

# DISCUSSION PAPER

## 1. TITLE

Average Earnings Determinations for Workers Deducting Equipment Expenses from Gross Income

## 2. ISSUE(S)

At issue is how to determine the average earnings of workers who deduct equipment operation expenses from gross income on their taxes — for example, a worker who owns and operates a gravel truck as part of an employment contract. The Workers' Compensation Board ("WCB") currently uses straight-line depreciation to deduct equipment expenses in calculating some workers' average earnings.

The application of the current policies on equipment and expense deductions is also at issue. The current policies are directed at labour contractors without Personal Optional Protection ("POP") and at fishers who own vessels. In practice, these policies are applied to many workers who are not labour contractors or fishers with vessels, but who deduct equipment expenses for tax purposes.

## 3. BACKGROUND

### 3.1 Law

Section 33.1 of the *Workers Compensation Act* ("Act") provides direction to the WCB in setting a worker's wage rate. It provides that a worker's short-term wage rate is based on "the rate at which the worker was remunerated by each of the employers for whom he or she was employed at the time of the injury". After the shorter of the "initial payment period"<sup>1</sup> or "the date the worker's injury results in a permanent disability", the WCB then sets a worker's "long-term wage rate" based on average earnings in the 12-month period immediately preceding the date of injury.

### 3.2 Policy

An introductory statement in the policies on workers that supply equipment in the *Rehabilitation Services & Claims Manual* ("RS&CM"), Volume II provides that any portion of the wages paid to a worker which represents rental of equipment supplied by the worker is excluded from average earnings.

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<sup>1</sup> Section 1 of the *Act* provides that the "initial payment period" is 10 cumulative weeks of benefits.

Policy items #68.61 and #68.62 provide specific guidance on setting the short- and long-term average earnings of a "labour contractor without coverage under section 2(2)" of the *Act*.<sup>2</sup> By policy, labour contractors may register for POP.<sup>3</sup> Labour contractors who do not purchase POP have their average earnings calculated using these policies.

Policy on determining the short-term average earnings of labour contractors that supply equipment provides that the individual's gross earnings are subject to a percentage deduction to represent all of the costs of supplying equipment for the contract, including fuel, maintenance, insurance, licensing, etc.<sup>4</sup> These deductions are made from the worker's gross earnings in place of any CCA or other operating expense deductions declared to the CRA.

Policy on determining a labour contractor's long-term average earnings is more detailed. It provides that for a labour contractor declaring a CCA with the CRA for "revenue-generating equipment", the WCB will substitute a straight-line depreciation deduction for the CCA deduction amount. The policy includes a schedule that varies the amount deducted according to the type of equipment supplied. Examples of the 17 types of equipment listed include backhoes, skidders, automobiles, and gravel trucks. In addition to the substitution of a straight-line depreciation amount for a CCA amount, the WCB also deducts other equipment operating expenses from gross earnings, such as fuel, maintenance, insurance, and licensing, using the actual values of such costs.

Policy item #68.63 provides guidance on setting the average earnings of fishers who own their vessels. It is similar to the labour contractor long-term average earnings policy, and provides that WCB officers should deduct 7.5 percent of the vessel's purchase price as straight-line depreciation from a fisher's gross earnings, instead of the CCA amount. Other actual expenses are also deducted.

The former Panel of Administrators approved these policy items as part of the Bill 49 consequential policy amendments effective June 30, 2002.<sup>5</sup> The guidance on straight-line depreciation found in these policy items is also found in the pre-Bill 49 *RS&CM*, Volume I.<sup>6</sup> The pre-Bill 49 policy does not refer to "labour contractors", but to "workers". The present straight-line depreciation approach has remained essentially unchanged since it was developed in 1985.

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<sup>2</sup> Strikethrough copies of the policies under consideration for change are found in Appendix "B".

<sup>3</sup> If such individuals purchase POP coverage, they are compensated based on the amount of coverage purchased from the WCB.

<sup>4</sup> The percentages vary with the kind of equipment supplied — for "medium" equipment, 60 percent of gross contract values is taken to represent payment for labour, and for "heavy" equipment, 25 percent of gross is used.

<sup>5</sup> See Panel of Administrators' Resolution #2002/06/18-02.

<sup>6</sup> *RS&CM* Volume I, policy item #71.41.

## 4. DISCUSSION

The subsequent sections of this paper discuss the following issues:

- The current challenges of using straight-line depreciation in long-term average earnings determinations;
- The CRA's use of CCAs in taxes, and challenges that may be faced if the WCB adopts CCAs in long-term average earnings determinations;
- Whether the approach used for short-term average earnings could be adapted for determining long-term average earnings;
- Who the average earnings policies apply to; and,
- Whether policy should have a statement concerning the intent of the average earnings policies.

### 4.1 Challenges in Using Straight Line Depreciation

A number of challenges with the current policy on the use of straight-line depreciation for long-term average earnings determination have been identified. These challenges are discussed in the following subsections.

#### 4.1.1 *Straight Line Depreciation versus Capital Cost Allowances*

Regardless of whether a worker is declaring a CCA to the CRA for equipment, if a worker is supplying equipment as a required component of the contract of service, the contract price includes a payment in respect of the equipment supply. The problem is how to equitably quantify the cost of supplying that equipment in average earnings determinations in order to derive the labour component.

