Paying Wages: A Payroll Manager’s Guide to the Wage Earner Protection Program

Bankruptcy laws aren’t generally the kind of thing payroll administrators care or need to know about. But the so-called Wage Earners Protection Program (WEPP) is the rare exception. Designed to ensure that employees don’t get stiffed on wages when their companies go bankrupt, the WEPP has potentially significant repercussions on payroll operations of not just bankrupt companies but solvent ones that haven’t yet and may never reach the point of bankruptcy. Here’s a look at what payroll managers need to know about the WEPP.

Employees Used to Get the Shaft in Bankruptcy

When a company files for bankruptcy, the claims of its creditors, i.e., persons to whom it owes money, are put on hold. Since the company doesn’t have enough assets to pay all of its debts, the creditors must fight it out amongst themselves. The pecking order: Creditors holding a secured interest generally ones get paid first. Any money left after the secured creditors are paid is used to pay the claims of unsecured creditors.

WEPP Changes the Ground Rules

A federal bill known as C-12, which took effect on July 7, 2008, did 2 things to remedy this situation:

1. **Gave Higher Priority to Unpaid Wage Claims**

C-12 (now Section 81.3 of the *Bankruptcy Act*) assigns “priority claim” status to employees’ claims against the bankrupt company for “wages, salaries, commissions or compensation” for services rendered in the past 6 months up to $2,000. Such claims are secured against the company’s current assets (cash, accounts receivable and inventory) and rank ahead of “normal” bank security, CPP and EI contributions and federal and provincial sales tax payments.

2. **Implemented WEPP**

C-12 also implemented the WEPP setting out a 2-step process for recovering unpaid wage claims during bankruptcy:

- First, employees of bankrupt companies collect their unpaid wages directly from the government; and
- The government takes over the employees’ claims against the bankrupt company and seeks to recover the money it paid to the employees from the company’s assets during the bankruptcy proceeding.

The Guaranteed Payment

The WEPP guarantees that employees of companies that go bankrupt (or become subject to receivership) receive unpaid “wages” of up to 4 weeks’ maximum insurable earnings under the *Employment Insurance Act*. The wages must be earned 6 months before bankruptcy. The definition of “wages” under Section 2(1) of the Act includes:

- Salary;
- Commissions;
- “Compensation for services rendered”; and
- Vacation pay.

The WEPP regulations (Sec. 2) also include the following as “wages”:

- Gratuities that employers account for;
- Disbursements of a travelling salesperson that have been “properly incurred”;
- Production bonuses; and
- Shift premiums.

Note that “wages” do <u>not</u> include severance or termination pay.

WEPP Procedure

Eligibility Criteria: To be eligible for payment, employees must have stopped working for the employer for at least 7 consecutive days. Employees don’t qualify if they’re officers, directors, managers (or owners of a controlling interest in the company or related to anybody who is).

Trustee Notification: The trustee or receiver must determine which employees are owed wages for services rendered in the past 6 months. It must notify these employees of their right to seek payment under WEPP and distribute copies of an application form for employees to fill out. Trustees and receivers must also furnish information, such as about the value of wages and vacations owed, to employees so they can complete the form. Employees must then apply for WEPP payment by submitting the application form to Service Canada within 56 days of the date the trustee or receiver is appointed.

Payment Process: Eligible employees receive unpaid wages and vacation, minus EI and CPP (but not income tax) source deductions. Employees pay income tax on WEPP payments later. Employees get a T4A slip in the mail that they must complete with their tax return for the year. Service Canada withholds income tax on WEPP payments.

Government Subrogation: When they get their money, employees must assign, or transfer, their legal claim for the unpaid wages to the government which can then pursue the claim in bankruptcy. The legal term for this process is “subrogation,” which basically means the government steps into the employee’s shoes for purposes of asserting their claims against the company.

Although it might sound like a technicality, the subrogation rule has an important practical effect. It means the company’s other creditors must slug it out with the government in the bankruptcy proceeding. And elbowing out claims for unpaid wages will be much tougher than it was before, especially since unpaid wages of up to $2,000 are assigned “priority claim” status under Sec. 81.3 of the Act. Moreover, under Section 36(1)(b) of WEPP, if payments are made to employees under the law and the bankrupt company doesn’t have enough assets to repay those claims, the government can recover the money from the company’s directors via subrogation.

Employees have the option of bypassing the WEPP process and asserting their claims directly against the employer in the bankruptcy proceeding. Priority claim status applies to unpaid wage claims (up to $2,000) whether they’re asserted directly by the employee or by the government via subrogation.

General Impact on Payroll

The WEPP didn’t change the way you process payroll. But the heightened risk of liability for unpaid wages in the event of bankruptcy might cause upper management, to look over your shoulder and ask pointed questions about how you make CPP, EI and sales tax deductions and remittances. There are 2 reasons for this:

Pressure from Lenders: The assignment of priority status to wage claims in bankruptcy means that banks have to worry about competition from employees (or the government via subrogation). As a result, many financial institutions demand more detailed payroll records so they can get a precise fix of the company’s payroll liabilities before lending money to borrowers. And, of course, it ultimately falls to payroll managers to ensure that company officials come up with the payroll records that lenders demand.

Personal Liability of Directors: If the bankrupt company doesn’t have enough assets to pay the government’s unpaid wage claims, the government can seek to hold the company’s directors personally liable for the money. Directors can also be held personally liable for a company’s unpaid wages under provincial employment standards law, even if the company goes bankrupt. This heightened risk of personal liability gives directors a greater incentive to review payroll procedures and outstanding liabilities.