

Fall 2010

A resource for workers' compensation insurance

The **Compensator**

Employee or Independent Contractor?

Understanding the difference



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Employee or Independent Contractor?

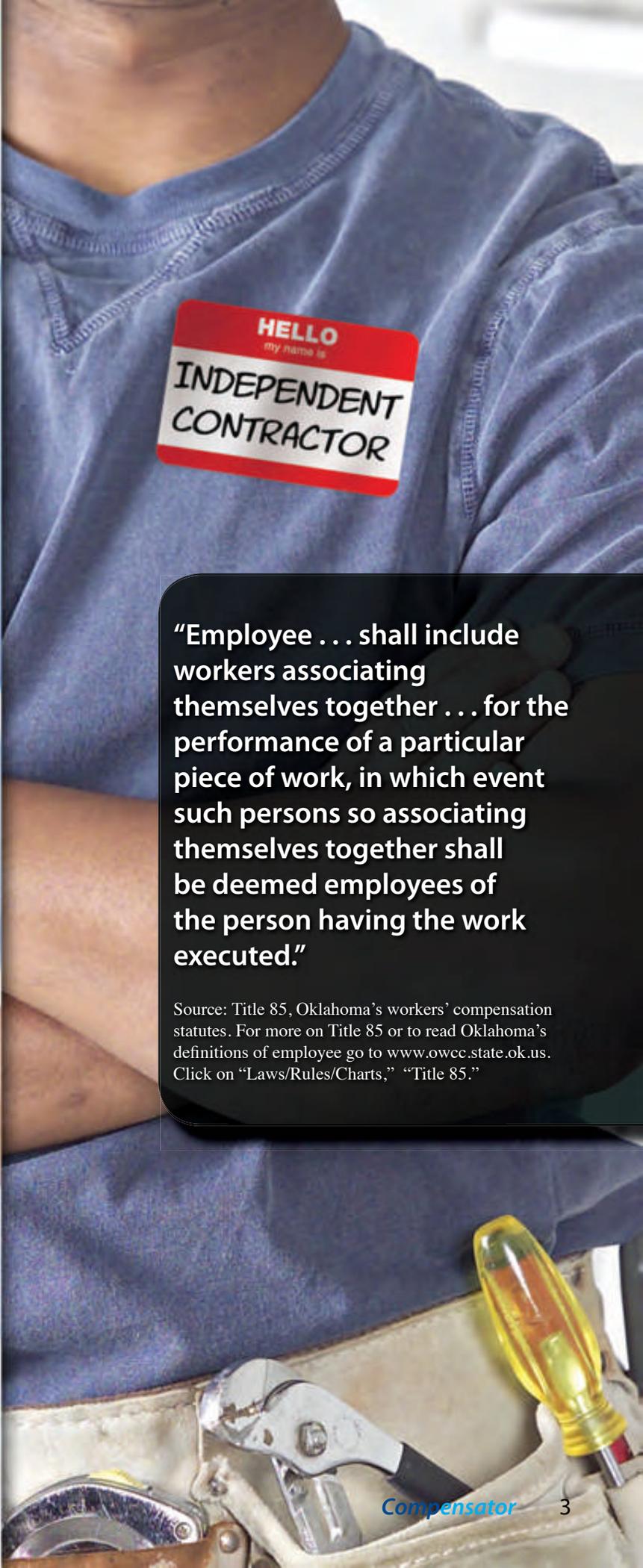
Most employers understand their workers' compensation insurance coverage, however one area that can cause confusion is classifying workers as either independent contractors or employees.

Because there is no universal test for independent contractor status, employers are faced with a variety of state and federal definitions and overlapping statutes. A situation that qualifies someone as an independent contractor under the Internal Revenue Service (IRS) tax code may not be the same under Oklahoma's workers' compensation statutes. Correctly identifying workers under each circumstance is becoming critical as federal and state agencies more closely scrutinize employment reporting practices. Misclassification can result in federal and state penalties, and increased workers' compensation premiums at the end of the policy year. See the article on page 10, "Feds push for employment law compliance."

The issue of independent contractor versus employee is a common frustration among employers according to Sandra Teer, CompSource premium audit manager.

"Often an employer believes he or she can apply IRS criteria to their workers' compensation policy, but that isn't always the case," Teer said. "One of the biggest misconceptions relates to the definition of 'employee' within Oklahoma's workers compensation laws. When workers are associating themselves together under an agreement to complete a job, they are considered employees of the person having the work executed."

Cont. on Page 4



“Employee . . . shall include workers associating themselves together . . . for the performance of a particular piece of work, in which event such persons so associating themselves together shall be deemed employees of the person having the work executed.”

