EMPLOYMENT STANDARDS FACT SHEET

INCENTIVE-BASED PAY AND MINIMUM COMPENSATION ENTITLEMENT

Who does this Fact Sheet apply to?

This Fact Sheet applies primarily to employees who are paid in whole or part by incentive-based pay and who are subject to the *Employment Standards Code's* (*Code*) provisions regarding recording of hours of work, and payment of overtime, vacation pay and general (statutory) holiday pay.

What is the purpose of this Fact Sheet?

This Fact Sheet explains the process used to determine if earnings paid to employees under an incentive-based pay plan have met the minimum requirements under the *Code* for the payment of wages, overtime and general holiday pay.

What is incentive-based pay?

For the purpose of applying minimum standards under the *Code*, compensation or pay arrangements can be categorized as one of the following:

- Pay that can be calculated as an hourly rate; or
- Incentive-based pay

Pay that can be calculated as an hourly rate

This is the most common form of pay arrangement. It is expressed either as an hourly rate or in the form of a fixed rate that is based on a daily, weekly, bi-weekly, semi-monthly or monthly pay period. Where the employee is required to work a predetermined number of hours in the pay period to earn the fixed rate, an hourly rate can be calculated. The minimum employment standards provisions in the *Code* are designed primarily to address these pay arrangements.

Incentive-based pay

If the pay arrangement cannot be expressed as an hourly rate, Employment Standards will consider the pay arrangement to be incentive-based. The characteristic that typically defines this type of pay plan is that the employee is paid for a quantity of output rather than for a fixed unit of time (i.e. hour, day etc.). To determine if the minimum wage, overtime and general (statutory) holiday pay requirements of the *Code* have been complied with under an incentive-based pay plan, a minimum compensation entitlement is calculated and compared to the incentive pay earnings. The details of this process are outlined in the next section, *Minimum Compensation Entitlement*.

Examples of incentive-based pay arrangements include the following:

- Commission on sales (e.g. 4% of sales or 25% of gross profit).
- Piecework (e.g. $10 per square yard for carpet installation).
- Percentage of revenue (e.g. 10% of revenue earned by a truck).
- Rate based on distance travelled (e.g. 15 cents per kilometre).
- Flat rate per trip or route (e.g. $100 per return trip between Edmonton and Calgary).
- Flat rate per load (e.g. $35 per load of gravel from quarry delivered to construction site in Leduc).
- Flat or book rate (e.g. 3 hours pay at $25 per hour for doing a carburetor job).
- Set rate for a defined task (e.g. $150 per day for picking up garbage on a defined route).

Note: The onus is on the employer to ensure that affected employees are clearly informed and have a full understanding of all aspects of the pay plan.

Determining whether the compensation can be expressed as an hourly rate

It is increasingly common to find situations where the employer and employee agree to a pay arrangement whereby the employee is paid a fixed amount but the hours to be worked are not known in advance. This happens most frequently where pay is based on day rates but can also occur in other pay arrangements.

Where there is uncertainty about whether the pay arrangement is incentive-based, Employment Standards will consider a number of factors to make the determination. A key factor will be whether the employee is expected to work a fixed or variable number of hours in order to earn the fixed amount. If a fixed number of hours can be determined, the hourly rate can then be calculated.

Other factors that will be considered include:

- employer's pay records for the employee,
- employer's pay records for other employees doing similar work,
- normal hours of operation of the business,
- hours of work typical in the industry,
- industry overtime provisions in the *Employment Standards Regulation*, and
- any other relevant information gathered from the employer, employees or other sources.

If an hourly rate cannot be determined, Employment Standards will consider the pay arrangement to be incentive-based.

Minimum Compensation Entitlement (MCE)

To calculate whether an employee's earnings meet the minimum employment standards requirements in a pay period, the employee's actual earnings are compared to the employee's minimum compensation entitlement (MCE).

The MCE is the sum of:

- regular hours of work multiplied by the employee's hourly wage rate (as determined below), plus
- overtime hours worked multiplied by 1.5 times the employee's hourly wage rate, plus
- hours worked (if any) on a general holiday multiplied by 1.5 times the employee's hourly wage rate.

Note: The average daily wage for a general holiday, vacation pay and termination pay are not included in the MCE calculation.

