

# Practice Directive 1-37-1 (A)

## Classification Criteria

Effective April 1, 2007

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### Explanatory Note

This Practice Directive explains how the Board assigns a firm to one or more classification units and aids in the interpretation of Policies 1-37-1 through 1-37-4.

### INTRODUCTION

Policy 1-37-2 creates a rebuttable presumption<sup>1</sup> that a firm will be classified in a single classification unit based upon its industry:

*“An employer is assigned to a single classification unit based on the industry in which the employer is operating...”*

This presumption may be rebutted if the firm meets the criteria for:

- Multiple classification
- Special hazard operations
- The “inescapable inclusion exception”
- The “ancillary operations exception”
- The “extraprovincial operations exception”
- The “residential employers exception”

Thus, in determining a classification a Board officer<sup>2</sup> must:

- (1) Start with the presumption that the firm will be classified in a single classification unit based upon its industry unless there is evidence to the contrary
- (2) Obtain and record any information that may support one of the above exceptions, and if so
- (3) Determine whether there is sufficient evidence to rebut the single classification presumption

As each such decision must be justifiable, and may be required to be proved to be justifiable, the determining Board officer must record all information obtained, all facts considered, the weight given to each fact, and the application of policy to the facts.

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<sup>1</sup> A certain conclusion will follow unless proof, or at least evidence, to the contrary is given.

<sup>2</sup> As at 1 March 2003, the *President's Assignment of Authority under Part 1 of the Workers Compensation Act* authorizes a Claims Analyst, Employer Service Representative, Assessment Officer, or Office Assessor to make classification decisions.

Although policy does not restrict a Board officer's reasoned discretion in determining a classification, any deviation from policy must be exceptional, substantiated, and defensible. Appeal Division *Decision 2002-0149* states, in part:

*"Helping the employer to avoid a high assessment rate, however, would not be a valid reason to stray from published policy. Such an approach could well lead to a lack of structural integrity in the classification system, and would require the need for domino-effect 'fix-ups' throughout the industry."*

## **APPLICATION**

### **1. THE PRESUMPTION THAT A FIRM IS TO BE CLASSIFIED IN A SINGLE CLASSIFICATION UNIT BASED UPON ITS INDUSTRY**

Policy AP1-37-1 states, in part, that:

*"Employers and independent operators are assigned to classification units on the basis of the industry in which the firm is operating."*

As most firms in British Columbia operate within a single industry, it follows that most firms will be assigned to only one classification unit. That one classification unit will be the classification unit which, in the Board officer's reasoned judgement, best reflects the firm's industrial undertaking.

If a firm ("Firm A") contracts to provide a product or service and then contracts out the supply of that product or service to another firm, Firm A remains within the industry associated with the provision of that product or service. Thus, Firm A remains classified with other firms that provide the same product or service (and who produce that product or perform that service themselves). This supports policy, as it puts competing firms on an equal footing.

If a firm operates in more than one industry but does not qualify for multiple classification,<sup>3</sup> the firm will be classified as follows:

- (a) If one or more industries represent at least 25% of the firm's operations,<sup>4</sup> in the industry that has the highest base rate and represents at least 25% of the firm's operations,
- (b) If no one industry represents at least 25% of the firm's operations, in the industry coming closest to the 25% figure
- (c) In case of a tie, in the industry with the higher base rate

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<sup>3</sup> See Policy AP1-37-2 for multi-class criteria.

<sup>4</sup> In determining "25% of the firm's operations" the Board will look primarily at revenue, but units of production, payroll or any other basis or any combination thereof which the Board feels best represents a true picture of the firm's activity could be used.

