How to Calculate Vacation Pay

written by Rory Lodge | July 19, 2019

Accurate calculation of vacation pay is a tough challenge. Its complexity stems partly from variations in pay arrangements and partly from differences in provincial employment standards laws. Here's what you need to know to get the calculation right regardless of the payment situation or particular employment standards law that applies.

Vacation Pay, 101

The employment standards laws of each jurisdiction give employees the right to take vacation with pay under specific circumstances. Basic rule: **Vacation pay** is calculated as a fixed percentage of **vacationable earnings** paid during the **vacation entitlement year**. To apply this rule you need to understand these basic definitions:

- **"Vacation":** Means actual time away from work, also referred to as "annual vacation," "paid vacation" or "vacation leave;"
- **"Vacation pay":**Means the pay owed to employees resulting from their right to vacations;
- **"Vacation entitlement years":** Means the 12-month periods employees typically have to work to earn the right to each successive vacation; and,
- **"Vacationable earnings":** Means the earnings on which vacation pay is based.

Typically, vacation pay is a percentage of vacationable earnings in which the percentage is based on the length of employment or the related length of the annual vacation. For example, if an employer grants 3 weeks of vacation to employees upon completing 3 vacation entitlement years, vacationable earnings are paid at 6%, which would be termed the "vacation percentage."

The 2 Key Vacation Pay Calculation Factors

To get vacation pay calculations right, you need to account for the fact that employers can use several different methods to make vacation payment, **and** that the definition of vacation entitlement years varies.

Factor 1: Method of Vacation Pay

There are at least 4 methods an employer can use to make payments of vacation pay required by employment standards laws:

Method 1: Paying Vacation Pay on Each Paycheque

This method is the easiest to implement. All it requires is calculation and payment of vacation pay in each pay period. There's no need for accrual or tracking of vacation time or dollars other than what must be shown as the current vacation pay on employee direct deposit statements or payroll cheques.

Legal Restrictions: Unfortunately, this method isn't allowed in all jurisdictions and circumstances. The provinces whose employment standards laws allow for paying vacation pay on each paycheque include:

- BC and ON: with the employee's agreement;
- AB, MB and NB: at the employer's discretion; and,
- QC: if the method is provided for in a collective agreement or if employees are paid on a daily basis.

Method 2: Accruing Vacation Entitlements in Time

Under this method, employees accrue units of vacation time as they work. For example, at the start of each vacation entitlement year, the employer might simply credit employees with the vacation time they are due under their employment contract. Or, employees might accrue 1 vacation day per month to a maximum of 10 per year for an entitlement of 2 weeks annual vacation. Under such arrangements, vacationable earnings themselves aren't accrued; instead, employees are paid at the rate of pay current when any subsequent vacation time is taken.

Legal Restrictions: Employers are free to use this method as long as the current pay for any vacation time taken at least equals the applicable vacation pay required. (See the discussion under method 4 below.)

Method 3: Accruing Vacation Entitlements in Dollars

The most common method of paying vacation pay is to accrue dollars, not time. There are 2 ways you can do this. In the first, base vacationable earnings are accrued during each vacation entitlement year. After completion of each year, the vacation percentage is applied to the total vacationable earnings accrued in that year. The result is the vacation pay that must be paid for that vacation entitlement year.

Under the second and more common method, the vacation percentage is applied to each pay period's vacationable earnings and the resulting vacation pay is accrued during the entitlement year itself.

These different dollar accruals appear to be very similar. The key difference between them is the point in time when the vacation percentage is applied. In the first method, the percentage is applied at the completion of the vacation entitlement year; in the second method, it's applied *during* the year. This difference becomes significant when the employment standards vacation pay requirements change after the end of a vacation entitlement year.

Example: Ben, whose employment is subject to federal regulation under the *Canada Labour Code*, was hired on March 12, 2010. That's the date his employer uses to mark the start of each new vacation entitlement year. After March 11, 2015, Ben will have completed 5 years of continuous employment and thus be entitled to 3 weeks' vacation time for the March 12, 2014 to March 11, 2015 vacation entitlement year. His employer must pay his vacationable earnings for that year at a minimum of 6%. His total vacationable earnings for the vacation entitlement year: $45,135.87. At 6%, Ben must be paid at least $2,708.15 in vacation pay.

