

COMPENSATION PRACTICE AND QUALITY DEPARTMENT

PRACTICE DIRECTIVE # C9-11

TOPIC: Composition of Earnings
ISSUE DATE: January 14, 2008
(amended February 4, 2008)

Objective

This practice directive provides guidance to WorkSafeBC officers in determining the types of remuneration that should be included in establishing a worker's average earnings.

For more information about including Employment Insurance payments in the composition of average earnings, refer to Practice Directive ("PD") #C9-8, *Employment Insurance Payments*.

For more information about the composition of average earnings for workers and fishers who deduct business and/or equipment expenses, refer to PDC9-10, *Workers Deducting Business and/or Equipment Expenses*.

Law & Policy

Section 33(1) of the *Workers Compensation Act* ("Act") provides, in part:

The Board must determine the amount of average earnings and the earning capacity of a worker with reference to the worker's average earnings and earning capacity at the time of the worker's injury.

This section provides the general direction for determining a worker's average earnings.

Section 33(3.1)(a) of the *Act* specifically excludes employer contributions to a worker's benefit plan(s), while s.33(3.1)(b) excludes special expenses and allowances provided to the worker because of the nature of the worker's employment.¹

Policy item #68.00, *Composition of Average Earnings*, of the *Rehabilitation Services and Claims Manual, Volume II*, ("RSCM") states that a worker's average earnings are normally composed of wages or salary. However, it also recognizes that a worker may receive other types of payments as part of employment

¹ See also RSCM Policy items #68.21, *Benefit Plans*, and #68.23, *Special Expenses or Allowances*.

remuneration. Direction regarding the treatment of specific types of payments is set out in *RSCM* Policy items #68.10 to #68.90.

Adjudicative Guidelines

A) General

Given the different types of employment-related payments that may be provided to a worker, it is important to ensure that only the labour component of a worker's remuneration is included in the calculation of average earnings.

The following is a list of payments that have been identified in policy as **appropriate for inclusion** in the calculation of average earnings:

- Commission, piecework, bonuses, tips and gratuities (Policy Item #68.10)
- Statutory holiday payments and vacation allowances (Policy Item #68.10)
- Regular overtime payments (Policy Item #68.11)
- Subsequent salary increases that are effective retroactively to before the date of injury - unless more than 75 days have passed since the rate was established (Policy Item #68.13)
- Monies in respect of room and board providing the benefit is discontinued by the employer during the period of disability (Policy Item #68.22)
- Employment Insurance payments received by a worker employed in an occupation or industry that results in recurring seasonal or recurring temporary interruptions of employment (Policy Item #68.40 and PD #C9-8, *Employment Insurance Payments*)
- Monies in respect of government sponsored work programs (Policy item #68.80)

The following is a list of payments that have been identified in policy as **not appropriate for inclusion** in the calculation of average earnings:

- Severance or termination pay (Policy item #68.12)
- Prospective salary increases or promotions that a worker might have received if the injury had not occurred (Policy item #68.13)
- Special Expenses or Allowances (Policy item #68.23)
- Strike pay (Policy item #68.30)
- Monies in respect of the supply of rental equipment (Policy item #68.60)
- Monies in respect of operating and/or equipment expenses (Policy item #68.61 and BPIS #16, *Workers Deducting Business and/or Equipment Expenses*)
- The following types of payments made by the employer on behalf of the worker (Policy item #68.21):
 - contributions payable under the *Canada Pension Plan*
 - premiums payable under the *Employment Insurance Act*

- contributions to a retirement, pension, health and welfare, life insurance or another benefit plan for the worker or the worker's dependants

Once a decision is made regarding the worker's average earnings and a wage-rate is established, the 'composition' of the worker's average earnings can only be reconsidered if less than 75 days have elapsed since the decision was made. As a result, it may be necessary to establish provisional earnings (provisional rate) where there is an expectation that further proof of earnings may be required (e.g., a time lag for commission earnings to be determined and paid by the employer; or payments in respect of room and board that may be terminated by the employer).

