

Noteworthy Decision Summary

Decision: WCAT-2006-03798 **Panel:** Warren Hoole **Decision Date:** October 4, 2006

Policy item AP1-38-2, "Payroll – Categories" - Practice directive 1-38-2(A) "Shareholder Earnings – Assessment of Dividends" – Shareholders' dividends and assessable payroll

Policy item AP1-38-2 of the *Assessment Manual* authorizes the Workers' Compensation Board operating as WorkSafeBC (Board) to include dividend income in a firm's assessable payroll only to the extent that the included dividend amount is reasonably equivalent to the value of the active shareholders' services. Example 2 of practice directive 1-38-2(A) is inconsistent with the policy to the extent that it authorizes the Board to include all dividend payments in assessable payroll, without regard to the value of the shareholders' activities.

The appellant firm owns a number of warehouses, which it then rents out to clients. At issue was whether the Board correctly added \$90,942 of shareholder dividends, which were mostly a return on investment, to its June 30, 2005 recalculation of the firm's 2004 assessable payroll.

Section 39 of the *Workers Compensation Act* authorizes the Board to levy assessments on firms in order to maintain the accident fund. Policy item AP1-38-2, "Payroll – Categories," states that "dividends are not considered part of payroll unless paid as remuneration for activity in the business." Practice directive 1-38-2(A) "Shareholder Earnings – Assessment of Dividends" states in example 2 that where a shareholder is active and receives no remuneration other than dividends, the full amount of the dividends paid to that shareholder will be included in assessable payroll. The panel concluded that example 2 of the practice directive is not reasonably consistent with policy item AP1-38-2 to the extent that it authorizes the Board to include all dividend payments in assessable payroll, without regard to the value of the shareholders' activities. The panel allowed the firm's appeal in part, finding that \$6,000 of the amount of shareholder dividends were properly included in the appellant firm's 2004 assessable payroll.

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Panel: Warren Hoole, Vice Chair

Introduction

In a statement of account dated June 30, 2005, the Workers' Compensation Board (Board) added \$90,942 in shareholder dividends to the appellant firm's 2004 assessable payroll. This resulted in an additional assessment of \$900.33 for 2004.

The firm disagreed with this decision and appealed to the Review Division of the Board. In *Review Decision #R0056614*, dated February 10, 2006, a review officer allowed the firm's appeal in part.

The review officer determined that one of the shareholders was not active in the firm's business. Consequently, the review officer directed that the inactive shareholder's dividends were not to be included in recalculating the firm's 2004 assessable payroll. The review officer confirmed that the dividends paid to the other two shareholders were properly included in recalculating the firm's assessable payroll.

The firm now appeals *Review Decision #R0056614* to the Workers' Compensation Appeal Tribunal (WCAT). In his notice of appeal, the firm's representative indicated that the appeal should proceed by way of a "fast-track read and review."

I have considered the WCAT's *Manual of Rules of Practice and Procedure* (MRPP), including item #8.90, "Method of Hearing," and I have reviewed the issues, evidence and submissions in this appeal. I am satisfied that the firm's appeal does not raise significant factual disputes, nor does the appeal involve questions of credibility or other compelling reasons for an oral hearing. Rather, the appeal primarily involves the application of law and policy to evidence already on file. I therefore find that an oral hearing is not necessary for the full and fair adjudication of this appeal.

There are no other parties to the appeal.

Issue(s)

Did the Board correctly add \$90,942 of shareholder dividends to its June 30, 2005 recalculation of the firm's 2004 assessable payroll?

Jurisdiction

This appeal is brought under subsection 239(1) of the *Workers Compensation Act* (Act) which permits appeals of Review Division findings to the WCAT.

The WCAT may consider all questions of fact, law and discretion arising in an appeal, but is not bound by legal precedent. The WCAT must make its decision on the merits and justice of the case, but in so doing, must apply a policy of the Board's governing body that is applicable in the case. The WCAT has exclusive jurisdiction to inquire into, hear and determine all those matters and questions of fact, law and discretion arising or required to be determined in an appeal before it.

Background and Evidence

The evidence on file is relatively simple and does not appear to be in dispute.

The appellant firm is a corporation. Its business involves owning a number of warehouses, which it then rents out to clients.