Lisa started the same day as Ben for the same employer and has the same vacationable earnings in the vacation entitlement year starting March 12, 2014. However, Lisa quits her job effective March 10, 2015. When she gets her final pay, Lisa's entitled to vacation pay only at 4%, since she hasn't completed 5 consecutive employment years with the employer. Lisa's employer accrues the vacation pay owing from each pay period, not the vacationable earnings themselves. In anticipation of paying Lisa vacation pay at 6%, the employer had been accruing her vacation pay on earnings paid on or after March 12, 2014, at 6%. To calculate Lisa's final pay, the employer manually re-adds her vacationable earnings since that date and manually calculates the vacation pay owing to her at 4%. On $45,135.87, at 4%, this is $1,805.43. This is the minimum amount that Lisa must be paid for vacation pay under federal employment standards.

Legal Restrictions: In 13 of 14 jurisdictions (Yukon is the lone exception), the percentage employers must use to calculate employees' vacation pay increases from 4% to 6% after employees complete a specified number of continuous vacation entitlement years:

- 3 years: QC;
- 5 years: Fed, AB, BC, MB and ON;
- 6 years: NT and NU;
- 8 years: NB, NS and PE;
- 10 years: SK; and
- 15 years: NL.

Effective Sept. 1, 2019, federally regulated employers must adjust the vacation pay calculation rate from 6% to 8% after an employee completes 10 continuous vacation entitlement years. In SK, the vacation percentage is given as weeks of vacation time over 52, and the base vacation time entitlement is 3 weeks, which rises to 4 weeks after completion of 10 vacation entitlement years. And in Yukon, the rate remains at 4% regardless of vacation entitlement years completed. Click here for the specific vacation pay entitlements of each province.

Example: Jake, whose employment is covered by SK employment standards, has worked without interruption for the same company since April 18, 2009. He's entitled to 4 weeks' vacation time for the vacation entitlement year ending April 17, 2019. For that vacation time, Jake must be paid 4 over 52 of his earnings in the vacation entitlement year ending on April 17, 2019. Assuming that these vacationable earnings were $37,956.21, his vacation pay would have to be at least 4 over 52 of these earnings, or $2,919.71. Note this is a lower number than would be calculated at 8%, since the fraction 8 over 100 is higher than 4 over 52, or its equivalent 8 over 104. At 8%, Jake would be entitled to vacation pay of $3,036.50 on the same vacationable earnings.

Method 4: Paying Regular Wages or Salary for Vacation Time Taken

Some employers use this method because it seems simple: Employees receive their regular wages or salary when on vacation, particularly when that vacation time is taken in less than whole work weeks. However, using this method may yield a vacation amount that doesn't comply with the vacation pay employees are entitled to under the law.

Example: Alley was hired by her BC employer on February 4, 2018, and under BC employment standards law is entitled to 2 weeks' annual vacation, payable at 4% of the vacationable earnings in the previous vacation entitlement year. To calculate vacation pay, her employer uses the anniversary of hire to mark the start of each employee's vacation entitlement year. In the 12 months ending February 3, 2019, Alley was paid the following vacationable earnings:

- Base salary, $53,500;
- Sales commissions: $26,245.13; and
- Vacation pay: $2,940.15.

Her vacationable earnings thus total $82,685.28. Alley took the 2 weeks from August 7, to August 20, 2018, as her vacation for the vacation entitlement year ending on February 3, 2018. During those 2 weeks, her employer continued Alley's then current bi-weekly base salary, $3,000. However, 4% of her vacationable earnings is $3,307.41. Result: Her employer didn't pay Alley all of the vacation pay to which she's entitled under BC employment standards law.

Legal Restrictions: As illustrated by Alley's example, vacation pay may be owed on vacation pay previously paid. This is the case in the following jurisdictions, where vacation pay is itself a vacationable earning: Fed, BC, AB, SK, QC, YT, NT and NU.