The current straight-line depreciation schedule amounts in the long-term average earnings policies on labour contractors and fishers who own vessels are based on an estimate of the useful life of the equipment. The percentage from the schedule is applied to the purchase price of the equipment and the resulting figure deducted from gross earnings regardless of the age of the equipment, or whether a CCA is taken in respect of the equipment.

The purchase price of the equipment for the purposes of the straight-line depreciation calculation has been raised as requiring some clarification. Policy is currently silent on what constitutes the purchase price of equipment. Current practice is that the purchase price is made up of the invoiced value of the equipment asset, plus applicable taxes. If another asset is traded in against the purchase of the new asset, the value of the trade is not deducted from the purchase price figure.

The CRA's rules allow significant variation in the amount of a deduction an individual may take using a CCA. Where the straight-line depreciation deduction is less than the CCA amount, this approach results in higher average earnings for the worker. Conversely, using a straight-line depreciation deduction that is higher than the declared CCA results in a worker's average earnings being much lower than if the CCA was used.<sup>7</sup>

The latter situation most often arises with older equipment, where the CCA amount associated with the equipment is lower, or not taken, and the other expenses that the worker must incur to maintain the equipment increase. In such situations, the WCB uses the increased expenses associated with operating the equipment, and replaces the relatively low CCA amount with the larger straight-line depreciation amount. Where the straight-line deduction amount significantly reduces the worker's earnings for wage-loss purposes, disputes may result with workers over this policy.

#### *4.1.2 The Straight-Line Depreciation Schedule*

A further challenge with the straight-line approach is that the schedule in policy contains depreciation percentages for only 17 pieces of equipment. In cases where a piece of equipment is not on the list, policy directs WCB officers to select a percentage from the schedule that "most closely represents the piece of revenue generating equipment involved".

This approach presents a problem if the equipment under consideration is not like other equipment on the schedule. For example, there is no farming equipment listed in the schedule, and WCB officers advise that the list does not contain a close equivalent for any such equipment.

The question of whether other equipment should be considered for addition to the schedule has been made more problematic by the fact that there is little credible information available on the expected useful life of equipment, which is necessary in order to determine straight-line depreciation amounts. It is unclear how the percentages in the current policy were determined. In reviewing the depreciation policies of the CRA, some Canadian provinces and states in the United States of America (USA), the USA's Internal Revenue Service, and the USA's military, there is little consistency between the figures used by each. In addition, use of the schedule will always present the problem of finding an equivalent for some pieces of equipment, as such a list cannot be made fully comprehensive.

#### *4.1.3 Revenue-Generating Equipment*

Current policy on long-term average earnings calculations for labour contractors references that straight-line depreciation must be applied to "revenue-generating

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<sup>7</sup> In one example, a fisher declared net fishing income (including a CCA deduction) of \$3,457 to CRA in the previous year, and the WCB's straight-line depreciation amount resulted in a calculation that put the fisher's average earnings at *negative* \$3,438.

equipment". There is no definition for this term in the *RS&CM*, Volume II, though the schedule provides limited guidance by the types of equipment listed.

This phrase is also used in the *Assessment Manual* ("AM") as part of the workplace party status determination policies. The Assessment Department has developed a practice directive on this term which sets out factors to consider such as the cost, size, and scarcity of the equipment, and also provides a list of examples. However, as the use of the phrase for assessment purposes is for workplace status adjudication, the term may not be appropriate for compensation purposes.

In order to eliminate possible confusion between the *AM* and the *RS&CM*, Volume II, it may be appropriate to remove the phrase "revenue-generating equipment" from the *RS&CM*, Volume II. Instead of using that phrase, it may be of benefit to add a statement to policy that provides that straight-line depreciation applies to equipment that is a required component of the contract of service.

## 4.2 Capital Cost Allowances

### 4.2.1 *The Use of Capital Cost Allowances in Taxes*

The CRA allows individuals to deduct amounts representing equipment depreciation costs from their gross income on their taxes by using CCAs. CCA amounts are calculated on a declining-balance basis, resulting in large deduction amounts early in the life of a piece of equipment, and increasingly smaller amounts over time as the equipment ages.<sup>8</sup>

Individuals deduct CCAs to obtain a tax advantage by minimizing personal earnings in respect of the loss of value of equipment over time. It is worth noting that the initial value that a CCA is calculated on can also include the legal, accounting, and engineering fees that relate to the buying or manufacture of the asset.

In addition, the CRA allows and/or requires CCAs to be further varied in other ways, such as:

- Where a new asset is acquired mid-year by an ongoing business, half of the usual CCA applies to the value of the equipment purchased, or to the difference between the selling price of the old equipment and the purchase price of the equipment replacing it.
- In years where an individual does not require the full available amount of a CCA to minimize taxable earnings, an individual may opt to take a

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<sup>8</sup> Most of the equipment assets depreciated by the workers described in this paper attract a 30 percent declining-balance depreciation rate, and some (such as freight trucks) are depreciated at 40 percent. Fishing boats attract a 15 percent rate, but some may be accelerated to 33 ⅓ percent.

reduced CCA, or to not take one. In such situations, the individual usually has other expenses that allow the reduced CCA.<sup>9</sup> Where an individual does this, more of the value of the equipment for tax purposes remains undepreciated, allowing the individual to take greater deductions in the future than would otherwise be possible.