Additional practice guidance is provided below with respect to the following items:

- Statutory holiday and vacation payments
- Overtime
- Bonuses
- Out-of-country earnings
- Dividends and shareholder (principal) repayment loans

B) Statutory Holiday and Vacation Payments

Statutory holiday pay and vacation pay are considered earnings and should be included when setting a worker's wage rate as provided by *RSCM Policy item #68.10, Extraordinary or Irregular Wage Payments*. This is applicable to both short-term average earnings and long-term average earnings.

Only vacation and/or holiday entitlement that is earned in the period under consideration and paid to a worker is included in the composition of average earnings (e.g., a worker is paid 4.5% of his or her annual salary in respect of vacation entitlement).² Compensation is not provided in respect of a worker's inability to accrue additional vacation time during the period of disability.

Vacation pay, earned during a period when the worker is receiving wage loss benefits, is deducted from section 30 benefits when it is paid.³

² For inclusion in average earnings, vacation and/or holiday entitlement must represent an additional amount that supplements the worker's wages.

³ *RSCM Policy item #34.41, Vacation Pay*, requires WorkSafeBC to continue payment of wage loss benefits during a vacation period or statutory holiday. However, this policy is intended to ensure that there is no interruption in the payment schedule (i.e., entitlement). It is not intended to address how much compensation is appropriate with respect to the section 30 calculation.

Compensation under section 30 is calculated as the difference between the worker's pre-injury earnings and what the worker earns, or is deemed capable of earning, after the injury. Any statutory holiday pay and/or vacation allowance paid while the worker is receiving wage loss benefits is deducted from the section 30 benefit amount because it is considered to be 'earnings'. This deduction is necessary because the statutory holiday and/or vacation pay was included in calculating the worker's average earnings.

Vacation pay that was accrued prior to the injury and paid out during the time the worker is receiving section 30 benefits is not deducted.

C) Overtime

RCSM Policy item #68.11, *Overtime*, states that only regular overtime is included in the calculation of a worker's average earnings. Policy item #68.11 does not make a distinction between the calculation of short-term average earnings and long-term average earnings.

As is the case with vacation pay, only regular overtime entitlement that is earned in the period under review is included in the composition of average earnings. If the worker has worked overtime but has deferred payment, the value of the overtime earned during the period of review may still be considered in the calculation of average earnings.

For the purposes of identifying 'regular' overtime, the worker should be able to demonstrate a relatively predictable and repetitive pattern of earning overtime payments.

With respect to calculating short-term average earnings, the frequency in which the worker earns overtime is an important consideration. Since the objective is to accurately capture time-of-injury earnings, the worker would generally have to demonstrate a regular pattern of earning overtime within the three-month period immediately preceding the date of injury.⁴

For example, a worker who received at least one overtime payment in each of the three months under review would be able to demonstrate a regular pattern of earning overtime, and therefore the payments would be included in the calculation of short-term average earnings. In this example, it would be appropriate to set the wage rate based on the worker's monthly earnings (rather than a weekly or daily rate of pay).⁵

⁴ An exception may be made, for example, where a worker received 'regular' overtime and was off on holidays for two months just prior to the date of injury.

⁵ A shorter period of time for establishing 'time of injury earnings' (e.g., weekly earnings) may be appropriate where the worker is able to demonstrate a more frequent pattern of receiving overtime payments.

With respect to calculating long-term average earnings, the period of review for determining if the worker had a regular pattern of earning overtime will generally be the 12-month period immediately preceding the date of injury. However, a longer period of review may be undertaken where necessary.

For example, the worker may have a pattern of working overtime on an annual basis, but only during a specific time of year (e.g., over a holiday season). The nature of the overtime in this case would still be viewed as regular and should be included when calculating the long-term average earnings.

D) Bonuses

RSCM Policy item #68.10, *Extraordinary or Irregular Wage Payments*, confirms that “such items as commission, piecework, bonus, tips and gratuities must be included in a worker’s average earnings where the Board can verify the information provided to the Board through independent sources.” This policy applies to the composition of both initial average earnings and long-term average earnings.

There are two important questions when considering whether a bonus should be included in the calculation of average earnings:

1. Does the bonus represent remuneration for work?
2. When was the bonus payment earned?

Where a worker receives an employment bonus during the time period under review, the amount is included in average earnings where it is determined that the bonus is related to actual work done.

