

COMPENSATION PRACTICE & QUALITY DEPARTMENT

PRACTICE DIRECTIVE # C9-3

TOPIC: Net System of Compensation
ISSUE DATE: June 30, 2002
(Amended May 8, 2009)

BACKGROUND

On June 30, 2002, section 33 of the *Workers Compensation Act* (the “Act”), relating to the calculation of average earnings, was amended by Bill 49, the *Workers Compensation Amendment Act, 2002*. As a result, the Panel of Administrators approved amendments to the Board's policies concerning average earnings.

PURPOSE

This practice directive provides an overview of the legislative and policy changes relating to the calculation of average net earnings. This practice directive does not provide guidance for determining a worker's gross average earnings. Please see Practice Directive #C9-4, *Initial and Long-Term Average Earnings* and Practice Directive #C9-12, *Long-Term Average Earnings: Section 33.4 – Exception Circumstances*.

In the past, a compensation factor of 75% was applied to a worker's gross average earnings, subject to the statutory minimum and maximum, to produce a “net” wage loss amount. This “net” figure was the amount that the worker received from the Board. In this context “net” referred to the final amount payable after the 75% compensation factor had been applied.

The term “net” now has a new meaning. It refers to average net earnings after probable allowable deductions for federal and provincial income taxes, Employment Insurance (“EI”) deductions and Canada Pension Plan (“CPP”) contributions are deducted from a worker's gross average earnings. These are collectively known as “allowable deductions”. This means that, subject to minimum and maximum rules, a worker's gross average earnings¹ must be converted to average net earnings. As well, a compensation rate of 90% is applied to the average net earnings².

There are two methods for calculating average net earnings:

1. A Compensation Table is used for the first 10 cumulative weeks of temporary disability benefits, or until the effective date of a permanent disability award.
2. After 10 cumulative weeks of temporary disability benefits, or the effective date of a permanent disability award, a more individualized approach is taken.

Each of these methods will be described in detail in this directive.

¹ gross average earnings were defined under the prior legislation as “Average Earnings”.

² net average earnings are now defined under the new legislation as “Average Net Earnings”.

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EFFECTIVE DATES AND TRANSITION RULES

Please see Practice Directive #C1-1, *Effective Dates and Transition Rules* and Practice Directive #C14-3, *Reopenings*.

LAW

Sections 33.8, 33.9 and 33.91 of the *Act* establish a worker's average net earnings by deducting the following items from the worker's average earnings:

- (a) Probable EI premiums payable;
- (b) Probable CPP contributions payable; and
- (c) Probable federal and provincial income taxes.

The method for determining these, as they relate to both short-term and long-term claims, is detailed below.

POLICY

Chapter 9 of the *Rehabilitation Services and Claims Manual* (the "RSCM") Vol. II, provides guidance with respect to determining average net earnings.

ADJUDICATIVE GUIDELINES/INSTRUCTIONS

1. INITIAL PAYMENT PERIOD (first 10 cumulative weeks of temporary disability benefits)

For the first 10 cumulative weeks of temporary disability benefits, or until the effective date of a permanent disability award, a Compensation Table will be used for the purpose of calculating a worker's probable allowable deductions.

Effective January 1 of every year, the Board implements the Compensation Table, which is based on the prior year's rates for income tax, EI and CPP. The Compensation Table provides standard deductions for each \$100 increment of gross annualized earnings on \$100 rounded increments, up to the statutory maximum. The following outlines how the allowable deductions are calculated:

(a) EI and CPP

In determining the EI and CPP payable, the Board considers the EI deductions and CPP premiums that are required by law to be deducted from most workers' earnings, up to the statutory annual maximum. The Board does not take into consideration the fact that a worker might have fully contributed the maximum allowable EI or CPP. Also, as noted in section 33.8(4) of the *Act*, "*premiums and contributions ...are deemed to be payable by all workers*". Therefore, for the purposes of the initial rate, the personal circumstances of a worker are not taken into consideration – e.g., if a worker was exempt from paying either CPP or EI, this would not be considered.