- Where an asset is sold for greater than its declared value to the CRA, any proceeds greater than the CRA-depreciated value must be "recaptured" in the individual's taxes as income. In the opposite case, where an asset is sold for less than its CRA-depreciated value, the individual can declare a "terminal loss" and deduct that amount against his or her gross earnings. In both cases, such adjustments are declared as non-cash earnings or losses.<sup>10</sup>

#### *4.2.2 Challenges in Using Capital Cost Allowances in Average Earnings*

It has been suggested that CCAs be adopted by the WCB to determine a worker's average earnings, as it is seen as simpler for WCB officers to use a worker's reported tax amounts for average earnings purposes.<sup>11</sup> However, using CCAs in average earnings determinations would introduce a higher degree of volatility into workers' wage loss amounts when compared with the WCB's straight-line depreciation approach, depending on the age of the equipment. A table demonstrating this is found in Appendix "A", and the challenge is further illustrated in the following example:

An owner-operator buys a \$100,000 gravel truck, and grosses \$75,000 in earnings per year. The owner-operator may take a 30 percent CCA deduction from the value of the truck in all but the first year, where only half of the normal CCA amount is allowed. Accordingly, in the first year he owns the gravel truck, he can deduct \$15,000 from his gross earnings to arrive at a net taxable earnings figure of \$60,000. In the next year, he is allowed to deduct \$25,500 (30 percent of the gravel truck's depreciated value of \$85,000), leaving him with a net taxable earnings figure of \$49,500. Based on a single year's difference in the age of the asset, the owner-operator's earnings fluctuate by \$11,500.

CCAs allow workers to have tax years where they declare little or no personal income, significantly distorting a worker's "take home" earnings. This problem was recognized when the practice of using the WCB's straight-line depreciation table

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<sup>9</sup> Most such expenses, such as maintenance, are also deducted from gross earnings by the WCB to determine long-term average earnings.

<sup>10</sup> The WCB has no explicit policy on how to treat such income adjustments, but they are addressed in Appendix A of Practice Directive #33A, which provides guidance that "adjustments to the net income may be necessary in order to obtain a more accurate reflection of earnings" where a worker declares capital gains or losses.

<sup>11</sup> New Brunswick, the Yukon, and the Northwest Territories and Nunavut use this approach. See section 5 for more information.

began in 1985. The memorandum that accompanied the directive on this then-practice stated, in part:

[Replacing a CCA with the WCB's straight-line depreciation] is designed to reflect more closely the actual depreciation that results from the operation of these items as opposed to the formulae for capital cost allowances used by Revenue Canada. Since it also eliminates most of the anomalies that would otherwise result where there are instances of recaptured capital cost allowances, any future recaptured capital cost allowance will not be considered as having any impact on the rate set on a claim.

Individuals are also permitted to re-file their taxes with the CRA in subsequent years, and change the deductions used to determine their taxable income.

The intents of tax law and workers' compensation law are very different, resulting in different regulatory and policy frameworks around how to handle equipment supply in determining an individual's earnings. The CRA uses declining balance calculations and allows more variability in CCAs for tax reasons and to stimulate economic growth. As a result, using CCAs would cause wider variance in average earnings determinations between similarly-paid workers supplying similar equipment, depending only on the age of the equipment supplied.

#### **4.3 The Short-Term Method**

In order to simplify the setting of long-term average earnings, the short-term method could be adopted to determine long-term average earnings. As noted earlier, the short-term method provides that the individual's gross earnings are subject to a percentage deduction to represent all of the costs of supplying equipment for the work. The percentages vary with the kind of equipment supplied — for "medium" equipment 40 percent of gross contract values is taken to represent payment for equipment, and for "heavy" equipment, 75 percent of gross is used.<sup>12</sup> Such deductions are made for all costs associated with owning and operating equipment, and result in profit margins of 60 percent or 25 percent.

This method is a compromise between a precise determination of earnings and administrative simplicity, and it can yield more favourable earnings amounts than the current long-term average earnings method. Thus, when workers are transitioned from short-term average earnings to long-term average earnings at 10 weeks, and actual expense figures and straight-line depreciation are used, the result is often a reduction in compensation. This may result in disputes over the policy.

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<sup>12</sup> "Medium" equipment is identified in the policy as "motor vehicles used for pilot car or local delivery services, minor excavating equipment, e.g. two-wheel drive agriculture-type tractors, complete with backhoe attachments and/or front-end loader attachment." "Heavy" equipment is identified as "logging trucks, skidders, bulldozers, line haul trucks."

It is noted that *AM* policy contains an additional deduction category, where 15 percent of the contract value is used to represent equipment costs for assessment purposes.<sup>13</sup> This category could possibly be adopted as a "light" equipment deduction for compensation purposes. This would allow WCB officers to make a deduction from gross earnings to represent the costs of supplying smaller pieces of equipment such as lawn mowers, leaf blowers, portable compressors, chain saws, and portable welding equipment.

#### **4.4 Policy Application**

The current policies on equipment and expense deductions are applied in determining the average earnings of labour contractors without POP. In practice, these policies are applied to many workers who are not labour contractors, but who deduct equipment expenses for tax purposes. This reflects the pre-Bill 49 application of the policy to workers.

The policy on fishing vessel depreciation is directed at fishers who own vessels. Yet some fishers who do not own vessels have equipment expenses, for equipment such as diving gear. Currently WCB officers use the CCA amounts declared to the CRA for such equipment in long-term average earnings determinations.

