

# DISCUSSION PAPER

## 1. TITLE

Average Earnings and Worker Expenses

## 2. ISSUE

Policy provides that in calculating the average earnings of a worker or fisher "who, for business or taxation purposes deducts operating and/or equipment expenses, operating costs or expenses will be deducted from gross earnings".<sup>1</sup> There is little guidance in policy on acceptable operating costs or expenses, prompting questions as to the types of costs or expenses appropriate for deduction.

## 3. BACKGROUND

### 3.1 Law and Policy

Section 33(1) of the *Workers Compensation Act* ("Act") provides that WorkSafeBC ("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".

The *Act* does not indicate that the WCB should consider the earnings of a worker's business or equipment. However, some workers receive payment for providing service, out of which they must pay for any operating costs and/or equipment costs. The portion that remains after deducting these costs represents payment for the worker's labour. This labour component of the worker's earnings is used to calculate average earnings for the purposes of determining compensation under the *Act*.

Policy items #68.61 (Workers Deducting Operating and/or Equipment Expenses) and #68.62 (Fishers) of the *Rehabilitation Services & Claims Manual*, Volume II ("RS&CM") authorize the deduction of operating costs or expenses from gross earnings to determine the labour component of a worker's or fisher's earnings. These policies offer little guidance as to the nature of acceptable deductions.

The policy for workers deducting expenses for business or taxation purposes specifically references only equipment depreciation and interest charges as being deductible costs. However, as the policy provides broad discretion to

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<sup>1</sup> Policy item #68.61 in the *Rehabilitation Services & Claims Manual*, Volume II.

make other deductions, many other costs are deducted in practice from such workers' earnings, including costs for fuel, maintenance, licensing, office equipment or space, and telephone or internet charges.

The policy for fishers contains more guidance, providing that in addition to equipment depreciation and interest charges, 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". The fishers' policy also provides that meal expenses will not be deducted from gross earnings, as food "is considered a direct benefit to the fisher and is a measurable return from the activities of fishing". Policy provides discretion to consider other deductions than the ones specifically referenced in the policy, but no guidance as to how such determinations may be made.

## **4. DISCUSSION**

### **4.1 General or Specific Guidance**

A worker may make many different types of expense deductions for business or taxation reasons, and what may be a valid business expense for one industry can be a personal expense in another. As a result, the question arises as to whether policy should contain detailed guidance on which expenses are to be deducted, or if policy should set out general principles for decision makers to consider.

Two other jurisdictions<sup>2</sup> leave detailed direction to practice documents and provide only general guidance on deductions in policy or law. This approach avoids several problematic issues, as a list or schedule of acceptable expenses in policy could not be made complete, would perhaps fetter the discretion of decision makers, and would require lengthy explanations to address the issue of expenses that should be deducted in some situations but not others. It is believed that providing general policy guidance would clarify the considerations behind WCB decisions in making deductions.

### **4.2 General Principles for Expense Deductions**

In practice, the WCB deducts most operationally oriented costs from gross earnings. However, meal expenses and the use of the worker's home for business purposes are generally not deducted from gross earnings, as the worker would incur these costs regardless of whether he or she is "self-employed". However, in some circumstances, such expenses could be valid for

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<sup>2</sup> The Yukon and Manitoba - see section 6 for more information.

business reasons.<sup>3</sup> Thus, the principles set out in policy should allow the WCB to be flexible in its assessment of whether an expense should be deducted.

Four key principles have been identified as relevant when determining whether an expense should be deducted from a worker's gross earnings:

- 1) *Whether the worker's gross earnings include payment in respect of the expense*

The first and most important principle is whether the payment made to the worker is for more than just the worker's labour. In such cases, the WCB may deduct expenses from the worker's gross earnings. For example, if a worker must pay other providers for independent information and advice as part of the job, the costs of that information and advice should be deducted from the worker's gross earnings.

- 2) *Whether the worker incurred the expense directly as a result of supplying equipment and/or materials to the employer*

In cases where a worker bears costs in supplying equipment or materials to the employer, the WCB should deduct such costs from the worker's gross earnings. For example, if a worker supplies a backhoe to an employer, the worker must fuel and maintain the backhoe. Payments to the worker include the supply of equipment, with the fuel and maintenance costs, and such expenses should be deducted from the worker's gross earnings.

- 3) *Whether the expense resulted from the worker operating his or her business*

In cases where a worker must pay expenses as a result of operating somewhat independently of the employer, the employer's payments to the worker may be adjusted to recognize such expenses. For example, where a worker who must pay significant legal and accounting fees in order to work receives payment to offset the costs incurred, such expenses should be deducted from the worker's gross earnings.

- 4) *Whether the worker would incur the expense regardless of the nature of the employment*

There are certain types of expenses that everyone must bear regardless of whether they are employed, such as housing, food and utility costs.

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<sup>3</sup> For example, the WCB would not deduct the costs of meals for a trucker on the road, as the trucker must feed him- or herself regardless of whether he or she is employed as a trucker. However, it may be more appropriate to deduct meal costs from gross earnings in the case of a food industry consultant with worker status who must pay for food samples in order to facilitate work with a client.

Where such costs are reasonable, and do not appear to be directly related to the worker's provision of service to an employer, such costs should not be deducted from the worker's gross earnings.

Adding these principles to policy would provide a framework within which WCB officers could consider expenses appropriate for deduction from a worker's gross earnings. As current policy is silent on the issue, the principles would provide greater guidance to decision makers for such decisions.

