Employment Standards
Rights and responsibilities at work

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Incentive-Based Pay Plans and Minimum Compensation Entitlement

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This Fact Sheet applies to employees who are paid in whole or in part by incentive-based pay and who are subject to the *Employment Standards Code's* (Code) provisions regarding recording of hours of work, payment of overtime, vacation pay and general (statutory) holiday pay. Some employees are not paid an hourly, weekly or monthly wage.

It is important to determine whether an employee who receives incentive-based pay is receiving at least the minimum compensation entitlement as set out in the employment standards legislation.

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 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,

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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 per cent of sales or 25 per cent of gross profit).
- Piecework (e.g. $10 per square metre for carpet installation).
- Percentage of revenue (e.g. 10 per cent 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. three hours pay at $25 per hour for doing a brake job).
- Set rate for a defined task (e.g. $150 per day for picking up garbage on a defined route).

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

There are 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.

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

Minimum compensation entitlement

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.

Determining whether an employee is receiving at least the minimum wage

To determine whether an employee who receives a commission is receiving at least the minimum wage, follow these steps:

Step 1: Total the employee's wages earned during the pay period.

Step 2: Total the employee's work hours during the pay period.

Step 3: Divide the total in Step 1 by the total in Step 2.

- If the result is more than the minimum wage ($13.60 per hour) then the employee is entitled to the wages in Step 1.
- If the result is less than the minimum wage ($13.60 per hour) then the employer must pay the employee more than the wages in Step 1.

Example

Ming is employed to install carpets. Ming gets paid each week and receives $10 per square metre of carpet that he installs. During one week, Ming installed 39 square metres of carpet. During that week, Ming worked 7 hours on Monday, 6 hours on Tuesday, 6 hours on Wednesday, 7 hours on Thursday, 5 hours on Friday and 7 hours on Saturday. Sunday was Ming's day off.

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Step 1: Total Ming's wages during the one week pay-period.

- $10 per square metre x 39 square metres = $390 earned.

Step 2: Total Ming's work hours during the 1 week pay-period.

- 7 + 6 + 6 + 7 + 5 + 7 = 38

Step 3: Divide $390 by 38.

- $390 / 38 = $10.26
- Based on this, we now know that Ming received less than the minimum wage for that week of work because $10.26 is less than $13.60.

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 meet 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 applied:

- When an employee's compensation is entirely incentive-based (i.e. straight commission), the applicable wage rate is the minimum wage.
- When an employee's compensation is a combination of salary and incentive-based pay, the salary portion is to be converted into an hourly wage rate. Where the hourly rate is greater than the minimum wage, the applicable wage rate is the hourly wage rate. Where the hourly rate is less than the minimum wage, the applicable wage rate 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 applicable wage rate is the hourly wage rate. Where the hourly rate is less than the minimum wage, the applicable wage rate is the minimum wage.

Overtime and the MCE

For each week, hours worked in excess of 8 in a day must be calculated, and any hours worked in excess of 44 hours 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 Regulation, those hours will apply. Special rules apply to the Oilwell Servicing industry when an employee is paid a combination of salary and bonus. For further information, please see the "Oilwell Servicing" Fact Sheet at http://work.alberta.ca/esfactsheets.

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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 5% of an employee's wages, vacation pay and general holiday pay earned in the 4 weeks immediately preceding a general holiday.

Example A

An employee is paid straight commission and normally works 8 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 4 weeks prior to the week of the general holiday, the employee earned commission of $2,500. During the month, the employee earns $2,600 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 $13.60)....................$2,284.80

Overtime hours..0.00

Hours Worked on the General Holiday

8 (hours worked) x $20.40 (1.5 x $13.60).........$163.20

Minimum Compensation Entitlement............$2,448.00

Total commission earned in pay period.........$2,600.00

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:

Average daily wage = 5% of wages, vacation pay and general holiday pay earned in the 4 weeks immediately preceding a general holiday.

= 5% of 2,500 = $125.00

In this pay period, the employee has earned $2,725 ($2,600 in commission plus an average daily wage of $125).

Example B

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An employee is paid only by 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 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 (44 x 2 x $13.60)....................... $1196.80
Overtime hours (22 x $20.40)............................ $448.80
Minimum Compensation Entitlement................ $1,645.60
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 must be paid $1,645.60.

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. For more information, please see the "Vacations and Vacation Pay" Fact Sheet at http://work.alberta.ca/esfactsheets.

Vacation pay is calculated on:

- The total commission earned, if the commission earned in a pay period exceeds 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).

Recordkeeping

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 Regulation.

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