All three policies appear to be inappropriately limited in their application. In practice, all have been applied to calculate the average earnings of workers who have equipment expenses. In order to properly capture the category of individuals these policies attempt to address, it may be appropriate to direct the policies at workers who for business or taxation purposes deduct operating and/or equipment expenses.<sup>14</sup>

#### **4.5 Intent of Average Earnings Policies**

Section 33(1) of the *Act* provides that the WCB must determine a worker's average earnings with reference to the "worker's average earnings and earning capacity at the time of the worker's injury". It does not reference that the WCB should consider the earning capacity of a worker's business or equipment. Individuals may receive payment for providing services, out of which they must pay for any equipment and its operating costs. The portion of the payment that remains is for their labour.

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<sup>13</sup> For collecting assessment premiums, the *Assessment Manual* allows three categories of "equipment allowance" deductions at 15 percent, 40 percent, and 75 percent. By practice, these categories are characterized respectively as "Chain Saw", "Medium Equipment", and "Heavy Equipment" deductions. The assessment deductions for "Medium" and "Heavy" equipment use the same amounts as the identically-named deductions made for compensation purposes.

<sup>14</sup> There are different ways in which the CRA allows individual proprietors and partners to write off business expenses, including filing a "Statement of Farming Activities", a "Statement of Fishing Activities", and a "Statement of Business Activities".

The current policies guide WCB officers on how to properly determine the average earnings of individuals who are paid for their labour, equipment, and operating costs. The policies are consistent with the *Act* in that they provide that a worker should be compensated for the labour component of their earnings. However, there is no statement in policy that provides a rationale for why the WCB does not compensate for equipment or business costs.

A statement regarding the intent of closely considering the tax information of a worker was contained in a prior policy found in the *RS&CM*, Volume I, which provided:

The Board policy in all cases where a person derives their income from self-employment and other employment, is not to take the net taxable income as the sole criteria for determining average earnings. The net taxable income should be looked at in light of all other relevant facts and particulars, and judgment must be given on what is reasonable in view of all the facts and circumstances.<sup>15</sup>

This statement was not incorporated into the *RS&CM*, Volume II policies. In order to clarify the intent of the policies under consideration in this paper, it may be of assistance to WCB officers to add an updated version of this statement back into the *RS&CM*, Volume II.

## 5. OTHER JURISDICTIONS

The other Canadian jurisdictions were contacted to determine how each dealt with the issue of determining compensable earnings for workers supplying equipment and writing off operating expenses on their taxes.

Five jurisdictions may use a method similar to BC's short-term method to calculate long-term average earnings, but three of the five have the ability to use figures declared to the CRA, including CCA deductions, as an alternative:

- To determine earnings for "owner-operators", Alberta uses the greater of "the worker's gross income, less business expenses" (including CCAs), or "25% of gross income for all owner-operators except welders who own and operate a welding unit." Welders' earnings are based on 50 percent of gross income.
- Saskatchewan uses 25 percent of gross contract values to represent average personal earnings where the worker supplies equipment.
- Quebec has a schedule of eight deduction types ranging from 10 to 90 percent, which are deducted from gross contract values to represent

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<sup>15</sup> From *RS&CM*, Volume I policy item #66.11.

average personal earnings where the worker supplies equipment or materials.

- Newfoundland makes an initial decision using a standard percentage from a schedule, which is deducted from the gross earnings of the worker. The schedule is practice, and varies the percentage amount depending on the equipment or materials supplied or the nature of the contract, with percentages listed for over 180 equipment and contract types. If the worker believes that the earnings calculated on this basis are inequitable, she or he has an opportunity to submit evidence (i.e. tax information from the previous year) to the claim adjudicator that shows actual personal earnings information, including CCA deductions from gross earnings. If that evidence is acceptable, Newfoundland may base the average earnings of the worker on the submitted evidence.
- Nova Scotia makes an initial decision using a standard percentage from a schedule, which is deducted from the gross earnings of the worker. The schedule is policy, and consists of four broad categories of equipment and contract deductions. The categories are "Labour and Materials", "Logging (Chain Saw)", "Courier Service", and "Trucking and Leased Equipment". If the worker believes that the earnings calculated on this basis are inequitable, she or he has an opportunity to submit evidence (i.e. tax information from the previous year) to the claim adjudicator that shows actual personal earnings information, including CCA deductions from gross earnings. If that evidence is acceptable, Nova Scotia may base the average earnings of the worker on the submitted evidence.

Three other jurisdictions use CCAs in long-term average earnings determinations, two of which may use an alternate method if figures reported to CRA are not available:

- New Brunswick compensates based on the personal earnings a worker declares to the CRA (including CCA amounts), except where insufficient information is available to determine personal earnings. In such cases, policy allows the claim adjudicator to default to a method similar to the short-term average earnings determination method used in BC.
- The Northwest Territories and Nunavut compensate on the same basis as New Brunswick, and in practice also default to a method similar to the short-term average earnings determination method used in BC where there is insufficient information available to determine personal earnings.
- The Yukon uses CCAs in workers' earnings calculations, but has identified that this leads to inequitable results for some, as discussed in section 5.2, above. The Yukon will be undertaking a policy project

similar to this one to find a more equitable way to figure equipment costs into wage loss determinations.

Two other jurisdictions do not consider equipment deductions in calculating long-term average earnings. Ontario and Manitoba determine average earnings from the net business income reported by the contractor, and then "add back" non-cash expenses such as CCAs for major equipment. Actual expenses such as fuel and maintenance are used in the calculation.

