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# The importance of an employment contract

The date of an employee's dismissal may end the employment relationship. However, it rarely marks the end of a payroll professional's obligations. Virtually every employee — even one dismissed with cause — is entitled to some sort of payment post termination. A well drafted and enforceable employment contract can reduce uncertainty and save an employer untold dollars. Word of note: The specifics of each obligation will vary depending upon the jurisdiction in which the employer operates. As such, it is important an employer operating in more than one jurisdiction know and meet the statutory obligations in each.

## Obligations upon termination of employment

Following termination, a payroll professional always has the following obligations to a dismissed employee, even where cause is alleged:

**Accrued pay and expenses:** Wages accrued up to the point of termination, as well as approved business expenses, must be paid out to the employee. The timing of these payments is determined by statute and is often less than seven days from the date of termination date depending on the province in which the employer operates.

**Vacation pay:** An employee is also entitled to payment for accrued but unused vacation time. The statutory minimum for vacation pay varies between jurisdictions. In Ontario, for example, an employee is entitled to a minimum four per cent of wages earned during the period of employment. In British Columbia that number jumps to six per cent after five years of employment.

**Record of employment:** A record of employment must be issued within five calendar days of termination regardless of the reason for termination. The issuance of a record of employment is governed by federal



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## LEGAL VIEW

legislation and rules regarding issuance are applicable in every Canadian jurisdiction. Important to remember is an amended record of employment will be required if the circumstances surrounding a termination change. For example, a new record of employment must be issued if a just cause termination is later determined to be a dismissal without cause (whether by order of a court or arbitrator or by agreement of the parties).

**The importance of an employment agreement:** In a situation involving termination without cause, a well drafted employment contract is the most effective tool an employer has to maximize certainty and minimize unknown liability. A contract does this by clearly and legally stating the obligations of the parties in the event the employment relationship is terminated.

Without a contract in place stating otherwise, the law requires an employer to provide an employee reasonable notice of termination (or pay in lieu of notice). An employer may also be responsible for continuing all health benefits, maintaining corporate perquisites and paying bonuses for a period of time when the employee is not working.

The length of reasonable notice is not set out in a statute. It is determined by courts and based upon a number of factors including the employee's age, position, salary and whether he was lured away from other secure employment. A reason-

able notice period is often between three and five weeks per year of employment and can result in awards of upwards of two years' continuation of wages, perquisites, allowances, benefits and bonuses.

**Termination clause:** In contrast to the uncertainty of a court determined reasonable notice period, an employment agreement can, in all Canadian jurisdictions (except Quebec), limit an employee's notice period to a predetermined level which can be as minimal as the time periods stipulated by applicable employment standards legislation. In most provinces, the legislation provides for one week's notice per year of employment up to a maximum of eight weeks. The termination clause will not be enforceable if it provides an entitlement that is below minimum employment standards obligations.

If an employment contract does not limit an employee's notice entitlement to the statutory minimum, payment based on the statutory minimum should still be paid to an employee as soon as possible. If further payment is subsequently required, it can be made at that time. In the event of a settlement, it is imperative an payroll professional review the settlement documents to understand how the payments have been structured and the tax consequences (For example, a lump-sum payment characterized as retirement allowance versus incremental payments throughout the notice period).

**Bonus payments:** Every employer should consider including a provision in its employment agreement requiring an employee to be actively at work on the bonus payout date in order to be entitled to receive a bonus. Absent clear language to this effect, an employee may be entitled to receive whatever amount of bonus may have been earned to the end of the notice period.

*continued on page 8*

# Tax consequences post termination

*Continued from page 7*

**Health benefits:** Absent clear language in an agreement limiting health benefit coverage to the statutory minimum, an employee terminated without cause may be entitled to benefits throughout the notice period. HR professionals should therefore consult with their insurance providers to ensure health benefits are not prematurely cut off. If this should happen and the employee requires access to a health benefit the employee may on the hook for the value of the benefit itself — not only the premiums.

**Tax implications:** The tax consequences of a post-termination payment vary depending upon the nature of the payment. Salary, bonus, commission payment, accumulated overtime, and unused vacation credits are all taxed as employment income, the rationale being such amounts are paid in lieu of wages. As

such, the employer is required to deduct CPP, EI and Income Tax (or QPIP and QPP in Quebec) at source on any such payments. However, if the parties structure the payment as a retiring allowance, the payment is not subject to Income Tax deductions outlined above. Instead, a retiring allowance, like Severance Pay in Ontario, is subject to a lump-sum income tax withholding ranging from 10 per cent to 30 per cent depending on the amount of the payment.

Employers and payroll professionals are encouraged to consult with their tax advisor and/or legal counsel when structuring a settlement involving a reasonable notice period in excess of the statutory minimum.

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