According to the firm's application for registration with the Board, dated August 19, 1997, the firm estimated its annual payroll at \$20,000 and stated that in "some years, no wages taken out of company." The firm indicated that it had three principal shareholders: FA (president); DA (secretary); and SA (treasurer).

In October 2004, the Board audited the firm's payroll records for 2003.

According to an "Audit Adjustment Summary" dated October 19, 2004, the firm had reported wages of zero for 2003. However, for the 2003 calendar year, one of the Board's auditors identified dividend payments from the firm to FA, DA and SA, totaling \$206,787. With deductions for dividend payments in excess of the statutory maximum, the auditor determined that the firm's 2003 assessable payroll amounted to \$111,786.

This increased assessable payroll resulted in the Board levying an assessment on the firm of \$1,084.32 for 2003.

In a fax dated December 3, 2004, the firm requested that the Board transfer a credit from one of its affiliated firm accounts into the firm's account in order to pay the increased 2003 assessment of \$1,084.32.

According to a letter from the Board dated December 7, 2004, the requested transfer occurred and the affiliated firm's credit was applied to the firm's outstanding account of \$1,084.32.

According to the Board's computerized "Notepad" filing system, a Board officer contacted the firm on June 6, 2005, regarding its report of zero payroll for the 2004 calendar year. The Board officer indicated that she spoke with the firm's accountant and reminded him that the 2003 report of zero payroll had been amended to \$111,786 following the October 2004 audit. The Board officer went on to summarize her conversation with the firm's accountant as follows:

We discussed the requirement of [shareholders] to report dividends if they are not T4'd and that running the [firm's] administrative duties is considered "activity" in the [firm] whether they are "in the field" or not.

[The firm] owns several warehouses which it rents to different clients. I have faxed a copy of Practice Directive AP1-38-2(A)...outlining reporting [shareholder] earnings.

[The accountant] stated the three [shareholders] received \$30,314 each in dividends in 2004 so I have amended the payroll.

In a letter to the Review Division dated July 13, 2005, the firm's accountant agreed that \$90,942 had been paid in shareholder dividends for 2004, with equal shares to FA, DA and SA. The accountant stated that DA was not active in the business. The accountant also stated that the shareholder dividends were mostly a return on investment.

In a letter to the Review Division dated November 3, 2005, the firm's accountant stated that FA had advised him that FA and SA provided management services to the firm in 2004 with a value of approximately \$3,000 each.

Submissions

The firm's accountant filed a brief submission with his notice of appeal, dated March 1, 2006. The accountant indicated that the dividends paid to FA and SA were mainly a return on investment and that neither FA nor SA would have received \$30,314 each for the management services they performed. The accountant argues that, if the dividends were payment for services, DA, the inactive shareholder, would not have received an equal share of the dividends. In addition, the accountant reiterated that FA and SA had provided management services to the firm in 2004 with a value of \$3,000 each.

Although the accountant does not request a particular remedy, I assume from the nature of his submissions that he submits that the shareholder dividend component of the firm's assessable payroll for 2004 is properly set at either zero, or, in the alternative at \$6,000.

Reasons and Findings

Section 39 of the Act is applicable to the issue under appeal and authorizes the Board to levy assessments on firms in order to maintain the accident fund:

39(1) For the purpose of creating and maintaining an adequate accident fund, the Board must every year assess and levy on and collect from independent operators and employers in each class, by assessment rated on the payroll, or by assessment rated on a unit of production, or in a manner the Board considers proper, sufficient funds, according to an estimate to be made by the Board to

(a) meet all amounts payable from the accident fund during the year;

...

WCAT panels are bound by published policies of the Board pursuant to subsection 250(2) of the Act. The policies relating to this issue are set out in the Board's *Assessment Manual*. I note in particular policy item AP1-38-2, "Payroll – Categories," which states, in relevant part:

(c) Shareholders' earnings

The total remuneration paid to each active principal, shareholder, director, or officer of a corporation is assessable. Remuneration is defined as any payment made to the principal regardless of the label attached to it. It includes:

- earnings shown in official statements of remuneration issued by the corporation for income tax purposes;
- management fees;
- payments purporting to reimburse business expenses except for the payment of out-of-pocket expenses; and
- payments of personal expenses made on behalf of the active shareholder, director, or officer.