## 2. INFORMATION REQUIRED TO MAKE CLASSIFICATION ADJUDICATIONS

A classification adjudication must be made when a firm first registers with the Board and may be required to be made when:

- An Assessment Officer audits a firm,
- The Board learns of information that indicates the need for a classification review, or
- A firm requests a classification review<sup>5</sup>

The firm must provide to the Board all pertinent information applicable to a classification determination.<sup>6</sup> The determining Board officer may and should assist the firm in discharging its statutory duty by ensuring that the following minimum information is obtained and recorded:

- The industry or industries in which a firm is active
- The products a firm manufactures or provides
- The services a firm provides
- The processes a firm uses to provide its product or service
- The equipment a firm uses to provide its product or service
- Whether a firm has common ownership with its client(s)
- Whether a firm is active in any industry designated as a special hazard

In addition, the determining Board officer may require and obligate<sup>7</sup> that the firm provide the following information, as applicable:

- The firm's revenue figures, showing revenue generated by various activities
- The firm's payroll figures, showing where the firm has worker activity in a classification
- The firm's individual workers' occupations
- The firm's operating locations
- The firm's competitors (from which their classifications may be determined)
- Any other information deemed necessary by the Board officer to make a classification adjudication

As always, a Board officer must use reasoned discretion as to what information may be necessary to adjudicate a particular classification decision and must record the information obtained (and, if necessary, why the information was requested).

## 3. APPLY POLICY TO DETERMINE IF ONE OR MORE OF THE EXCEPTIONS APPLY

### 3.1 MULTIPLE CLASSIFICATIONS

Policy 1-37-2 defines the four-part test for multiple classification eligibility. The presumption is that a single classification will apply unless the firm meets each of the four eligibility criteria. If a firm does not meet any one of the four criteria, the presumption holds, and the firm cannot be assigned to more than a single classification unit.

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<sup>5</sup> Policy AP1-37-2 places the onus on a firm to inform the Board of its industrial activities and any changes to them, as and when such changes occur.

<sup>6</sup> Sections 38 and 88 of the *Workers Compensation Act*

<sup>7</sup> Section 88 of the *Workers Compensation Act*.

Before a Board officer can determine whether a firm is eligible for multiple classification, the firm must separate and submit payroll and revenue information for each possible classification unit,<sup>8</sup> evidencing that the operation in question is separate from the firm’s other activities and is able to stand on its own as an independent business operation.

The following example shows how a multiple classification may apply. It does so because of the exception noted in criterion two of the four-part test for multiple classification eligibility. Part two states that there may be circumstances when such activities as clerical, accounting, sales, or marketing do not simply assist, support, or service the firm’s main industry.

**Example:**

Firm A has two main operations. The “development” department buys land and constructs houses on the land. The “sales” department sells the houses built by Firm A as well as houses built by Firm B. If at least 50% of Firm A’s revenue is derived from selling houses for Firm B, multiple classification may be considered. While sales is often considered an ancillary operation, in this example the sales activity for Firm A does not exist simply to assist, support or service its own construction activity.

The following is an illustration of the application of the fourth criterion in the four-part test:

**Example:**

Firm X has a pub, a marina, and a campground. The total annual assessable payroll for all undertakings is \$825,000, and the total revenue for all undertakings is \$1,650,000.

| Activity      | Payroll          | % of total  | Revenue            | % of total  |
|---------------|------------------|-------------|--------------------|-------------|
| Pub           | \$450,000        | 55%         | \$900,000          | 55%         |
| Marina        | \$250,000        | 30%         | \$500,000          | 30%         |
| Campground    | \$125,000        | 15%         | \$250,000          | 15%         |
| <b>Total:</b> | <b>\$825,000</b> | <b>100%</b> | <b>\$1,650,000</b> | <b>100%</b> |

All three undertakings have specific personnel and offer more than 50% of their product to the public. The pub and marina each generate more than 25% of the firm’s total annual assessable payroll and therefore would be eligible for multiple classification. The campground does not meet any of the three considerations for payroll or revenue and therefore the campground classification unit would not be assigned.

Payroll from activities that do not receive a separate classification must be added to the classification unit of the firm’s main industrial activity.<sup>9</sup> In the example above, the pub would be

<sup>8</sup> This is a continuing obligation: to keep multiple classifications on an account, a firm must separate, maintain, and report payroll and claims in the applicable classification unit. When a firm fails to do so, the Board may, after reasonable notice, classify the unreported industrial activity, levy an assessment on the estimate, and impose a percentage of the assessment as a penalty for the default.