Factor 2. What's Considered to Be a Vacation Entitlement Year

Remember that vacation pay is based on the vacation entitlement year, i.e., the 12-month period in which employees earn the right to both vacation time and vacation pay. The second factor that adds to the complexity of calculating vacation pay calculations are the 3 potential definitions of vacation entitlement year:

Definition 1: January to December Calendar Year

The main advantage of using a January to December calendar year as the vacation entitlement year is that it enables you to fix the employee's entitlement to vacation pay in the next payroll year as of the last payroll in December. This makes life simple since the only payroll history values you must carry forward from one payroll year to another is the vacation time or pay entitlement from the payroll year just completed. You can even eliminate the need to carry this value forward by allowing employees to take vacation during the vacation entitlement years in which they earned those vacation rights.

Example: Company ABC uses a Jan. to Dec. vacation entitlement year and allows employees to take their vacation during the year in which they earned those vacation rights. ABC employee Laurie takes the 2 weeks of vacation she's entitled to under ON employment standards for her 2013 vacation entitlement year during the first 2 weeks of September 2014. Consequently, at year end, there are no vacation pay time or dollar values that ABC has to carry forward for Laurie from the 2013 to 2014 payroll years.

The disadvantage of using the calendar year option and allowing employees to take their vacations before the end of the vacation entitlement years in which these vacations are earned is the risk that employees will use take these vacations and receive vacation pay to which they may ultimately not be entitled. This could happen if an employee uses her annual vacation during the year and then leaves her job without giving sufficient notice before the end of December. In other words, in the example above, ABC would be out of luck if Laurie quit on October 1, 2014 after using her 2 weeks of 2014 vacation in September.

The other risk: Since vacation pay entitlements are based on wages paid during the vacation entitlement year, paying vacation pay in advance may result in failure to pay the full amount owed by year's end.

Example: When Laurie takes her vacation in Sept. 2014, ABC pays her in vacation pay the wages she'd have earned for her normal working hours, i.e., 37.5 hours per week at $17.25 per hour, or $1,293.75. But at year-end, Laurie's vacationable earnings for 2014 are $35,843, including overtime and production bonuses. Her entitlement to vacation pay for 2014 is 4% of these vacationable earnings, or $1,433.72.

The way to resolve this problem is to verify at year-end that sufficient vacation pay has been paid to each employee by comparing the dollars paid for any vacation time taken against the applicable vacation pay employment standards requirements. Thus, at year-end, ABC would have to pay Laurie the difference between this amount and the regular wages it paid to Laurie during her vacation, or $139.97, to ensure that she gets all the vacation pay to which she's entitled under the ON employment standards laws.

Legal Restrictions: Using a Jan. to Dec. vacation entitlement year is permitted only in the following jurisdictions:

- SK and QC: with the employee's consent; and,
- Fed, BC, AB, ON and NS: at the employer's discretion.

MB gives employers discretion to use a Jan. to Dec. vacation entitlement year but also lets employees appeal to the government employment standards board to make the employer base vacation entitlement years on the anniversary of each employee's date of hire.

Definition 2: Another 12-Month Period Fixed by the Employer (or Law)

Employers who are allowed to define the vacation entitlement year as the 12 months from Jan. to Dec. may also want to establish any other 12-month period as the vacation entitlement year. This option is common in industries where employees are required to take their vacations during an annual plant shutdown. Another reason to use a fixed 12-month period other than Jan. to Dec. is to align the vacation entitlement year with the employer's fiscal year for accounting purpose, which results in less accounting work at year-end.

Legal Restrictions: Two provinces require all employers to use a 12-month period fixed by the provincial employment standards as the vacation entitlement year:

- QC: May 1 to April 30 of the following year, unless agreed otherwise with employees; and,
- NB: July 1 to June 30 of the following year.

Using a 12-month period as the vacation entitlement year, whether by mandate or election, can significantly complicate the calculation of vacation time and pay entitlements since it requires employers to carry employee history across the payroll years used in T4 reporting. That can cause problems because payroll systems design is based on the assumption that employee payroll history is reset for each new payroll tax year. Not all payroll systems can manage the requirement to carry employee history across tax years for vacation pay purposes, at least not without sometimes significant manual efforts on the part of payroll staff.

