Compensation Payments in respect of Personal Injuries (Exemption of Investment Income)

Part 07-01-02

This document should be read in conjunction with section 189 of the Taxes Consolidation Act 1997

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Revenue
Cáin agus Custaim na hÉireann
Irish Tax and Customs

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1. Introduction

Section 189 of the Taxes Consolidation Act 1997 (TCA) exempts permanently incapacitated individuals from Income Tax, Pay Related Social Insurance (PRSI), Universal Social Charge (USC) and Capital Gains Tax on the income arising and gains accruing from the investment, in whole or in part, of compensation payments which arise from an order under section 38 of the Personal Injuries Assessment Board Act 2003 or the institution by the individual of court proceedings in respect of personal injury claims.

The injury must be such that the individual is permanently and totally incapacitated from maintaining himself or herself.

The purpose of this manual is to:

- provide guidance on how section 189 applies in practice,
- set out the main features of the exemption, and
- advise how disability benefit, invalidity pension, and certain other social welfare payments are to be treated when ascertaining a person's income for the purposes of deciding if exemption under section 189 applies.

Section 613(1)(c) TCA 1997 provides for an exemption from Capital Gains Tax for the actual compensation or damages received for any wrong or injuries suffered by a person. Please refer to Tax and Duty Manual Part 19-07-10 - Miscellaneous exemptions for certain kinds of property (S.613) for further details.

2. Meaning of Permanently and Totally Incapacitated

Section 189 TCA applies to an individual who is permanently and totally incapacitated from maintaining him or herself, by reason of a mental or physical infirmity which arose from an injury.

"Maintain" means to support oneself by earning an income from working. Total incapacity, therefore, means that an individual is not capable of earning a living from any kind of work. The incapacity must also be permanent so that there must be no prospect of the individual recovering or of the condition improving to the extent that the individual would be able to maintain him or herself.

This is a high threshold of incapacity. For example, a visually impaired individual or an individual who has lost the use of his or her legs could be described as permanently incapacitated but not necessarily totally incapacitated or incapable of maintaining himself or herself by working.

To assist in assessing the circumstances of an individual, a certificate from a medical practitioner:

- stating the cause, nature and extent of the infirmity and the nature and extent of the incapacity arising therefrom, and
- confirming that the individual is permanently incapacitated by reason of physical or mental infirmity from maintaining him or herself

should accompany any claim for the exemption.

Notwithstanding the explanation of 'permanent and total incapacity' above, by long-standing practice, engagement in rehabilitative work in sheltered workshops has not been considered as indicating that an individual may not be permanently and totally incapacitated.

3. Conditions of Exemption

3.1 Overview

Section 189 TCA requires that:

- the compensation payment must arise -
  - (i) pursuant to the issue of an order to pay under section 38 of the Personal Injuries Assessment Board Act 2003, or
  - (ii) following the institution of a civil action by or on behalf of an individual, for damages in respect of personal injury;
- the injury must have resulted in the individual being permanently and totally incapacitated, either physically or mentally, from maintaining him or herself, and
- the income or gains must arise from the investment in whole or in part of payments made on foot of the personal injury which resulted in the permanent and total incapacity.

Where there is a pre-existing incapacity, it will be necessary to establish that the injuries giving rise to the compensation resulted in the individual becoming permanently and totally incapacitated from maintaining him or herself. In this connection, the extent of the injuries, the medical evidence, the individual's previous ability to maintain him or herself through a profession, business or occupation, and the details of the award made in the case will be elements in determining the eligibility for the relief.

The following payments do not qualify for exemption:

- compensation payments received as a result of minor injuries, and
- a compensation payment to an individual whose injury causes a permanent incapacity, but the incapacity is not such that the individual would be rendered totally incapacitated or does not prevent the individual from carrying on a profession, business or occupation.

The amount of the compensation payment may be an indicator of the extent to which the person is incapacitated. In general, the payments will be large. However, this may not always be the case as an award may be substantially reduced because the person's own negligence was a factor, which contributed to the injury.

3.2 Out of Court Settlements

While the compensation must arise from an order to pay under section 38 of the Personal Injuries Assessment Board Act 2003 or the institution of legal action, a payment made by way of out-of-court settlement also qualifies for exemption.

3.3 Payments from the Criminal Injuries Compensation Tribunal

Payments from the Criminal Injuries Compensation Tribunal should be regarded as arising from the institution of legal action. (This tribunal compensates, on an ex-gratia basis, victims of crimes of violence where recourse to the courts is not available because, for example, the aggressor is not known).

3.4 Hepatitis C Compensation Payments

Where it is medically certified that an individual is suffering from a degenerative condition which will ultimately cause a permanent and total incapacity by reason of mental or physical infirmity and this condition gave rise to the compensation payment, Revenue accepts that the requirements of section 189 are met.