<sup>9</sup> In determining “main industrial activity” the Board will look primarily at revenue, but units of production, payroll or any other basis or any combination thereof which the Board feels best represents a true picture of the firm’s activity could be used.

viewed as the main industrial activity as it has substantially more payroll and revenue than the other activities.

If a classification unit is being added to a firm's account, the four-part test for multiple classification eligibility must be met before the classification change policy (Policy 1-37-3) is applied. If application of the two policies results in different effective dates for any change, the date most favourable to the firm will be used in the absence of fraud or misrepresentation. This might happen, for example, if there is a rate increase resulting from the addition of a new classification due to an evolutionary change in business operations.

### 3.2 SPECIAL HAZARDS

Policy 1-37-2 designates specified high-risk industrial operations as special hazard operations. When a firm's annual payroll associated with such a high-risk industry exceeds four times the "maximum wage rate",<sup>10</sup> the Board will add that high-risk industry's classification unit to the firm's account. If the firm is not assigned the high-risk industry classification unit at the start of a calendar year but exceeds the required payroll amount at any point during that calendar year, the Board will consider this an inadvertent misrepresentation<sup>11</sup> on the part of the firm and will backdate the special hazard classification to January 1<sup>st</sup> of that calendar year.

#### **Example:**

Firm Y is a road construction company. If, as part of a road construction contract, the firm builds a bridge, and the assessable payroll for that portion of the contract is \$275,000, the firm should have the bridge building classification unit added to its account. Bridge building is deemed a special hazard activity and therefore all payroll associated with it is assessed at the higher rate, while road construction activities may still be reported under the appropriate classification unit.

### 3.3 THE "INESCAPABLE INCLUSION EXCEPTION"

The presumption may be rebutted by way of the "inescapable inclusion exception" found in Policy 1-37-1:

"Where a firm's operations are an inescapable part of another firm's operations, the firm's classification will be the same as that of the other firm regardless of ownership."

The "inescapable inclusion exception" requires that the following three-part test<sup>12</sup> must be satisfied:

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<sup>10</sup> Section 33 of the *Workers Compensation Act*. The maximum wage rate for 2003 is \$60,100.

<sup>11</sup> Policy AP1-37-3 (Change of Classification).

<sup>12</sup> The determinative aspect of the "inescapable inclusion exception" is the word "inescapable", which is defined in the *Gage Canadian Dictionary* to mean "cannot be escaped or avoided". Thus, by denotation, "inescapable" only allows for a choice between two mutually exclusive alternatives: either something is "capable of being avoided" or is "incapable of being avoided". There is no gradation between these polarities, and policy does not attempt to qualify or diminish the plain-language effect of "inescapable" (for example, by inserting word(s) synonymous with "nearly" or "practicably"). Accordingly, if a firm's operations can be severed from another firm's operations and that other firm can subsist, then the employer's operations are not an inescapable part of that other firm's operations.

- (1) The employer's (the firm under classification consideration) operations are a core-business operation of the other firm,
- (2) The other firm cannot continue to subsist if the employer's operations are severed from that other firm's operations, and
- (3) The employer's operations are clearly integrated into that other firm's core-business operations; and, for this purpose, the following factors<sup>13</sup> must be considered:
  - (a) The employer's routines, skills, and competencies
  - (b) The degree of captivity of the employer
  - (c) The employer's actual and potential client base
  - (d) The presence or absence of a functioning sales department and budget
  - (e) The presence or absence of a functioning marketing department and budget
  - (f) The absence or diminishment of accounts receivable
  - (g) The integration of information technology systems
  - (h) Whether the employer's processes and equipment are specific to the employer and the other firm or are industry-wide
  - (i) The nature and extent of competing firms within the employer's industry

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Guidance as to what constitutes an "inescapable part of another firm's operation" is found in the immediately following paragraph of Policy 1-37-1:

"If the firm's operations do not fall within this category, but are ancillary, or an extension or add-on phase, to another firm's operations, the classification will be the same as the other firm's if there is a degree of common ownership."