Prince Edward Island advised that their registration policies preclude a worker from having significant equipment expenses. However, that WCB also advised that benefits would be adjusted if a worker was paid for more than just labour.

## **6. OPTIONS AND IMPLICATIONS**

The following section outlines various options for calculating long-term average earnings for workers and fishers that own and operate equipment, and the application of the policies guiding such calculations. An option that is not presented is "adding back" CCAs to workers' net earnings, as is done in Ontario and Manitoba. That option is not presented as it does not reflect the intent of section 33(1) of the *Act*.<sup>16</sup>

### **6.1 Options on Average Earnings**

#### **Option 1: Status quo**

Under this option, the BOD would not consider any changes to the current policies.

##### *Implications*

- WCB officers would continue to have difficulties interpreting and applying current policy.
- Policy on when to apply the straight-line depreciation schedule or to use CCA amounts for equipment would remain ambiguous.
- Policy would remain silent on how to treat equipment that is not "revenue-generating", and what constitutes the "purchase price" of equipment.
- The schedule in policy for available equipment straight-line depreciation percentages would remain narrow in scope.
- Policy would continue to allow situations where a worker's average earnings would be lower than those calculated using a CCA amount, especially where the CCA amount is low, or none is taken. As noted in section 4.1.1, above,

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<sup>16</sup> See section 4.5, above.

other associated equipment operating expenses tend to increase where a worker takes a smaller or no CCA, intensifying the effect of straight-line depreciation on such workers' earnings. Conversely, policy would continue to shield workers from the effects of significant CCAs.

### **Option 2: Use the figures reported by the worker to CRA for long-term average earnings**

Under this option, a worker's gross earnings would be reduced by CCA amounts for equipment declared to the CRA.

#### *Implications*

- As WCB officers would only have to base the figures on the same earnings the worker reports to the CRA, the calculation of long-term average earnings would be administratively simplified.
- This option would result in a wide variance in average earnings amounts between similarly-paid workers supplying similar equipment, depending only on the age of the equipment supplied.
- CCAs in the early years of an equipment asset's life may result in substantial reductions to earnings.
- This option would compensate workers based on amounts determined under another regulatory scheme established for a purpose other than workers' compensation.

### **Option 3: Use the short-term method for long-term calculations**

Under this option, long-term average earnings for workers with equipment deductions would be calculated based on a year's gross earnings, from which a percentage would be deducted based on whether or not the equipment in question is "heavy" or "medium", as currently set out in the short-term average earnings policy.

A sub-option to consider along with the option to use the short-term method for long-term average earnings determinations is the addition of a category for "light" equipment, to represent equipment supply costs for lighter equipment than is allowed under the "medium" and "heavy" categories. This sub-option could be implemented regardless of whether the short-term method is adopted for use as the long-term method.<sup>17</sup>

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<sup>17</sup> Draft policy reflecting this sub-option is attached in Appendix B.

### *Implications*

- The calculation of long-term average earnings would be administratively simplified.
- The possibility of over- or under-compensation exists depending on the actual amounts of a worker's equipment expenses. This method can often result in higher average earnings amounts than when actual deductions are used.
- This option would require less information gathering than is currently performed by WCB officers.
- The change from short-term to long-term average earnings at 10 weeks would more often result in similar compensation amounts.
- If a "light" equipment deduction is added, policy would have greater capacity to represent equipment costs for smaller pieces of equipment in average earnings determinations. This would reduce the short-term average earnings of workers who supply equipment that is not "medium" or "heavy", and who do not currently have a deduction made for their equipment costs.

#### **Option 4: Calculate long-term average earnings using a comparison of figures determined using two methods, and use the calculation that results in higher average earnings for the worker**

Under this option, the WCB would compare average earnings calculated using CCAs with another method. The method that results in higher average earnings amount would be used to determine the long-term average earnings of the worker. Where a worker does not take a CCA, the WCB would not make a deduction for the cost of equipment in the workers' average earnings.

#### *General implications for all sub-options*

- Situations where the current straight-line depreciation resulted in minimal earnings for a worker declaring a small or no CCA would be eliminated.
- As other associated equipment operating expenses tend to increase where a worker takes a smaller or no CCA, as is usually the case with older equipment, the increased equipment operating expenses could be seen as a fair representation of the costs associated with providing older equipment.
- Many long-term average earnings determinations would be calculated on the basis of CCAs, which are set in compliance with another regulatory scheme established for a purpose other than workers' compensation, but only where this is more favourable for the worker.

- Where CCA amounts are used in average earnings, workers may amend previous years' taxes to obtain a more favourable result.
- As WCB officers would in many cases base average earnings figures on the same earnings the worker reports to the CRA, the calculation of long-term average earnings would be administratively simplified.

The sub-options and implications of various approaches under this method are set out below.

***Option 4(a) - Compare CCA method with current straight-line depreciation method***

Under this sub-option, issues would remain with the application of the straight-line depreciation equipment schedule, as outlined in Option 1, above. In addition, policy would specify that straight-line depreciation would be calculated based on the invoiced value of the equipment as the "purchase price", including any applicable taxes.

***Option 4(b) - Compare the CCA method with the short-term method***

Under this sub-option, for many claims the implications would be as in Option 3, above, as the short-term method tends to provide higher average earnings amounts than those calculated using CRA-accepted deductions.

