



Wisconsin Compensation Rating Bureau

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## GENERAL CIRCULAR LETTER 435 - MARCH 10, 2003

To: Members of the Bureau

FROM: Donna Knepper

RE: Audit Issues

On September 30, 1996, the WCRB released General Circular Letter 386 explaining audit procedures for independent contractors. The Circular, in part, states:

"It is no longer appropriate, therefore, for auditors to include remuneration paid to such uninsured subcontractors in the calculation of an insured's final worker's compensation premium. However, subcontractors who have not elected to cover themselves personally, regardless of whether or not they have employees or a policy covering those employees, are covered for injuries to themselves under your insured's policy unless they meet the nine statutory criteria to be an independent contractor as defined in Section 102.07(8)(b), Wis. Stats."

Carriers are reminded that, in the absence of a Certificate of Insurance, the nine point test MUST be applied to the subcontractors to determine whether or not additional premium should be charged. The nine point test is as follows:

"Section 102.07(8)(b)

8)(a) Except as provided in par. (b), every independent contractor is, for the purpose of this chapter, an employee of any employer under this chapter for whom he or she is performing service in the course of trade, business, profession, or occupation of such employer at the time of the injury.

(b) An independent contractor is not an employee of an employer for whom the independent contractor performs work or services if the independent contractor meets all of the following conditions:

*[The following nine part test applies to independent contractors who are not statutory employees. It was created by Chapter 64, Laws of 1989, effective January 1, 1990.]*

**1.** Maintains a separate business with his or her own office, equipment, materials, and other facilities.

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2. Holds or has applied for a federal employer identification number with the federal internal revenue service or has filed business or self-employment income tax returns with the federal internal revenue service based on that work or service in the previous year. (The added language was taken from the unemployment insurance definition of independent contractors.)
3. Operates under contracts to perform specific services or work for specific amounts of money and under which the independent contractor controls the means of performing the services or work.
4. Incurs the main expenses related to the service or work that he or she performs under contract.
5. Is responsible for the satisfactory completion of work or services that he or she contracts to perform and is liable for a failure to complete the work or service.
6. Receives compensation for work or service performed under a contract on a commission or per job competitive bid basis and not on any other basis.
7. May realize a profit or suffer a loss under contracts to perform work or service.
8. Has continuing or recurring business liabilities or obligations.
9. The success or failure of the independent contractor's business depends on the relationship of business receipts to expenditures.

(c) The department may not admit in evidence state or federal laws, regulations, documents granting operating authority, or licenses when determining whether an independent contractor meets the conditions specified in par. (b) 1. or 3."

Another audit concern is the application of the Minimum Minimum Premium Rule. The following is a copy of the rule and examples of its application.

"The minimum premium is subject to final adjustment at final audit. It is determined on the basis of those classifications developing premium as follows:

- If the circumstances upon which the minimum premium was originally determined have changed during the policy period, the minimum premium shall be changed in the manner indicated and the audit shall be made accordingly.
- In the event that the designated minimum premium is greater than 20 percent of the earned payroll, then the minimum premium shall be 20 percent of the earned payroll, but not less than the applicable expense constant. This amount is not subject to pro rata or short rate cancellation.
- When more than one state is insured on the same policy, the highest minimum premium shall be charged even if that state is on an "if any" basis.

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In the event of mid-term cancellations, this rule only applies if it produces a lower minimum premium than would be produced under Rule 3-A-3 of this manual."

The minimum premium is determined as follows:

**Minimum Premium = WI Minimum Premium Multiplier X current rate + expense constant**

The following examples may help illustrate how the rule and the exception work in tandem:

(NOTE: In all examples, the applicable manual rate is \$10.00, the applicable minimum premium shown on the Policy Information Page is \$850, and the expense constant is \$200.)

*Example 1:* The final audit develops \$10,000 in earned payroll. The final premium is 10,000 x \$10.00 divided by 100 or \$1,000 plus the expense constant of \$200 for a total of \$1,200. Neither minimum premium rule applies, as the audited premium exceeds the minimum.

*Example 2:* The final audit develops \$5,000 in earned payroll. The calculated premium is \$5,000 x \$10.00 divided by 100 or \$500 plus the expense constant of \$200 for a total of \$700, which is less than the minimum premium. The Wisconsin Exception refers to 20% of earned payroll or .20 x \$5,000 for a total of \$1,000. Since \$1,000 is greater than the policy minimum shown of \$850, the Wisconsin Exception does not apply, and the \$850 Minimum is applicable under Basic Manual Rule F., paragraph 5.

*Example 3:* The final audit develops \$3,000 in earned payroll. The calculated premium is \$3,000 x \$10.00 divided by 100 or \$300 plus the expense constant of \$200 for a total of \$500. The Wisconsin Exception calculation is 20% of \$3,000 or \$600, which is less than the \$850 policy premium. Therefore, the Exception applies and the minimum premium charged is \$600.

*Example 4:* The final audit develops no earned payroll. Since 20% of 0 is nothing, the Wisconsin Exception obviously applies, and since the minimum charge under the Exception is the Expense Constant, the actual minimum charged would currently be \$200. The last example is, by far, the most common situation, as a number of risks, primarily contractors, often buy policies they are not required to purchase because they have no employees, solely to obtain a Certificate of Insurance. Since there is no loss exposure in this situation, the Office of the Commissioner of Insurance believes that the Expense Constant is adequate payment to the carrier for issuing the policy. Similar arguments are used for employers with very small payroll.

Remember, in any of the above examples, if the policy is canceled mid-term, the Minimum Premium Rule applies only if it produces a lower premium than would be produced under Rules X-B. or X-C.