If a director of a publicly traded company receives an official income tax statement from the company for directors' fees, these are not assessable if the director:

- only attends periodic meetings;
- is not a part-time or full-time employee; and
- is not an officer of the corporation.

Fees paid to directors of private companies are assessable.

Dividends are not considered part of payroll unless paid as remuneration for activity in the company.

Earnings in official income tax statements issued by the corporation to a spouse, child or family member of a principal or shareholder are included in payroll and are assessable.

If an individual is an active shareholder, director, or officer of more than one registered firm, then the combined remuneration from those firms is assessable. The combined earnings are prorated between the various firms as is the excess earnings if the earnings are above the maximum.

I also note practice directive 1-38-2(A) "Shareholder Earnings – Assessment of Dividends." The "guiding principles" with relation to dividends include:

Shareholders, directors, or officers (also referred to as "principals") of a corporation who have any degree of activity in the operation are considered to be workers of the corporation. They qualify for the benefits prescribed by the Act and their remuneration is subject to assessment.

The practice directive goes on to illustrate a number of different scenarios and whether or not dividends will be included in the firm's assessable payroll. The following example is relevant to this appeal:

2. Actual dividends (not the taxable dividends) as reported to the [Canada Revenue Agency] will be considered assessable if a principal receives no other earnings, with the exception of dividends, and the principal is active in the business.

Example:

A principal receives actual dividends (not taxable dividends) of \$40,000 and no T-4s, management fees, or any other earnings. The actual dividend amount of \$40,000 is assessable.

Having set out the applicable law, policy and practice directive, I turn now to the substance of this appeal.

There appears to be no dispute that DA is inactive in the firm. Policy item AP1-38-2 specifically states that dividend income will not be assessable when paid to an inactive shareholder. I therefore agree with the review officer's conclusion that DA's dividend income of \$30,314 is not properly included in the firm's 2004 assessable payroll.

The more important question in this appeal relates to the treatment of dividends the firm paid to FA and SA in 2004. The firm's representative concedes that both FA and SA were active in the firm's business.

Despite receiving a copy of practice directive 1-38-2(A), the representative has not offered any evidence in this appeal to demonstrate that FA and SA received earnings from the firm other than in the form of dividends. On the basis of the evidence on file, I must therefore find that FA and SA are both active, even if only to a relatively minor extent, in the business of the firm, and receive dividends but no other earnings from the firm.

My finding in this regard brings the facts of this appeal squarely within the meaning of example 2 of practice directive 1-38-2(A). This example states that, where a shareholder is active and receives no remuneration other than dividends, the full amount of the dividends paid to that shareholder will be included in assessable payroll. If the second example in the practice directive is followed in the circumstances of this appeal, it is a simple matter to conclude that the Board correctly included the full value of FA's and SA's dividend payments in the firm's assessable payroll.

The question then, is whether or not example 2 of the practice directive should be followed in the circumstances of this appeal.

As already noted, practice directives are not binding. However, in my view, practice directives should generally be applied where they are consistent with the applicable law and policy and where there are no unusual or extenuating circumstances that make the application of a practice directive inappropriate.

I reach this conclusion because practice directives foster predictability and consistency in decision-making. I also note that practice directives are available to the public and firms may often rely on this information in organizing and operating their businesses. For these reasons, I consider that practice directives should generally be followed.

However, in the case of practice directive 1-38-2(A), I consider that example 2 of the practice directive is not reasonably consistent with policy item AP1-38-2. Example 2 of the practice directive appears to capture all dividend income, even where a shareholder's activities on behalf of the firm generate only a small portion of the

dividend income. In other words, the practice directive fails to correlate the value of dividends paid to a shareholder with the value of the services provided by a shareholder to the firm.

In my view, it is not enough to simply state that, because a shareholder is active, all dividends the shareholder receives are equivalent to remuneration for the shareholder's activities on behalf of the firm. Such a conclusion does not allow for the common situation where a shareholder is active in the business to a minor extent only and the bulk of his or her dividends reflect a return on the shareholder's investment, rather than remuneration for the shareholder's activities on behalf of the business. Nor is such a conclusion required by the language of the applicable assessment policy.