In some cases, workers receive bonus amounts on top of their regular pay each pay period or on a weekly or monthly basis. Calculating initial average earnings in those circumstances is straight-forward. The officer would simply add the bonus amount to the worker’s regular pay.

More often, a worker will receive an employment bonus on a quarterly or annual basis. Such a bonus may be included in short-term average earnings to the extent that it represents time-of-injury earnings. In other words, the bonus may be included in short-term average earnings if it relates to the time period used to calculate those earnings. It is necessary for the WorkSafeBC officer to confirm the value of the bonus for work done during the period of time under review. For short-term average earnings, where the precise amount is not available, it may be necessary to prorate the bonus amount so that it reflects time-of-injury earnings.

For example, if a worker was injured the same week he received his annual bonus, obviously the entire bonus amount would not be considered time-of-injury earnings. Instead, the bonus amount would be prorated to match the time period used to calculate the initial wage rate. If the initial wage rate is calculated based on the worker's daily wages, the annual bonus amount would be divided by 365 to determine a daily value that would be added to the daily amount of wages. If the initial wage rate is calculated using three-month earnings, the bonus would be prorated accordingly.

There is often some delay between the worker earning a bonus and the payment of the bonus, which can complicate the decision regarding whether to include the bonus in average earnings, and if so, how much to include. If the bonus represents time of injury earnings, the payment of which has simply been deferred to some later date (for example, paid after the date of injury), it is appropriate to include the bonus in the initial average earnings. Bonuses that do not represent time of injury earnings, but instead relate to an earlier time period, are not included in initial average earnings.

For example, where the worker received an annual bonus five months prior to the date of injury, the bonus does not represent time of injury earnings and would not be included in short-term average earnings.

Employment bonuses, including those paid on an annual basis, are routinely captured in long-term average earnings. Long-term wage rates for workers who fall under the 'general rule' are calculated based on earnings from the 12 months immediately preceding the date of injury. If the worker received a bonus for work done in that 12-month period, it is included in long-term average earnings. Similar to the process for considering inclusion of bonuses in short-term average earnings, WorkSafeBC officers should confirm the value of the bonus for work done during the 12-month period.

An "attendance bonus" may also be included in the calculation of average earnings. This type of bonus is typically paid to a worker if he or she has fewer absences from work than the number of days specified by the employer. The bonus is linked to work performance since the worker does not receive the funds if he or she does not attend work. As such, attendance bonuses are closely related to actual work done and represent remuneration for that work.

Where the worker might have received a bonus but didn't because he or she was off-work at the time the bonus was paid, there is no bonus to include in the calculation of earnings. Bonuses that have not yet been paid cannot be included in average earnings unless the bonus amount can be quantified and there is a guarantee it will be paid in the future. In these cases, it may be appropriate to set a provisional rate pending the finalization of the worker's bonus payment.

Signing Bonus

A union and employer may negotiate a collective agreement where a 'signing bonus' forms part of the agreement. Signing bonuses are not included when calculating a worker's average earnings or deducted when calculating section 30 payments. The bonus is not representative of the worker's normal earning pattern and is not remuneration for work or services provided. Workers have received the payments as a result of a collective bargaining process and in particular, as an inducement to entering into an agreement.

Although Policy item #68.10 references bonuses as part of the worker's average earnings, it is in the context of an 'extraordinary' or 'irregular' wage payment. In other words, the policy is speaking of bonuses that are connected to the production or performance of the individual worker or the employer. This interpretation is reinforced by consideration of the other items mentioned in the policy. Commission, piecework, tips and gratuities are all directly linked to a worker's direct employment efforts. The signing bonus is a one-time lump-sum payment paid to a worker as an incentive to sign a collective agreement. Exclusion of these bonuses from the composition of average earnings is consistent with Policy item #68.10.

Since signing bonuses are not to be included in average earnings, they are also not deducted from temporary disability benefits under section 30. A signing bonus payment is treated in a manner similar to termination pay (see Policy items #34.42 and #68.12) in that the payment is in respect of a contractual agreement and not for work completed.

