

5 Termination Payment Calculation Traps to Avoid



Terminating employees is an experience nobody relishes. One of the worst parts about it is calculating the different termination payments the employee may receive. To get it right, you need to negotiate a set of complex legal requirements. Here's an overview of the laws and how to avoid 5 common mistakes that can cause violations and overpayments.

What the Law Says

There are legal requirements that employers must be aware of when processing termination payments. While specifics vary, the laws of each province follow the same basic pattern:

Notice Period: Employees who have worked for the same employer for at least a stated period—typically 3 months—are entitled to minimum notice of termination. The longer employees work for the employer, the more notice they get. Generally, employees get one week's notice for each year of service, but rules vary. Thus, an employee with 5 years' service would get 6 weeks' notice in SK but only 2 weeks in NL.

Wages in Lieu of Notice: Employers don't necessarily have to let the terminated employee actually stay on the job during the notice period. In most cases, the employer buys out the employee by paying wages instead of, or in lieu of notice. In some provinces—such as AB, BC, MB and ON—notice/wages in lieu of aren't an *either, or* proposition. Employers can split the notice period between work and wages in lieu. For example, a worker entitled to 6 weeks' notice can be allowed to work 4 weeks and receive wages in lieu for 2 weeks.

Other Termination Payments

Employment standards notice is a minimum. Employers often grant more generous severance packages under the terms of the contract, collective agreement or termination settlement agreement they negotiate with the employer. Such payments may include:

Severance: Certain employees are entitled to severance under Fed and ON employment standards laws. Of course, employees in other jurisdictions might also be due severance under their contract or termination settlement.

Overtime and Vacation Pay: All jurisdictions require employers to reimburse employees for overtime and vacation previously earned but not yet paid. These additional payments are typically due immediately upon or shortly after termination.

Sick Pay: Employees may be entitled to unused sick time.

Retiring Allowances: Although it's not required by law, employers often choose to make additional payments as a retiring allowance to compensate the employee for loss of employment and/or as recognition for past service.

How to Comply

Once you understand the terms of the severance package, you need to apply the rules and contract/settlement terms to properly calculate each form of termination payment. This is where things can get dicey. Although each situation is different, there are some common patterns you're likely to encounter when calculating termination payments. Here are 5 mistakes that HR commonly makes and how to avoid making them yourself:

1. Miscalculating Wages in Lieu for Employees with Irregular Work Weeks

Calculating wages in lieu of notice is straightforward when the employee works a regular workweek: You pay the amount the employee would have received if notice hadn't been given. This generally includes overtime, vacation and other types of pay the employee is entitled to under the law, contract and settlement. So, if an employee would otherwise have worked overtime during the notice period, e.g., where the employee is senior and overtime is assigned on the basis of seniority, wages in lieu of notice must include what would otherwise have been paid.

But calculating wages in lieu of notice for employees with *irregular* workweeks is different. In most jurisdictions, including Fed, AB, BC, MB, ON and SK, wages in lieu of notice for such employees are based on an average of wages earned over a set time period. And certain types of pay, such as overtime, sick, holiday and vacation pay, are often taken out of the equation. Failing to follow this rule will result in overpayments.

Example: An ON secretary fired after 4½ years of service is entitled to four weeks' notice under the ESA. She makes \$20 per hour, but doesn't work the same number of hours each week. To calculate her wages in lieu of notice, the company must average her pay over the last 12 weeks. Suppose the company is unaware of this and bases her payment on actual earnings over the last 12 weeks rather than an average. Here's what would happen (**NOTE:** In ON, overtime is due after 44 hours in a week):

Previous Service	Hours	Actual Earnings	Earnings employer should have used
Week 1	44 regular4 overtime	\$ 880\$ 120	\$ 880*
Week 2	36 regular8 sick	\$ 720\$ 160	\$ 720*\$160
Week 3	40	\$ 800	\$ 800
Week 4	40	\$ 800	\$ 800