The *Gage Canadian Dictionary* interprets salient language as follows:

Ancillary – 1: subordinate, dependent; 2: supplementary; auxiliary  
Extension – 2: a part that extends something; addition  
Add-on – 1: added to a whole.

By contrasting the descriptive language used in these policies, it is apparent that "an inescapable part of another firm's operations" cannot be a mere appendage of that other firm's operation. To be "inescapable", the employer's operations must be unequivocally central to the functioning of the other firm's revenue-generating core-business operations. To illuminate this relationship further, the employer's operations must play a critical role in:

- (a) the strategic activities that are integral to the other firm's achievement of goals and critical to its existing and future business direction, or
- (b) the activities that sustain the other firm by generating that firm's revenue or that represent critical product or service channels for that other firm.

Thus, as from the "other firm's" perspective, the employer's operations must be a core-business operation.

As Policy 1-37-1 also refers to the employer's operations, the nature of the employer's operations and whether these operations are an inescapable part of another firm's operations must be considered. That is, are the employer's operations patently and inseparably integrated into the other firm's core-business operations? The diversity, complexity, and mutability of British Columbia's economy do not allow for exhaustive or all-encompassing criteria; and, therefore, the noted factors are offered as guidance.

<sup>13</sup> Which are more akin to rules of statistical probability than to prescriptive rules.

- (j) The degree of direction and control exerted by the other firm on the employer whether or not the other firm is represented on the employer's Board of Directors

**Examples:**

A small carpentry firm contracts with a theatre company to construct a set for one of that company's productions. The carpentry firm provides an inescapable operation of the business of mounting a play, but it does not necessarily become an inescapable part of the theatre company's operations: the carpentry firm may contract to other parties, or the theatre company may contract with other carpentry firms. In either case, the degree of integration and captivity envisioned in policy is absent.

### 3.4 THE "ANCILLARY OPERATIONS EXCEPTION"

Policy 1-37-1's "ancillary operations exception" is an adjunct to the "inescapable inclusion exception":

"If the firm's operations ... are ancillary, or an extension or add-on phase, to another firm's operations, the classification will be the same as the other firm's if there is a degree of common ownership. Even if the firm is separately registered, the two firms will be regarded as one firm for the purpose of classification. The multiple classification criteria will then be applied."

The "ancillary operations exception" requires that the following three-part test be satisfied:

- (1) The employer's (the firm under classification consideration) operations are an ancillary, extension, or add-on operation of the other firm,
- (2) There is a degree of common ownership between the employer and the other firm, and
- (3) The employer's operations are clearly integrated into that other firm's operations; and, for this purpose, the following factors<sup>14</sup> must be considered:
  - (a) The employer's routines, skills, and competencies
  - (b) The degree of captivity of the employer
  - (c) The employer's actual and potential client base
  - (d) The presence or absence of a functioning sales department and budget
  - (e) The presence or absence of a functioning marketing department and budget
  - (f) The absence or diminishment of accounts receivable
  - (g) The integration of information technology systems
  - (h) Whether the employer's processes and equipment are specific to the employer and the other firm or are of industry-wide usage
  - (i) The nature and extent of competing firms within the employer's industry
  - (j) The degree of direction and control exerted by the other firm on the employer whether or not the other firm is represented on the employer's Board of Directors

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<sup>14</sup> (Which are more akin to rules of statistical probability than to prescriptive rules.)