This applies to individuals who have been diagnosed positive for Hepatitis C antibodies or Hepatitis C. See related Tax and Duty Manual Part 07-01-05 for further information.

4. The Exemption

4.1 Overview

The exemption provides for an Income Tax, PRSI and USC exemption on -

- income that is:
  - chargeable to tax under Schedule C, Cases III, IV or V of Schedule D, or Schedule F, and
  - arising from the investment, in whole or in part, of a qualifying compensation payment (or arising from the investment of such income).

and a Capital Gains Tax exemption on:

- chargeable gains arising from the disposal of assets that were acquired using:
  - a qualifying compensation payment or
  - funds sourced from the investment or reinvestment of such payments.

Qualifying Payments are set out in Chapter 3.

The exemption only applies to an individual whose aggregate of the income and gains derived from such compensation payments exceeds 50% of the aggregate total income and total chargeable gains (including allowable losses) of the individual for the year of assessment.

Where the exemption applies, any exempt income and gains must still be included in an individual’s tax return.

If two individuals who are married or are civil partners are assessed under the provisions of section 1017 or 1031C TCA 1997 (aggregation basis), the 50% test should be applied only to the income of the incapacitated spouse or civil partner. The test should not be applied to the aggregated income of two individuals who are married or civil partners in determining if exemption is due.

Notwithstanding the fact that deposit interest, Schedule F dividends, or other taxed income arising from the investment of a compensation payment are, under the provisions of section 189 TCA, excluded from total income, a refund of any retention tax or tax credits (as appropriate) attaching to such income may be made, if otherwise due.

4.2 Deposit Interest Retention Tax

Persons who are:

- permanently incapacitated or

- trustees of a special trust for permanently incapacitated individuals where the income is exempt from tax

can make a declaration to Revenue (Form DE2) that they would be entitled to a refund of the entire amount of DIRT if so deducted.

The financial institution, on receipt of notification from Revenue that no DIRT is to apply, will pay interest without the deduction of DIRT.

4.3 Life Assurance Exit Tax

Life assurance exit tax will be deducted in the normal manner. However, an individual or trust exempt under section 189 or section 189A TCA may be entitled to a repayment of the exit tax under section 730GA TCA.

4.4 Tax Deducted by Investment Undertakings

A repayment of any tax deducted by an investment undertaking can be made under section 739G TCA where the unit holder to which the deducted tax relates is entitled to claim income tax exemption under section 189 or section 189A TCA.

4.5 Dividend Withholding Tax (DWT)

An exemption from dividend withholding tax may apply to Irish resident persons as follows:

- Permanently incapacitated individuals who, by virtue of section 189(2) TCA, are exempt from income tax in respect of income arising from the investment of compensation payments made by the courts, or under out-of-court settlements, in respect of personal injury claims;
- The trustees of "qualifying trusts", the funds of which were raised by public subscriptions on behalf of individuals who are permanently incapacitated from maintaining themselves, where the income arising to the trusts from the investment of trust funds is exempt from income tax under section 189A (2) TCA;
- Permanently incapacitated individuals who, by virtue of section 189A(4)(b) TCA, are exempt from income tax in respect of payments received from "qualifying trusts" within the meaning of that section, and in respect of income arising from the investment of such payments.

Before accepting that such persons are exempt, the paying company or authorised withholding agent (AWA) must be satisfied that the person:

- If not a Qualifying Intermediary (QI), (see detailed description of QI under Part D of Tax Manual Part 06-08a-01) is the person beneficially entitled to the distribution, and

- Has made the appropriate declaration of exemption to the company making the distribution (see Schedule 2A TCA 1997) or, if the distribution is being paid to the excluded person through a QI, to the QI.

Further information on Dividend Withholding tax may be found in Tax and Duty Manual Part 06-08a-01.

5. Treatment of Payments by the Department of Social Protection

Where a person claims an exemption under section 189 TCA and that person is in receipt of any of the following payments from the Department of Employment Affairs and Social Protection:

- Illness Benefit,
- Invalidity pension,
- Injury or disablement benefit,
- Incapacity supplement paid to a person in receipt of disablement benefit,

and the injury or disability which gave rise to the payment of the benefit/pension is the same injury or disability which gave rise to the payment of the compensation, that benefit/pension should not be taken into account when calculating whether the investment income is the sole or main income of the individual.

Where any of the benefits listed above are increased because of a dependant spouse/civil partner or child, the full amount of the benefit/pension (including the increase) should be excluded.

An invalidity pension and certain other benefits paid by the Department of Employment Affairs and Social Protection are liable to tax under Schedule E. Therefore, notwithstanding the fact that an invalidity pension or benefit payable by the Department of Employment Affairs and Social Protection is not taken into account for the purposes of calculating whether a person's sole or main income is derived from the investment of the compensation, the amount of such pension or benefit is still taxable under Schedule E in the hands of the recipient.

