

## Member's Quarterly

Spring 2019 Edition

## Feature

## Calculating Damages in Wrongful Dismissal Claims: Don't Forget Income Tax

*A case comment on Schram v Government of Nunavut*

**I**t is a well-accepted principle in Canadian employment law that when a non-unionized provincially regulated employee is dismissed without cause and the employer elects to provide pay in lieu of notice, the amount of compensation that the employee is entitled to should equal the compensation the employee would have earned had the employee worked through the applicable notice period. This is simply an application of the principles governing recoverability of damages for breach of contract, which require the plaintiff to be put in the same position as if the contract has been performed. Such compensation normally includes items such as the salary and commissions the employee would have earned, any bonuses that the employee would have become entitled to, and any shares or options that would have vested during the notice period.

A recent case from the New Brunswick Court of Appeal has highlighted another source of compensation that is not as routinely considered as part of employee entitlement calculations: income tax liability.

In *Schram v Government of Nunavut*, 2018 NBCA 41, the employee was a resident of New Brunswick and was hired by the government of Nunavut as a Staffing Consultant. The employee subsequently relocated to Iqaluit and worked for the government of Nunavut for approximately three and a half years, following which her employment was terminated without cause. She was required to vacate her employer-provided housing in Iqaluit and she returned to New Brunswick. The employee subsequently sued for wrongful dismissal and was awarded additional damages at trial. While the employee was living in Iqaluit, she paid income taxes in Nunavut. However, as she received her damages from her wrongful dismissal claim after she had returned to New Brunswick, she paid taxes on those amounts in New Brunswick at a higher tax rate.

At trial, the judge rejected the employee's claim for additional tax liability as a result of having to pay taxes in New Brunswick rather than Nunavut, stating that: "As a practical matter, I fear that wrongful dismissal cases in New Brunswick, which have generally not considered the tax consequences based on residency or the consequences of larger lump sum payment of damages, would become overly cumbersome as litigants try and add another layer of analysis beyond that which is necessary for what is essentially a breach of contract case. Each jurisdiction has its own complicated income tax structure. It is best left to those in the business of drafting or applying the income tax laws to resolve what tax a person is required to pay."

The New Brunswick Court of Appeal overturned the trial judge's decision to deny compensation for the employee's additional liability for income tax, noting that the principle in *Hadley v Baxendale* is that damages are recoverable for a contractual breach if they are "such as may fairly and reasonably be considered either arising naturally... from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties." Given that the lower tax rates in Nunavut compared to New Brunswick, as well as the employee's return to New Brunswick following the termination of her employment, were both found to be within the contemplation of the parties at the time the employment contract was entered into, the New Brunswick Court of Appeal allowed the employee's claim for an income tax gross-up.



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Employers should consider potential income tax liability on pay in lieu of notice when hiring employees from out of jurisdiction. If the employer is aware the employee is moving to the jurisdiction for the purpose of accepting the position, it would be open to the courts to find that it was within the contemplation of the parties that the employee would return to their original residence upon termination of employment. Conversely, if an employee's home jurisdiction has a lower tax rate than the jurisdiction in which they were employed, employers could consider making the argument that the amount of damages to be awarded should be reduced by the amount of the tax savings the employee will receive by virtue of paying taxes on the settlement in their home jurisdiction rather than the jurisdiction in which they were employed.

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