***Option 4(c) - Compare the CCA method with a standard straight-line depreciation of 15 percent for all equipment<sup>18</sup>***

Under this sub-option, workers would be compensated based on amounts declared to CRA, but CCA deductions would effectively be capped at 15 percent of the purchase price of the equipment, eliminating the problems of substantial CCAs early in the life of the equipment. The use of 15 percent reflects an approximate six-year useful life for equipment, and is within five percentage points of 11 of the 17 pieces of equipment on the current schedule.

The schedule of straight-line depreciation deductions would be eliminated from policy, along with the problems associated with finding equivalencies on the schedule or adding equipment to it. This sub-option would decrease the wide variance in average earnings amounts between similarly-paid workers supplying similar equipment that would result from the use of un-capped CCAs.

This sub-option would cause a reduction in compensation compared to the present policy in cases where a worker who provides equipment that is on the current schedule at less than 15 percent straight-line depreciation declares a CCA amount greater than the current scheduled amount. Workers who provide equipment that is on the schedule at greater than 15 percent would not see this effect. It is worth noting, however, that generally CCA deductions in later years would be less than

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<sup>18</sup> Draft policy reflecting this sub-option is attached in Appendix B.

the current schedule's straight-line deduction amounts, resulting in increased average earnings in many cases. Policy would specify that straight-line depreciation would be calculated based on the invoiced value of the equipment as the "purchase price", including any applicable taxes.

## **6.2 Options on Policy Application**

### **Option A: Status quo**

Under this option, the BOD would not consider any changes to the application of policies on how the average earnings of workers supplying equipment are determined.

#### *Implications*

- Policy would remain limited in scope to "labour contractors without coverage under section 2(2)" and fishers who own fishing vessels.
- There would be no statement in policy as to the intent of making deductions for supplying equipment.

### **Option B: Change the application and intent of average earnings policies**

Under this option, the short-term and long-term policies on average earnings would be combined and changed in application, and directed toward workers who for business or taxation purposes deduct equipment and/or operating expenses from gross income.<sup>19</sup> The average earnings policy on fishers would remain separate. In addition, a general statement would be added back into policy that the intent of deducting equipment operating expenses from a worker's gross earnings is to compensate workers on the labour component of their business earnings.

#### *Implications*

- Policy would reflect its current application to individuals that declare equipment and/or business expenses to CRA.
- WCB officers would be better able to explain the intent of deducting equipment expenses from gross earnings.

## **7. CONSULTATION**

Stakeholders are invited to provide feedback on the discussion paper, options, draft policy, and any additional comments that may be relevant to the issue.

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<sup>19</sup> Draft policy reflecting this option is attached in Appendix B.

Attached as Appendix "B" is draft policy reflecting:

- the sub-option in Option 3 (the addition of a deduction for light equipment in short-term average earnings);
- Option 4 (c) (the use of CCA deductions in long-term workers' and fishers' average earnings, subject to a 15 percent straight-line depreciation cap); and,
- Option B (a change in the policies' application to workers deducting operating and/or equipment expenses).

Stakeholder comments will be accepted until **June 24, 2005**. When responding, please provide your name, organization, and address. Comments may be sent by mail, fax or e-mail to:

By mail: Cameron Angus  
Policy Analyst  
Policy and Research Division  
Workers' Compensation Board  
P.O. Box 5350, Stn Terminal  
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By e-mail: [policyd1@wcb.bc.ca](mailto:policyd1@wcb.bc.ca)

The WCB's governing body, the Board of Directors, will consider the opinions expressed by stakeholders before it adopts any amendments to the current policies.

Please note that all comments become part of the Policy and Research Division's database and may be published, including the identity of organizations and those participating on behalf of organizations. The identity of those who have participated on their own behalf will be kept confidential according to the provisions of the *Freedom of Information and Protection of Privacy Act*.

## APPENDIX "A"

### Differences between Straight-Line Depreciation and Declining-Balance (CCA) Depreciation

Over a ten-year period a 30 percent declining-balance depreciation deduction is roughly equivalent to a 10 percent straight-line depreciation deduction, as they result in complete or almost complete depreciation of an asset in that time. For the individuals under discussion in this paper, most available CCAs are at 30 percent, although there are some assets that attract lower and higher amounts. The following chart demonstrates how straight-line depreciation and CCAs can vary depending on the age of the equipment, based on an original asset purchase price of \$100:

	Straight Line Depreciation of 10% Per Year		Declining Balance Depreciation of 30% Per Year (including first year 50% rule for CCA)		Difference between CCA and Straight Line
	Deduction Amount	Asset Valued At	Deduction Amount	Asset Valued At	
<b>Year 1</b>	- \$10.00	\$90.00	- \$15.00	\$85.00	\$5.00
<b>Year 2</b>	- \$10.00	\$80.00	- \$25.50	\$59.50	\$15.50
<b>Year 3</b>	- \$10.00	\$70.00	- \$17.85	\$41.65	\$7.85
<b>Year 4</b>	- \$10.00	\$60.00	- \$12.50	\$29.15	\$2.50
<b>Year 5</b>	- \$10.00	\$50.00	- \$8.75	\$20.40	- \$1.25
<b>Year 6</b>	- \$10.00	\$40.00	- \$6.12	\$14.28	- \$3.88
<b>Year 7</b>	- \$10.00	\$30.00	- \$4.28	\$10.00	- \$5.72
<b>Year 8</b>	- \$10.00	\$20.00	- \$3.00	\$7.00	- \$7.00
<b>Year 9</b>	- \$10.00	\$10.00	- \$2.10	\$4.90	- \$7.90
<b>Year 10</b>	- \$10.00	\$0	- \$1.47	\$3.43	- \$8.53

As shown in this table, compared with the WCB's straight-line depreciation approach a CCA can vary widely from year to year depending on the age of the asset.