E) Out-of-Country Earnings

Out-of-country earnings may be included in the calculation of average earnings. This situation may present, for example, where the worker is a recent immigrant or a temporary foreign worker.

If the out-of-country earnings are from the time period used to calculate the worker's wage rate, the earnings are included in average earnings. There is nothing in the legislation or policy that limits average earnings to monies earned in Canada. The same principles that apply to the inclusion of Canadian earnings would apply to out-of-country earnings. The out-of-country earnings would have to be verified by authentic and arms-length documents, such as the equivalent to a Canadian T4 tax form or documentation from the employer.

The exchange rate to be applied to the out-of-country earnings can be obtained from the Finance Department. The WorkSafeBC officer should use the average exchange rate for the earnings period being used or, if unavailable, the current exchange rate.

F) Dividends and Shareholder (Principal) Repayment Loans

Effective January 1, 2008, *RSCM*, Policy item #68.90, *Principals - Composition of Earnings*, includes the following on dividends and shareholder repayment loans:

“When determining the composition of a principal's average earnings, the Board may consider dividends and the repayment of a principal's loan to the employer as earnings in cases where it is shown that the amount received by the principal represents payment for the principal's labour”

Dividends

Where a worker is a principal of a limited company, it is appropriate to consider income derived from dividends where the evidence clearly establishes that the dividends represent payment to the principal in exchange for productive services, activities or work performed for the company. If the evidence indicates that only a portion of the principal's dividend income represents payment for work, then it is appropriate to include only that amount in the calculation of average earnings.

This approach is also consistent with the *Assessment Policy Manual*, AP1-38-2, which states that dividends are considered part of the company's payroll if they are paid as remuneration for activity in the company.

Shareholder Repayment Loans

In a 'shareholder repayment loan,' the active principal puts his or her own 'seed' money into starting up the business venture (corporation). The principal is deemed to have loaned his/her money to the company (the employer). If the principal later withdraws that money from the corporation, it may be in the form of a shareholder repayment loan. In essence, the employer is returning the money that the principal originally loaned to the business.

If the shareholder repayment loan represents payment to the principal for productive labour provided to the company, those amounts are properly included in the principal's average earnings. This is an evidentiary issue based on the facts of each individual case. The following factors should be considered:

- The principal has a clearly established pattern of receiving income from the employer of a certain amount (e.g., \$5,000 per month). Subsequently, the income paid by the employer is reduced (e.g., \$3,000). The principal begins receiving shareholder loan repayments from the employer (e.g., the employer repays the principal \$2,000 each month to pay down the shareholder loan). If the pattern of income paid to the principal changes because the repayment of shareholder loans supplements or replaces the reduction in "earned income," there is evidence to support that the loan repayment should be included in

average earnings.

- If the pattern of shareholder loan repayments is sporadic, or was taken for reasons other than to provide the principal with income, it may be harder to show that the shareholder repayment loan should be included in average earnings. For example, if the shareholder repayment loans appear to be taken on an "as needed" basis, and does not establish a pattern of reliance on those payments as earned income, or if they are taken to finance a personal purchase (taking a vacation), they may not be eligible for inclusion in average earnings.
- In some cases, the principal may have been advised by an accountant, tax lawyer or other financial advisor to instigate a change in business practices for income tax reporting purposes. If the principal was advised to structure "earned income" as a shareholder repayment loan rather than as T4 income to confer a tax advantage, it may explain a shift in payment received by the principal from income to shareholder repayment loans. If the principal restructured payments from the employer as shareholder repayment loans on advice from a financial professional, but the evidence supports that the principal intended to rely on those shareholder loan repayments either to top up or replace earned income, they would likely be included in average earnings.

CROSS REFERENCES:

PD #C9-8, *Employment Insurance Payments*
PD #C9-10, *Workers Deducting Business and/or Equipment Expenses*

HISTORY:

This is a new practice item. On February 4, 2008, minor amendments were made to further clarify practice with respect to vacation pay, overtime pay, and bonuses.

APPLICATION:

This item is intended to clarify existing corporate practice.