6. Worked Example

The following example illustrates how section 189 TCA operates in practice.

Joe is employed as a plumber. He has rented out 2 houses for many years, yielding a total net profit (after allowable expenses) of €28,800 per annum. He was involved in an accident on a building site, as a result of which he suffered severe injuries such that he is permanently and totally incapacitated from maintaining himself.

He instituted proceedings against his employer, and accepted an amount of €400,000 in an out-of-court settlement. This was invested, and currently yields €36,000 per annum. He is also entitled to an invalidity pension of €10,347 per annum.

In 2018, Joe claims an exemption under section 189 TCA 1997. His total income for 2018 is -

Investment Income	€36,000
Rental Income	€28,800
Invalidity Pension	€10,347
Total	€75,147

For the purposes of deciding whether Joe is entitled to the exemption, the invalidity pension is ignored.

As Joe's income from the investment of the compensation proceeds is €36,000, which is more than 50% of his total income excluding the invalidity pension, (i.e. €64,800 x 50% = €32,400), he is entitled to the exemption.

His income for income tax purposes is calculated as follows:

Rental Income	€28,800
Invalidity Pension	€10,347
Total Income for tax purposes	€39,147

The investment income of €36,000 is exempt from Income Tax, PRSI and USC by virtue of section 189 TCA.

The exempt income is not taken into account in computing total income for tax purposes. This does not relieve the individual of the obligation to return the exempt income if making a return of income.

7. Wards of Court

Wards of Court are individuals who, by reason of age, intellectual disability or other reasons, are unable to manage their affairs and who have been placed by the President of the High Court under the care of a Committee. The Committee can consist of one or more persons. While the Committee has responsibility for the care of the Ward of Court, it cannot spend, invest or disburse any of the Ward's assets without the express consent of the Office of the Wards of Court.

Persons who are Wards of Court can have varying degrees of incapacity. It should not be assumed that all such persons are permanently and totally incapacitated and therefore entitled to the exemption. The Committee for a Ward of Court must show that the Ward meets all the requirements of section 189 TCA before the exemption is granted.

8. Reinvestment in Other Assets

Section 189 TCA specifies that the exemption from income tax applies to income arising from the investment in whole or in part of such payments or of income from such payments. It is recognised that an asset may, over the period of an investment, appreciate in value and any re-investment of such funds may also qualify for the exemption.

Example

In 2000 Rachel used €200,000 from a qualifying compensation payment to acquire a property, the full cost of which came from a compensation payment. The property was let and the rental income generated was covered by the exemption under section 189 TCA.

Rachel sold the property in 2018 for €600,000 and all the proceeds (after costs) were re-invested in another investment property. In this case the exemption would also apply to all the rental income from the new property.

In these circumstances the source of income clearly arises from the investment of the compensation funds alone and not from any other source.

9. Assets Financed Partly by Borrowings

Where a relevant individual finances the purchase of an asset partly with a qualifying compensation payment and partly with a loan, only a portion of the income will qualify for exemption.

The income that qualifies is the proportion to which the compensation payment (together with any capital appreciation thereof) used to finance the asset bears to the total funds expended to finance the asset.

The exemption can only be given, in respect of income arising from the investment of the compensation payments.

10. Special Trusts for Permanently Incapacitated Individuals

The tax treatment, as set out in this manual, also applies to the exemption from Income Tax, Pay Related Social Insurance (PRSI), Universal Social Charge (USC) and Capital Gains Tax available under section 189A TCA for any -

- income earned by, and
- gains accruing to,

special qualifying trusts established for the benefit of specified permanently incapacitated individuals and arising from the investment of the trust funds.

See - Tax and Duty Manual Part 07-01-20 - Special Trusts for Permanently Incapacitated Individuals for further information.

11. Making a Claim

Claims to exemption can be made in advance of returns.

The following documentation should be provided in connection with -

- an advance claim,
- an initial claim, or
- an aspect query

1. A certificate from a medical practitioner:
   (i) stating the cause, nature and extent of the infirmity, and the nature and extent of the incapacity arising therefrom, and
   (ii) confirming that the individual is permanently incapacitated by reason of physical or mental infirmity from maintaining himself or herself; and

2. Evidence that the payment arose:
   (i) from an order under section 38 of the Personal Injuries Assessment Board Act 2003, or
   (ii) from the institution by, or on behalf of, the individual of a civil action for damages in respect of the injury giving rise to the incapacity. Where the person is a Ward of Court, a statement from the Office of the Wards of Court to the effect that the payment so arose should be accepted as evidence.

Following examination of the claim, the taxpayer should be advised of the outcome.