## APPENDIX "B"

### Draft Version of *Rehabilitation Services & Claims Manual*, Volume II Implementing the sub-option of Option 3, Sub-Option 4 (c), and Option B

#### ~~#68.61 — Labour Contractor Without Coverage under Section 2(2) — Short-Term Average Earnings~~

~~This policy enables the Board to determine the labour component of a labour contractor's remuneration for short-term average earnings where the labour contractor does not have coverage under section 2(2) of the Act.~~

~~A labour contractor's contract may include payment for any wages paid by the labour contractor to his/her employee(s) and/or equipment.~~

~~In calculating the labour component of a labour contractor's date of injury earnings, the amount of wages paid by the labour contractor to his/her employees is deducted from the gross contract value. In addition, where a contract involves the payment of monies for the supply of equipment, the monies paid with respect to equipment may be deducted from the gross contract value as follows:~~

~~Where medium equipment is supplied, the gross figure will be converted to gross wages by applying the following percentages:~~

<del>(a) — Medium Equipment</del>	<del>— Equipment</del>	<del>— 40%</del>
	<del>— Wages</del>	<del>— 60%</del>

~~Examples: Motor vehicles used for pilot car or local delivery services, minor excavating equipment, e.g. two-wheel drive agriculture-type tractors, complete with backhoe attachments and/or front-end loader attachment.~~

~~Where heavy equipment is supplied, the gross figure will be converted to gross wages by applying the following percentages:~~

<del>(b) — Heavy Equipment</del>	<del>— Equipment</del>	<del>— 75%</del>
	<del>— Wages</del>	<del>— 25%</del>

~~Examples: Logging trucks, skidders, bulldozers, line haul trucks.~~

## APPENDIX "B"

### Draft Version of *Rehabilitation Services & Claims Manual*, Volume II Implementing the sub-option of Option 3, Sub-Option 4 (c), and Option B

#### ~~#68.62 — Labour Contractor Without Coverage under Section 2(2) — Long-Term Average Earnings~~

~~In determining a labour contractor's long-term average earnings where the labour contractor's earnings include revenue-generating equipment and the labour contractor does not have coverage under section 2(2) of the Act, the Board depreciates any revenue-generating equipment in order to determine the labour component of the labour contractor's remuneration.~~

~~Operating costs or expenses will be deducted from the gross business income to obtain the business net income (the worker's average earnings). When asked to provide earnings information, the labour contractor will also be asked to list the purchase price of the piece of equipment.~~

~~The capital cost allowance or depreciation figure listed on the labour contractor's data will not be used. In place of this figure, a percentage will be selected from the straight-line depreciation tables set out below which most closely represents the piece of revenue-generating equipment involved. This percentage will then be applied to the purchase price of the item and the resulting figure will, along with the other operating costs or expenses of the business, be deducted from the gross to compute the worker's average earnings.~~

<b>Equipment Type</b>	<b>Annual Rate</b>
<b>Road Construction</b>	
Track type — Lesser than 200 HP	11%
Tractor — Greater than 200 HP	6%
Motor Grader	7.5%
Excavator	11%
Track Loader	11%
Backhoe (R/T Tractor)	18.5%
<b>Logging</b>	
Track type — Lesser than 200 HP	11%
Tractor — Greater than 200 HP	6%
Skidder	11%
Loader — Boom Type	7.5%
Loader — Front-end Type	11%
Log Truck and Trailer	8%

## APPENDIX "B"

### Draft Version of *Rehabilitation Services & Claims Manual*, Volume II Implementing the sub-option of Option 3, Sub-Option 4 (c), and Option B

#### Transportation

Line Haul Tractor	10%
5-ton Truck	10%
1-ton Truck/Van	8%
Automobile	12.5%
Gravel Truck	17%

#### ~~#68.63~~ — *Fishers*

~~In order to determine the labour component of a fisher's remuneration, where a fisher owns the fishing vessel used to generate income, the fishing vessel is depreciated.~~

~~When asked to provide earnings information, the fisher will also be asked to list the purchase price of the vessel. In deducting operating costs or expenses from the gross figure to obtain the worker's average earnings, the capital cost allowance or depreciation figure listed on the worker's data will not be used. In place of this figure, the straight line depreciation percentage set out below will be used. This percentage will then be applied to the purchase price of the vessel and the resulting figure will, along with the other operating costs or expenses, be deducted from the gross business income to compute the worker's average earnings.~~

~~All Vessels 7.5%~~

~~Interest accrued (whether or not paid) as the result of an indebtedness, in respect of a fishing vessel used and owned by a commercial fisher, is considered an operating cost. The accrued interest is deducted from the gross income. The purchase of food as an operating cost is not deducted from the gross income as it is considered a direct benefit to the fisher and is measurable return from the activities of fishing. The purchase of fuel, fishing nets, etc., plus costs incurred in the maintenance of the vessel and its equipment are deducted from the gross income as operating costs. See also policy item #65.03.~~

## APPENDIX "B"

### Draft Version of *Rehabilitation Services & Claims Manual, Volume II* Implementing the sub-option of Option 3, Sub-Option 4 (c), and Option B

#### #68.61 *Workers Deducting Operating and/or Equipment Expenses*

A worker's earnings may include payment for equipment and/or other operating expenses. Section 33(1) of the *Act* provides that the Board must determine a worker's average earnings with reference to the "worker's average earnings and earning capacity at the time of the worker's injury".