## **5. OTHER JURISDICTIONS**

While adopting the expenses a worker declares to the Canada Revenue Agency would be a simple approach, it would present challenges for the WCB. Tax law and workers' compensation law have different purposes, and as a result, each system treats earnings differently. For tax purposes, individuals may expense many costs, lowering reported earnings a great deal while maintaining a secure standard of living. In taxation, the only consequence for this is that the individual pays less tax. Using the same expenses to determine average earnings for workers' compensation purposes would result in a reduction in benefits for many workers and fishers, many of whom expense costs for tax purposes that they would incur regardless of their employment.

The PRD also reviewed how other Canadian workers' compensation jurisdictions treat operating costs and expenses. Most of the jurisdictions do not compare easily, as they compensate workers with operating costs and expenses differently than in BC.

However, three jurisdictions are comparable. Ontario provides specific guidance as to what expenses will not be deducted from gross earnings in average earnings calculations, and concludes by giving decision makers discretion to exclude other expense deductions. The list of expenses that will not be deducted reads as follows:<sup>4</sup>

- pension plan and RRSP contributions
- depreciation and amortization
- charitable donations
- expenses arising out of the individual's use of personal home or vehicle for business purposes
- dividends from the business
- other items as appropriate

Two other jurisdictions have law or policy language that provides more general guidance in determining whether an expense should be deducted:

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<sup>4</sup> From policy 12-03-02 in the Ontario *Operational Policy Manual*.

- The Yukon *Workers' Compensation Act* provides that earnings do "not include any amount received for expenses incurred by the worker because of the worker's employment".<sup>5</sup>
- Policy in Manitoba provides that some expenses that should not be deducted from gross earnings as they are "personal expenses that the worker has allocated on financial statements as being due to business, such as expenses claimed for using his or her home for business".<sup>6</sup>

## 6. OPTIONS AND IMPLICATIONS

### Option 1: Status quo

Under this option, no changes would be made to policy in the *RS&CM*, Volume II.

#### *Implications*

- Policy would remain silent as to the expenses that should be deducted from the earnings of workers who have operating costs, occasionally resulting in disputes over appropriate deductions between staff and stakeholders.

### Option 2: Make Changes to the Policies on Fishers and Workers Deducting Operating Costs and/or Equipment Expenses

Under this option, policies dealing with fishers and workers who deduct operating expenses would be changed to incorporate general guidance as to the types of expenses that should be deducted from gross earnings. The four general principles described above would be added to the policies as questions to consider when deciding whether to deduct an expense.

A minor language change would also be made to cross reference policy on special expenses and allowances. Draft policy reflecting this option is found in Appendix A.

#### *Implications*

- Policy would provide clearer guidance on the deduction of operating costs from gross earnings.
- It is not anticipated that this approach will have a significant impact on current practice as the principles proposed in the draft policy reflect those considered in practice.
- This approach may result in fewer disputes between the WCB and stakeholders and fewer requests for review and appeals on the deduction of expenses from gross earnings.

<sup>5</sup> From section 117(1) of the Yukon *Workers' Compensation Act*.

<sup>6</sup> From policy #44.80.10.10 of the Manitoba *Policy Manual*.

## 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.

Stakeholder comments will be accepted until **May 12, 2006**. When responding, please provide your name, organization, and address. Comments may be submitted on line using the "comment" link on the web page this paper is linked from, or by mail, fax or e-mail to:

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WorkSafeBC's governing body, the Board of Directors, will consider the options 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

### Proposed Changes to the *RS&CM* Policies on Workers Deducting Operating and/or Equipment Expenses and Fishers

#### #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 does not apply to a worker receiving separate special expense reimbursements or allowances from an employer; the Board considers such earnings under policy item #68.63 *Special Expenses or Allowances*.**

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 equipment represents the labour component of the worker's earnings, on which average earnings are calculated.

#### (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 A

### Proposed Changes to the *RS&CM* Policies on Workers Deducting Operating and/or Equipment Expenses and Fishers

#### (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 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 A

### Proposed Changes to the *RS&CM* Policies on Workers Deducting Operating and/or Equipment Expenses and Fishers

Where the capital cost allowance or depreciation amount exceeds 15 percent of the purchase price, 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 **for equipment depreciation** from gross earnings for that equipment.

**In determining whether the Board will deduct other operating costs or expenses from a worker's gross earnings, the Board considers the following questions as appropriate:**

- 1) Did the worker's gross earnings in the time period under review include payment in respect of the expense?**
- 2) Did the worker incur the expense directly as a result of supplying equipment and/or materials to the employer?**
- 3) Did the expense result from the worker operating his or her business?**
- 4) Would the worker incur the expense regardless of the nature of the employment?**

Interest accrued (whether paid or not) as the result of debt in respect of equipment owned by a worker that is a required component of the contract of service is considered an operating cost. The accrued interest is deducted from gross income.

#### **#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. **This policy does not apply to a fisher receiving separate special expense reimbursements or allowances from an employer; the Board considers such earnings under policy item #68.63 *Special Expenses or Allowances*.**

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),

## APPENDIX A

### **Proposed Changes to the *RS&CM* Policies on Workers Deducting Operating and/or Equipment Expenses and Fishers**

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 a 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.

Where the capital cost allowance or depreciation amount exceeds 15 percent of the purchase price, 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 Board will not perform a deduction **for equipment depreciation** from gross earnings for that equipment.

**In determining whether the Board will deduct other types of operating costs or expenses from a fisher's gross earnings, the Board considers the following questions as appropriate:**

- 1) Did the fisher's gross earnings in the time period under review include payment in respect of the expense?**
- 2) Did the fisher incur the expense directly as a result of supplying equipment and/or materials for fishing activities?**
- 3) Did the expense result from the fisher operating his or her business?**
- 4) Would the fisher incur the expense regardless of the nature of the employment?**

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.