Example: Carlos has worked for his employer for over 7 years and is entitled to 3 weeks' annual vacation under QC employment standards law. Since he hasn't given his consent to an employer defined vacation entitlement year, his company is required to use a May 1 to April 30 period. His vacationable earnings for the period May 1 to Dec. 31, 2018 are $21,634. He wracks up another $14,856 in vacationable earnings from Jan. 1 to April 30, 2019. Thus, Carlos's vacationable earnings total $36,490 for the vacation entitlement year ending April 30, 2019.

Definition 3: The Anniversary of the Hiring Date

The definition of vacation entitlement year isn't always the employer's choice. In PE, NL, YT, NT and NU, employers *must* base the vacation entitlement year on each employee's hire date. As noted above, employers in MB have the discretion to set a Jan. to Dec. vacation entitlement year *unless* employees can persuade the government employment standards authorities to order the employer to use the anniversary of hire date instead.

Basing vacation entitlements on the anniversary of employee hire dates complicates compliance with the due dates by which employees must start their vacations. <u>Explanation</u>: These due dates are based on the end of each vacation entitlement year. Similarly, the dates by which employees must be paid vacation pay are based on the start of vacation times. With vacation entitlement years defined as fixed 12-month periods, both of these due dates are common to all employees. If vacation entitlement years are specific to each employee, so are the due dates by which employees must take vacations and be paid any vacation pay owing. This means that any employer processes involved must be run more than once a year and potentially once for each specific employee due date.

Legal Restrictions: Each jurisdiction has different due dates by which vacations must start and vacation dollars paid after the end of each vacation entitlement year regardless of how the vacation entitlement year is defined. In some cases, employee vacations must also be complete by the due date.

Final Twist: Partial Vacation Pay Entitlement Year: The Stub Period

Defining the vacation entitlement period as from Jan. to Dec. or any other fixed 12-month period other than the anniversary of the hiring date results in the creation of partial vacation entitlement years. A partial vacation entitlement year that occurs at the beginning of a person's employment is termed the "stub period" for calculating vacation entitlement. Thus, for example, an employee hired on April 1 by a company that uses a common Jan. to Dec. year to determine vacation entitlement will have a stub period from April 1 to Dec. 31.

In this situation employers are required to prorate an employee's eligibility for vacation based on the length of the stub period as compared to a 12-month year according to the following rules:

- <u>Fed</u>: Months of employment, including the month of hire and any completed month of employment, over 12;
- <u>SK</u>: 1 ¼ x the number of full or partial months of employment, including the month of hire;
- <u>QC</u>: 1 vacation day per month (not defined) of employment to a total of 14 days away from work, including days that would ordinarily be non-working days such as weekends; and,
- <u>NB</u>: 1 vacation day per month worked during the stub period, to a maximum of 2 regular work weeks.

In BC, AB, MB and ON, there are no specific rules governing how eligibility is to be prorated. <u>Exception</u>: In ON, a specific calculation rule applies to employees who don't work the same number of days per week. For such employees, the length of an employee’s vacation is 2 x the average number of days worked per work week in the stub period x the ratio of months (not defined) in the stub period over 12.

Example: HIJ Company, an ON company that uses a Jan. to Dec. vacation entitlement year for all employees, includes the month of hire as a complete month to calculate the number of months in the stub period. HIJ hires Glenn on March 15, 2019 to work an irregular schedule varying from 3 to 6 days per week depending on the company’s needs. Over the 42 work weeks in his March 15 to Dec. 31, 2019 stub period, Glenn works a total of 198 days, or an average of 4.71 days per week. For the stub period, he’s entitled to 2 x 4.71 x 10 (the number of months from March to December, inclusive), or 7.85 vacation days. As a matter of policy, HIJ rounds this up to 8 vacation days.

***Insider* Says:** NS doesn’t require proration. Employees hired during the stub period are entitled to a full 2 weeks’ vacation, unless they waive this right. However, the vacation pay for any such NS employee who claims this right is still based on actual vacationable earnings during the stub period.