In the following chart, Firm B contracts to provide inescapable or ancillary services to Firm A; depending on the circumstances of the ownership of the two firms, and the nature of the operations supplied, the classification results are different:

|   | <b>Firm B's operations are an <u>inescapable part of</u> Firm A's</b>                  | <b>Firm B's operations are <u>ancillary</u> to Firm A's</b>                            |
|---|--|--|
| <b>Firm A and Firm B have common ownership</b>  | Firm B takes the classification of Firm A, regardless of multiple classification rules | Firm A and Firm B are considered as one firm for classification purposes <sup>15</sup> |
| <b>Firm B does not have common ownership with Firm A, but <u>only</u> services Firm A</b>   | Firm B takes the classification of Firm A, regardless of multiple classification rules | Firm B is classified on the basis of its operations                                    |
| <b>Firm B has no common ownership with another firm, but <u>only</u> contracts within one specific industry to multiple clients</b> | Firm B is classified on the basis of its operations                                    | Firm B is classified on the basis of its operations                                    |

### 3.5 THE "EXTRAPROVINCIAL OPERATIONS EXCEPTION"

The single classification presumption will be rebutted if a Board officer determines that a firm exclusively administers or serves an operation outside of British Columbia. In such a case, the firm will be classified only on the nature of its operations within British Columbia.

#### **Example:**

A call centre doing help line work for a software manufacturer which produces its software outside British Columbia would receive the Call Centre classification unit. Normally a call centre operation would be ancillary to the manufacture and support of software, but as the firm has no operation other than call centre within British Columbia, it can only be classified on the basis of its British Columbia operations.

Firms performing only administrative functions for out-of-province operations are classified in Classification Unit 762003 (Administration of an Operation Conducted Outside BC).

### 3.6 THE "RESIDENTIAL EMPLOYERS EXCEPTION"

A residential employer is an individual (proprietorship) or family (partnership) that employs workers in or about a private residence, other than for the purpose of the owners' or occupiers' trade or business.<sup>16</sup>

<sup>15</sup> Multiple Classification policy must then be applied to both Firm A and Firm B, as if they were one firm.

<sup>16</sup> See policy AP1-2-1 for policy on residential employers and their exemptions from coverage.

Residential employers are classified in each of their main industrial activity and any classification that applies to work done in or about their private residence; and, therefore, the residential employer exception is an exemption from each of:

1. The presumption that a firm will be classified in a single classification unit based upon its industry, and
2. The multiple classification criteria<sup>17</sup> – the residential employer may be assigned an additional classification unit for work done in or about its private residence regardless of whether the four-part test for multiple classification eligibility is satisfied.

Where the Board registers a partnership or proprietorship to cover (revenue-producing) activity and the same partnership or proprietorship operates as a residential employer, the Board may add another classification to the existing account to cover workers employed by the residential employer.

**Examples:**

A proprietor registered in the Law Office classification unit hires a worker full-time to provide at-home childcare. In this case, the Board will add a separate classification, Hiring or Providing Domestic Childcare (CU 764029) to the proprietor's account effective the date she employed the caregiver.

A senior citizen, who employs a personal care attendant, hires a student to paint her house and supplies paint to that student. In this case, the Board assigns the Home Support Services classification (CU 764030) and the Painting or Wallpapering classification (CU 721041).

**4. DETERMINE WHETHER THERE IS SUFFICIENT EVIDENCE TO REBUT THE PRESUMPTION THAT A FIRM WILL BE CLASSIFIED IN A SINGLE CLASSIFICATION UNIT BASED UPON ITS INDUSTRY**

The standard of proof for decisions made under the *Workers Compensation Act* is the balance of probabilities.<sup>18</sup>

The Board officer must examine all available information to ascertain whether it is sufficiently complete and reliable to allow a reasoned determination to be made with confidence. And, if so satisfied, the Board officer must then assess each piece of information for accuracy, credibility, and relevance, both in isolation and in context of the totality of the information. Conflicting information must be weighed to determine whether it is more supportive of a single classification based on the firm's industry or not, and the more supported alternative must prevail.

This body of assessed and weighed information constitutes the evidence from which the Board officer must determine if the presumption has been rebutted. If, on the balance of probabilities, the evidence supporting the presumption outweighs the evidence contesting the presumption, the presumption must be upheld. In all cases, the determining Board officer must write down

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<sup>17</sup> The multiple classification criteria are not applied as residential employers do not generate revenue.

<sup>18</sup> The greater likelihood; a degree of proof which is more probable than not.

the reasons for their decision in EAS notepad and send a letter confirming the firm's classification.