The hourly rate to be used when calculating the MCE

Some pay plans are entirely incentive-based, while others pay a combination of salary or hourly pay plus an incentive component. To determine if an employee's earnings meets the *Code*'s minimum requirements for incentive-based pay, it is necessary to first determine the hourly wage rate that will be applied. This rate cannot be less than the minimum wage, but may be higher. In making this determination the following principles are to be applied:

- When an employee's compensation is entirely incentive-based (i.e. straight commission), the wage rate to be applied is the minimum wage.
- When an employee's compensation is a combination of salary and incentive-based pay, the salary must be converted into an hourly wage rate. Where the hourly rate is greater than the minimum wage, the wage rate to be applied is the hourly wage rate. Where the hourly rate is less than the minimum wage, the wage rate to be applied is the minimum wage. If the salary component of the earnings cannot be expressed as an hourly rate using the process outlined in the previous section, the minimum wage will be applied.
- When an employee's compensation is a combination of an hourly wage rate and incentive-based pay, and the hourly rate is greater than the minimum wage, the wage rate to be applied is the hourly wage rate. Where the hourly rate is less than the minimum wage, the wage rate to be applied is the minimum wage.

Overtime and the MCE

For each week, hours worked in excess of eight in a day must be calculated, and any hours worked in excess of 44 in a week must be calculated. The greater of these two amounts are overtime hours for that week and payable at 1.5 times the hourly rate (as determined above).

In industries where different overtime hours have been set by the *Employment Standards Regulation*, those hours will apply. Special rules apply to the Oilwell Servicing Industry. For further information refer to Fact Sheet #13 on Oilwell Servicing.

Agreements to bank overtime are not appropriate for incentive-based pay plans.

Calculating earnings in a pay period for incentive-based pay

An employee is entitled to the MCE (total of wages, overtime and general holiday pay for hours worked on a general holiday) or the actual incentive-based earnings in the pay period whichever is greater, **plus** the average daily wage for a general holiday for eligible employees.

"Average daily wage" is defined in the *Code* as the employee's daily wage averaged over the days worked during the nine weeks preceding the week of the general holiday.

Example A:
An employee is paid straight commission and normally works eight hours per day. In this monthly pay period there are 21 working days and a general holiday that falls on a normal day of work for the employee. In the nine weeks prior to the week of the general holiday, the employee worked 45 days and received commission of $5,625. During the month, the employee earns $1,450.00 in commission, and worked no overtime. On the general holiday the employee works eight hours.

The MCE calculation for the pay period is done as follows:

Regular hours (21 x 8 x $7.00)....................$1176.00
Overtime hours...0.00
Hours worked on the general holiday
8 (hours worked) x $10.50 (1.5 x min. wage).....84.00
Minimum Compensation Entitlement..........$1,260.00

Total commission earned in pay period.......$1,450.00

The employee is entitled to the greater of the MCE or total commission earned, **plus** the average daily wage (a regular day's wages for the general holiday) as calculated below:

$$\text{Average daily wage} = \frac{\text{Wages in previous 9 weeks}}{\text{Number of days worked}}$$

$$= \frac{\$5625}{45} = \$125.00$$

In this pay period the employee has earned $1,575 ($1,450 in commission plus an average daily wage of $125).

Example B:
An employee is paid straight commission and normally works 44 hours per week. The employer has established a bi-weekly pay period. In the current pay period the employee works 22 hours of overtime and earns $795.00 in commission. There is no general holiday in the pay period.

Because the employee's compensation is entirely incentive-based, there is no fixed hourly wage rate. Therefore, the minimum wage will be used to determine the MCE for the employee:

Regular hours (44x2 x $7.00)........................$ 616.00
Overtime hours (22 x $10.50) 231.00
Minimum Compensation Entitlement ....$ 847.00

Total commission earned in pay period.........$ 795.00

The employee is entitled to the greater of the MCE or total commission earned. In this example the employee has earned $847.00.

Vacation pay and incentive-based pay

Incentive-based earnings are wages for the purposes of calculating vacation pay. Vacation pay entitlements for employees paid in whole or in part by incentive-based pay are calculated in the same manner as for other eligible employees. Refer to Fact Sheet #6, *Vacations and Vacation Pay*, for more information.

Vacation pay is calculated on:

- The total commission earned, if the commission earned in a pay period exceed the regular hours portion of the MCE; or
- The regular hours portion of the MCE, if the commission earned is less than the regular hours portion of the MCE (as in Example B above).

Record keeping

When employees are paid either wholly or partly on an incentive-based pay plan, employers must maintain daily records of all regular and overtime hours worked. The only exception applies to employees and their employers who are exempted from this obligation by section 2 of the *Employment Standards Regulation*.

This document is for general information. For the purposes of interpretation and application of the law, the *Employment Standards Code* and the *Employment Standards Regulation* should be consulted.