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(b) Federal and Provincial Income Taxes

As outlined in section 33.8(5) of the *Act*, in determining the probable federal and provincial income tax, the Board only applies the following tax credits under the *Income Tax Act* and the *Income Tax Act (Canada)*:

- (1) tax credits based on basic personal amounts multiplied by a factor of 1.5; and
- (2) credits for the probable CPP contributions and EI premiums payable for the worker's average earnings.

For the purposes of an initial wage rate, the legislation does not take into account a worker's actual tax status.

In the short-term, therefore, workers with the same gross average earnings, subject to minimum and maximum, will have the same deductions for income taxes, EI and CPP.

The Compensation Table provides allowable deductions for each \$100 increment of gross annualized earnings by the Wage Rate Officer (WRO) using the Short-Term Average Earnings Decision Worksheet (ST AED Worksheet). Therefore, a worker's gross earnings must be converted into annual earnings. For example, if the worker earns \$3,000 gross per month, his or her "gross annualized earnings" would be \$36,000. Once the gross annualized amount is calculated by the ST AED Worksheet, the allowable deductions and the 90% compensation factor are automatically applied by Claims Management Solutions (CMS).

2. LONG-TERM WAGE RATE (after 10 cumulative weeks of temporary disability benefits)

After 10 cumulative weeks of temporary disability benefits, or the effective date of a permanent disability award, the long-term wage rate should be established. Please see Practice Directive #C9-4, *Initial and Long-Term Average Earnings* and Practice Directive #C9-12, *Long-Term Average Earnings: Section 33.4 – Exceptional Circumstances*, which provide guidance concerning rate reviews and the calculation of gross average earnings for long-term claims. In these cases, the gross average earnings must also be converted to average net earnings.

(a) EI and CPP

In setting the long-term wage rate, it is important to note that sections 33.9(1)(a) and (b) state: "...if premiums [contributors] are payable...". Therefore, workers exempt from, or ineligible for, EI or CPP would not have these amounts deducted. Where deductions are applicable, they will be calculated in accordance with the process outlined below.

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(b) Federal and Provincial Income Taxes

For the purposes of establishing a long-term wage rate, certain individual aspects of a worker's tax situation are considered. As outlined in section 33.9(4) of the *Act*, in determining the probable federal and provincial income tax payable, the Board considers the following:

- (a) tax credits based on basic personal amounts;
- (b) credits for the probable CPP contributions and EI premiums payable for the worker's average earnings;
- (c) spousal credit/wholly dependent person credit; and
- (d) infirm dependant credit.

The Board will not deduct probable taxes where the worker is not required to pay income tax. The above deductions are collectively referred to as "individualized" allowable deductions. However, they do not completely take into consideration the worker's actual tax status. As noted in section 33.8(5)(b), no other income deductions, which the worker might have declared for tax purposes, may be considered for the purposes of the establishing long-term average net earnings. Also, when using income tax credits for dependants, it is assumed that the dependants have no income, therefore, the full credit is allowed.

(c) Individualized Net Wage Rate

- WROs should use the Long-Term Average Earnings Decision Worksheet (LT AED Worksheet) to calculate a worker's long-term average gross earnings.

CMS will provide a net daily and a net weekly compensation amount (which will be equivalent to a net long-term wage rate). This amount includes the 90% compensation factor.

The Wage Rate Calculator is also used for the purposes of calculating individualized net (long-term) section 30 payments. Please see Practice Directive #C9-6, *Section 30 Benefits*. Also, the Wage Rate Calculator can accommodate situations where pension awards must be deducted from wage rates, where applicable.

3. APPLICABLE TO BOTH INITIAL AND LONG-TERM WAGE RATES

(a) Maximum Earnings

Gross average earnings continue to be subject to the statutory maximum, in accordance with section 31 of the *Act*. Therefore, if a worker's gross average earnings exceed the maximum, the maximum will be used for the purposes of calculating the average net earnings.