In this regard, policy item AP1-38-2 specifically states that "dividends are not considered part of payroll unless paid as remuneration for activity in the business." The correct approach to statutory interpretation in Canada is referred to as the "modern principle" and was described, for example, in *Rizzo & Rizzo Shoes Ltd. (Re)*, [1998] 1 S.C.R. 27. In essence, the modern principle states that interpreting legislation requires reading the words of the provision in context and according to their grammatical and ordinary sense, harmoniously with the scheme and the object of the statute. A similar approach is appropriate where, as here, the interpretation of a binding policy is in question.

The ordinary and grammatical sense of policy item AP1-38-2 appears to limit the Board's authority to include dividends in a firm's assessable payroll to those dividends paid as remuneration for activity in the firm's business. The ordinary sense therefore suggests that it is only the amount of dividends paid to the shareholder for services that is intended to be included in a firm's assessable payroll.

The primary purpose of policy item AP1-38-2 is to ensure that a firm does not artificially reduce its assessable payroll through the expedient of labeling as dividends payments that are in reality wages. This purpose remains unaffected by interpreting policy item AP1-38-2 as allowing for the inclusion in assessable payroll of dividends only to the extent that the dividends are remunerative of employment activities. The purpose underlying policy item AP1-38-2 is therefore consistent with the ordinary sense and grammatical meaning of that policy item in relation to dividend income.

Finally, it is a well-established principle of statutory interpretation that exceptions are generally to be construed restrictively in order to ensure that the exceptions do not become so broad as to render meaningless the primary rule.¹ I read policy item AP1-38-2 to state as a general rule that dividends are not considered part of payroll. The exception to this rule is where a shareholder is active in the business. In

¹ See for example: *Driedger on the Construction of Statutes*, 3rd ed. at page 369.

order to maintain the exceptional nature of including shareholder dividends in assessable payroll, only that portion of dividends that represents remuneration for services, should be included in assessable payroll.

For the above reasons, I therefore interpret policy item AP1-38-2 as authorizing the Board to include dividend income in a firm's assessable payroll only to the extent that the included dividend amount is reasonably equivalent to the value of the active shareholder's services.

To the extent that example 2 of the practice directive might be said to authorize the Board to include all dividend payments in assessable payroll, without regard to the value of the shareholder's activities, I would consider example 2 to be inconsistent with the correct interpretation of policy item AP1-38-2 and I would therefore decline to follow this component of the practice directive.

I am mindful that it may be difficult in some circumstances for the Board to attribute a value to shareholder activities. However, it is no solution to simply include all shareholder earnings in assessable payroll whenever a shareholder is active in the firm's business. In this regard, it may be helpful for the Board to review and update example 2 of practice directive 1-38-2(A).

Applying my interpretation of policy item AP1-38-2 to the facts of the current appeal, the only evidence on file as to the value of the shareholders' activities on behalf of the firm is found in the representative's November 3, 2005 letter.

In this regard, the representative estimated the value of services provided by SA and FA at \$3,000 each. I note that I do not consider this evidence to be compelling, particularly as it is merely hearsay with no supporting direct evidence. Nevertheless, I see no contradictory evidence on file.

In addition, the representative's estimate is also consistent with the fact that the inactive shareholder receives an equal distribution of dividends from the firm. If dividends were truly intended to remunerate FA and SA for their employment activities, it would make sense for FA and SA to receive a greater share of dividends than the inactive shareholder. It may therefore be inferred that FA's and SA's employment activities are relatively minor and that \$3,000 each is a reasonable estimate of the value of those activities. I therefore fix the value of SA's and FA's activities in the firm's business for the 2004 calendar year at \$3,000 each.

It follows that the appellant firm's assessable payroll for 2004 properly includes only \$6,000, in total, of the dividends the firm paid to SA and FA.

As a result, I allow the firm's appeal in part.

Conclusion

I vary *Review Decision #R0056614*. I confirm that the dividends paid to the inactive shareholder are not properly included in the firm's 2004 assessable payroll. With respect to FA and SA, I fix at \$6,000 the amount of shareholder dividends properly included in the appellant firm's 2004 assessable payroll.

The firm has not requested reimbursement for appeal expenses and none are apparent; consequently, I make no order regarding expenses of this appeal.

Warren Hoole
Vice Chair

WH/gl