Week 5	32 regular8 public holiday	\$ 640\$ 160	\$ 640*
Week 6	44	\$ 880	\$ 880
Week 7	40	\$ 800	\$ 800
Week 8	40 vacation	\$ 800	\$ 0*
Week 9	40 vacation	\$ 800	\$ 0*
Week 10	32 regular8 public holiday	\$ 640\$ 160	\$ 640*
Week 11	44 regular4 overtime	\$ 880\$ 120	\$ 880*
Week 12	24 regular16 sick	\$ 480\$ 320	\$ 480*\$320
TOTAL		\$10,160	\$ 8,000
AVERAGE (Total ÷ 12)		\$ 847/week	\$667/week

* Overtime, public holiday and vacation time not included in the calculation, but sick pay is.

Amount employer paid secretary: \$3,388 (\$847/week x 4 weeks)

Amount employer should have paid: \$2,668 (\$667/week x 4 weeks)

Overpayment: \$ 720

2. Confusing Wages In Lieu of Notice and Statutory Severance

Under Fed and ON law where severance is required, it's *in addition to* and not a substitute for wages in lieu of notice. In other words, employees are entitled to both. One of the common mistakes that employers make is thinking that statutory severance replaces wages in lieu of notice. It doesn't.

Example: An Ontario University fires a computer programmer after 10 years of service. The University realizes it doesn't have just cause so it offers to pay the programmer wages in lieu. Assuming the programmer is caught up on holiday and vacation pay, the minimum amounts the University must pay him under the ESA are:

- 8 weeks' wages in lieu of notice; plus
- Any sick time, vacation pay or other benefits that would have otherwise accrued during the notice period; plus
- 10 weeks' statutory severance.

In other words, the University can't use the programmer's statutory severance to satisfy its obligation to pay 8 weeks' wages in lieu of notice.

3. Treating Retiring Allowances Like Wages In Lieu of Notice

A similar mistake is treating retiring allowances the same as wages in lieu of notice for purposes of source deductions and reporting. Different tax and deduction rules apply to retiring allowances. For example, wages in lieu of notice are subject to

income tax, EI and CPP deductions. Retiring allowances are also subject to income tax, but are taxed at a flat rate. And no CPP or EI deductions apply to retiring allowances, although the payments still must be reported on the employee's Record of Employment (ROE). In any event, you need to keep the two payments separate. Keep in mind that:

- Minimum notice required under the ESA is considered wages in lieu of notice;
- Amounts above the minimum are considered retiring allowances; and
- Additional severance under Fed and ON law is also a retiring allowance.

Example: An ON employee who earns \$1,000 per week is terminated without cause. Under the ESA, he's entitled to 2 weeks' notice and 2 weeks' severance. But the employer gives him 10 weeks' notice. Assume that there's no vacation owing before termination and that the employee accrues vacation at 4%. The sides agree to a lump sum payment of \$10,000. Of the \$10,000 the employee receives:

- \$2,000 is wages in lieu of notice;
- \$2,000 is statutory severance;
- \$160 is vacation pay; and
- \$5,840, the balance, is a retiring allowance.

4. Omitting Pay for Statutory Holidays after Termination

Employees are entitled to pay for certain statutory holidays during the year. Because of the way the laws are written, in certain situations, an employee might also qualify for pay for holidays that occur after she's terminated.

5. Not Continuing Benefits Deductions during Notice Period

Another source of confusion stems from the fact that most employment standards laws require employers to keep offering particular types of benefits, such as pensions and healthcare, to terminated employees until the notice period expires, even if the employee has actually stopped working. And, because benefits coverage continues through the notice period, so do deductions for premiums and contributions.

Example: A law firm fires a junior associate and escorts him to the door the same day the associate speaks his mind to the managing partner. The managing partner orders payroll to pay only the minimum amount of wages due in lieu of notice and to stop all benefits immediately. The payroll department can't comply: It must continue benefits such as healthcare and pension contributions through the entire notice period, regardless of the fact that the associate no longer works there.