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(b) Minimum Earnings

Section 29(2) of the *Act* provides that, where a worker's gross average earnings fall below the statutory minimum, the worker is entitled to 100% of his or her average earnings. With respect to minimum, there is no provision in the legislation to convert the gross average earnings to average net earnings. In effect, a worker would receive 100% of his or her gross average earnings.

(c) Earnings Between 100% Minimum and Below Maximum

Workers whose gross average earnings are at or below the statutory maximum, and 90% of their average net earnings are above the statutory minimum, are entitled to 90% of their net average earnings.

(d) Earnings Slightly above Statutory Minimum

Historically, the Board has adjusted a wage rate where gross earnings were above the statutory minimum, but 75% of those gross average earnings fell below the statutory minimum. This was previously known as "falling between net minimum and gross minimum". CMS will make these adjustments. The rule, therefore is: **where a worker's gross average earnings are above statutory minimum, but 90% of the average net earnings fall below statutory minimum, the worker will receive the statutory minimum.**

This concept is demonstrated below:

Worker A has gross average earnings of \$15,600 that fall slightly below the present minimum of \$15,870. In accordance with the *Act*, the worker is entitled to 100% of those earnings – i.e., \$15,600.

Worker B has gross average earnings of \$16,000 that are above the minimum. Therefore, the worker's earnings must be converted to net and a 90% compensation factor must also be applied. In this case, using the Compensation Table, the result would be that the worker would be entitled to approximately \$12,845. The inequity is that worker B, who earns more than worker A, would receive less compensation. To alleviate the inequity between these two workers the following rule would be applied: **where a worker's gross average earnings are above statutory minimum, but 90% of the average net earnings fall below statutory minimum, the worker will receive the statutory minimum – i.e.,** worker B. would get \$15,870.

(e) Earnings Slightly above 100% Minimum - Individualized Net

After 10 cumulative weeks of temporary disability benefits, or the effective date of a permanent disability, the long-term wage rate would be set. Where a worker's gross average earnings are less than the statutory minimum, those earnings would not be subject to net. Statutory minimum applies to a worker's gross average earnings, so that

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the worker would receive compensation in an amount equal to the worker's average earnings. However, as discussed above, for those workers whose deductions place them slightly above the statutory minimum, some inequity may apply. This inequity is somewhat compounded in an individualized net system.

In the previous examples, the two workers had very similar gross average earnings. However, if they had different individualized allowable deductions, their respective net average earnings figure would be significantly different. For example:

Worker A has gross average earnings of \$15,600 that fall slightly below the present minimum of \$15,870. In accordance with the Act, the worker is entitled to 100% of those earnings – i.e., \$15,600. The worker's earnings are not converted to net, regardless of his or her tax situation.

Worker B has gross average earnings of \$16,000 that are slightly above the minimum; therefore the worker's earnings must be converted to net (and a 90% compensation factor must also be applied). In the case of "individualized allowable deductions", worker B might have no dependants and would therefore only receive the basic personal amounts as tax credits (compared to a worker who has dependants). The result might be that worker B would only receive \$10,000 in compensation. As noted in the previous example, worker B, who earns more than worker A, would receive less compensation. To alleviate the inequity between these two workers the same rule would be applied: **where a worker's gross average earnings are above statutory minimum, but 90% of the average net earnings fall below statutory minimum, the worker will receive the statutory minimum** – i.e., worker B. would get \$15,870.

4. REQUESTING INFORMATION

Information regarding the worker's income tax status should be requested after a worker is disabled for 5 weeks. In accordance with section 57.1 of the *Act* and RSCM Policy item #71.30, *Insufficient Information*, the worker has an obligation to provide this information. If the Board has insufficient income tax information for the purposes of establishing long-term average net earnings, the WRO will assume that only the basic personal income tax credits apply. Please see Practice Directive #C12-4, *Obligation to Provide Information*.

5. COMPLEX RATE SETTING

In order to expedite the calculation of complex earning cases, the Division has established a wage rate setting unit. Please see business process document entitled "*Long-term Rate Setting Unit – Interim Processes*".