This policy enables the Board to determine the labour component of a worker's earnings where the worker receives payment for providing services, out of which the worker must pay for any operating costs and/or equipment that is a required component of the contract of service. Such equipment is normally required to fulfill the contract, and represents a portion of the worker's costs in providing the service. The portion of the earnings that remains after deductions for operating costs and such equipment represents the labour component of the worker's earnings, on which average earnings are calculated.

In all cases where a worker who for business or taxation purposes deducts equipment and/or operating expenses from gross income, the Board's policy is not to take the net taxable income as the sole criterion for determining average earnings. The net taxable income should be looked at in light of all other relevant facts and particulars, and judgment given to what is reasonable in view of all the facts and circumstances.

#### *(a) Short-Term Average Earnings*

In calculating the short-term average earnings of a worker who for business or taxation purposes deducts operating and/or equipment expenses, the labour component of the worker's date of injury earnings must be determined as follows:

##### *(i) Light Equipment*

Where light equipment is supplied, the gross figure will be converted to gross wages by applying the following percentages.

Equipment	Wages
15%	85%

Examples of light equipment include chain saws, lawn mowers, and portable welding equipment and compressors not permanently mounted on vehicles.

## APPENDIX “B”

### Draft Version of *Rehabilitation Services & Claims Manual*, Volume II Implementing the sub-option of Option 3, Sub-Option 4 (c), and Option B

#### (ii) Medium Equipment

Where medium equipment is supplied, the gross figure will be converted to gross wages by applying the following percentages.

Equipment	Wages
40%	60%

Examples of medium equipment include motor vehicles used for pilot car or local delivery services, and minor excavating equipment (e.g. two-wheel drive agriculture-type tractors, complete with backhoe attachments and/or front-end loader attachment).

#### (iii) Heavy Equipment

Where heavy equipment is supplied, the gross figure will be converted to gross wages by applying the following percentages.

Equipment	Wages
75%	25%

Examples of heavy equipment include logging trucks, skidders, bulldozers, and line haul trucks.

#### *b) Long-Term Average Earnings*

In calculating the long-term average earnings of a worker who for business or taxation purposes deducts operating and/or equipment expenses, operating costs or expenses will be deducted from gross earnings to determine the labour component of the worker's gross earnings.

To calculate such a worker's long-term average earnings, the worker will be asked to provide the purchase price for any equipment that is a required component of the contract of service. The purchase price of such equipment is usually the invoiced value of the asset(s), including applicable taxes. Where a worker trades in another asset in order to purchase a new asset, the trade does not reduce the value of the acquired asset for the purposes of determining the purchase price.

The capital cost allowance or depreciation amount for taxation purposes for equipment that is a required component of the contract of service will be deducted from gross earnings where it does not exceed 15 percent of the purchase price of the equipment.

## APPENDIX “B”

### **Draft Version of *Rehabilitation Services & Claims Manual*, Volume II Implementing the sub-option of Option 3, Sub-Option 4 (c), and Option B**

In cases where the capital cost allowance or depreciation amount exceeds 15 percent of the purchase price, an equipment supply deduction amount equal to 15 percent of the purchase price will be deducted from gross earnings instead of the capital cost allowance or depreciation amount.

Where the worker does not declare a capital cost allowance or a depreciation amount for equipment that is a required component of the contract of service, the Board will not make a deduction from gross earnings for that equipment.

#### *#68.62 Fishers*

In calculating the earnings of a fisher who for business or taxation purposes deducts operating and/or equipment expenses, operating costs or expenses will be deducted from gross earnings to determine the labour component of the fisher's gross earnings.

To calculate a fisher's earnings, the fisher will be asked to list the purchase price of the vessel or the other equipment used to harvest fish. The purchase price of a vessel or equipment used to harvest fish is the invoiced value of the asset(s), including applicable taxes. Where a fisher trades in an equipment asset in order to purchase a new equipment asset, the trade does not reduce the value of the acquired equipment asset for the purposes of determining the purchase price.

The capital cost allowance or depreciation amount for taxation purposes for the vessel or equipment used to harvest fish will be deducted from gross earnings where it does not exceed 15 percent of the purchase price of the equipment.

In cases where the capital cost allowance or depreciation amount exceeds 15 percent of the purchase price, the amount equal to 15 percent of the purchase price will be deducted from gross earnings instead of the capital cost allowance or depreciation amount.

Where the fisher does not take a capital cost allowance or a depreciation amount for a vessel or equipment used to harvest fish, the WCB will not perform a deduction from gross earnings for that equipment.

Interest accrued (whether paid or not) as the result of debt in respect of a fishing vessel used and owned by a commercial fisher is considered an operating cost. The accrued interest is deducted from gross income.

The purchase of food as an operating cost is not deducted from gross income as it is considered a direct benefit to the fisher and is a measurable return from the activities of fishing. The costs of maintenance for the vessel or other equipment used to harvest fish, fuel, fishing nets, and other appropriate expenses are deducted from gross income as operating costs. See also policy item #65.03.