such payments, had they been paid to Ms. Tsiaprailis, would have been taxable.
>
> 16 To conclude that the payment for past benefits was not made "pursuant to" the insurance disability plan in these circumstances is to render the surrogatum principle meaningless. Hence, I would conclude that the portion of the lump sum allocated to the accumulated arrears is taxable and I would dismiss the appeal, with no order as to costs.

[6] In this particular case, the insurance company stopped paying benefits in early 2002. As a result, by early 2006, when the settlement was reached, the arrears of payments to that point, based on a payment of $1,055 per month, exceeded $50,000. Therefore the arrears as of the date of settlement were more than double the amount that the Appellant accepted in settlement. No documentation was introduced to show how the lump sum settlement amount of $20,500 was determined or to provide any assistance in determining how the amount should be allocated. It seems reasonable that the components of the claim made by the Appellant would be the same as in the claim described in the *Tsiaprailis* case. It would seem reasonable that there would be three components -- the amount claimed for the arrears (i.e. the missed payments

from January 2002 to the date of payment), the claim for future payments, and an amount for costs. Without any indication of how the amount of $20,500 was determined or how it was to be allocated, I am unable to conclude that the Appellant has established that any significant amount should be allocated to the extinguishment of the claim for future payments. The Appellant will be 65 in 2009 at which time the payments under the wage loss plan would have ceased in any event. As a result the time period related to the arrears was longer than the time period for potential future payments as of the date of the settlement.

[7] The amount received was significantly less than the amount of the arrears as of the date of payment and it seems reasonable to assume that almost the entire settlement amount received was to compensate the Appellant for the payments that were missed. Since the intent of the settlement amount would therefore have been to replace in part the periodic payments that the Appellant is claiming that she ought to have received under this disability insurance plan and since the Appellant would have been required to include the periodic payments in her income if she would have received such periodic payments, then almost the entire lump sum amount would be included in the income of the Appellant pursuant to paragraph 6 (1)(f) of the *Income Tax Act*.

[8] In the Reply the Respondent acknowledges that the Appellant incurred legal fees of $8,488. These legal fees were deducted by the Appellant's lawyer from the settlement amount that was paid in 2006 and therefore these fees were paid in 2006. There is no mention in the Reply of whether the Appellant was allowed a deduction for these legal fees. *In Farrell v. The Queen* 2005 TCC 352, 2005 DTC 842, [2005] 3 C.T.C. 2360 Justice Campbell confirmed that legal fees paid to recover an amount under a disability insurance plan were deductible under paragraph 8 (1)(b) of the *Income Tax Act*.

[9] It is not clear whether the Appellant was allowed a deduction for these legal fees and the matter should be referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that if the Appellant has not been allowed to claim a deduction for legal fees of $8,488, then the Appellant should be allowed to claim a deduction for this amount. Since, pursuant to subsection 171(1) of the *Act* the matter can only be referred back to the Minister of National Revenue for reconsideration and reassessment if the appeal is allowed, the appeal will be allowed to allocate $10 of the settlement amount to the settlement of the claim for future payments. The amount allocated to the extinguishment of her claim for future payments would not be included in the income of the Appellant pursuant to paragraph 6 (1)(f) of the *Income Tax Act*.

[10] As a result, the appeal is allowed, without costs, and the matter is referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that the amount to be included in the income of the Appellant for 2006 pursuant to paragraph 6 (1)(f) of the *Income Tax Act* is to be reduced by $10 and in the event that the Appellant has not been allowed to claim a deduction for legal fees of $8,488, that the Appellant be allowed a deduction for this amount in computing her income for 2006.

Signed at Vancouver, British Columbia, this 27th day of November 2008.

"Wyman W. Webb"

Webb J.

CITATION:	2008TCC651
COURT FILE NO.:	2008-1102(IT)I
STYLE OF CAUSE:	GERALDINE M. FRIZZLE AND HER MAJESTY THE QUEEN
PLACE OF HEARING:	Sydney, Nova Scotia
DATE OF HEARING:	November 6, 2008
REASONS FOR JUDGMENT BY:	The Honourable Justice Wyman W. Webb
DATE OF JUDGMENT:	November 27, 2008

APPEARANCES:

Agent for the Appellant:	George Beverly Frizzle
Counsel for the Respondent:	Kendrick Douglas

COUNSEL OF RECORD:

For the Appellant:

Name:
Firm:

For the Respondent:	John H. Sims, Q.C. Deputy Attorney General of Canada Ottawa, Canada