Source: Title 85, Oklahoma’s workers’ compensation statutes. For more on Title 85 or to read Oklahoma’s definitions of employee go to www.owec.state.ok.us. Click on “Laws/Rules/Charts,” “Title 85.”

For example, if you're a contractor building a house and four drywall workers come in to do a job for you, they should be classified as employees on that job."

"Since each circumstance is unique, I would encourage policyholders that if in doubt, call the CompSource premium audit department. We'll look at the situation and advise you if the individuals would be classified as employees under Oklahoma's workers' compensation law. It's better to call and check and hopefully avoid any surprises at the year-end audit. We are a great resource for employers when determining worker status," she added.



Employee misclassification extends across a broad range of industries, and commonly occurs in construction, skilled trades and home health care due to the independent nature of the work in these industries.

Mike Means, executive vice president for the Oklahoma State Home Builders Association, said their organization trains its members on issues such as employee misclassification, obtaining proper proof of coverage from others and maintaining proper coverage for their own business.

"We believe there are too many people doing jobs and exposing workers to claims by not carrying workers' compensation themselves," Means said.

"Usually the contractor is unaware a subcontractor doesn't have coverage until there's a claim and it's too late. "

– Mike Means, executive vice president for the Oklahoma State Home Builders Association



Did you know?

“We think any contractor, whether independent or with a small crew, should have workers’ compensation coverage. Usually the contractor is unaware a subcontractor doesn’t have coverage until there’s a claim and it’s too late. Then the contractor is facing a claim on their policy and possibly litigation. It’s for their protection to require proof of workers’ compensation insurance before a subcontractor starts on a job,” Means said.

Insurance agents are also doing their part to educate policyholders on the importance of proper classification.

Cont. on Page 6

CompSource’s premium audit department wants to ensure all of our policyholders understand the premium audit process. Below are facts that some readers may not know can impact premium calculation.

Did you know Certificate of Non-Coverage Cards (CNC Cards) are no longer being used in Oklahoma to exclude payments made to independent contractors?

Did you know if a person meets the criteria of “employee” as defined by Oklahoma’s workers’ compensation law, payments to that individual will be counted as wages on the workers’ compensation audit regardless of whether the payments are reported to the Internal Revenue Service on a Form 1099 or W2?

Did you know that Affidavits of Exempt Status forms presented for exclusion of premium must be evaluated by CompSource for validity and that they must have been obtained **before** work was initiated?

Did you know the most important action you can take for an audit is to ensure you keep complete payroll records that document payments with detailed job descriptions and classification of payroll?

Did you know that bonuses paid to employees are included in wages for which premium is calculated?

For more on this topic see “Understanding the Premium Audit Process,” a booklet available on CompSource’s website at www.compsourceok.com/premaud.htm.



“Employee misclassification continues to be a difficult matter for our policyholders, particularly in the construction industry,” said Larry Neal, insurance agent and owner of the J.T. Neal Insurance Agency.

“Often, someone sees themselves as an independent contractor because they perform the majority of the job alone, but they forget about the person who helps them with only one element of the job. For example, if a cabinetmaker has someone helping attach cabinets to walls, the helper is an additional exposure that’s not being covered under a workers’ compensation policy,” Neal said.

One tool that many agents and policyholders use in determining the classification of a worker is the Affidavit of Exempt Status Form and Fact Sheet.*

* The Affidavit of Exempt Status Form and Fact Sheet are available on CompSource’s home page at compsourceok.com.



The affidavit was created for use by individuals who are independent contractors and exempt from the requirement to carry workers’ compensation insurance; it is only valid for the person signing the affidavit.

Some contractors believe that if they have all their employees sign an affidavit they can be classified as an independent contractor, however that is not the case. If an independent contractor hires employees

Ask the expert

to work on a job, then that contractor must carry workers' compensation coverage for those employees unless they are exempt under the family of five rule.

Ideally, the working relationship should be determined prior to any work commencing. However, the issue of whether someone is an employee or an independent contractor often does not present itself until someone is hurt or killed on the job and a lawsuit is filed. If there is no workers' compensation coverage at the subcontractor level, then responsibility typically transfers from the subcontractor up the employment chain to the general contractor and a claim is filed under their policy. This creates a potential liability issue for the employer since no premium has been collected to cover the exposure.**

One solution for ensuring every employee is properly classified and everyone is adequately covered, is to be thorough in validating the contractor's information. It's better to be cautious and make sure you have proper protection from liability should an accident occur on the worksite.

Keeping the following points in mind should assist in navigating the majority of the issues surrounding insurance coverage verification or employee classification.

Cont. on Page 8

** The employer's liability is further discussed in chapter 2 section 11 of Title 85, Oklahoma's workers' compensation statute.

"In the past an auditor has contacted me for an audit at my place of business but this year I was asked to complete forms to return by mail. I prefer the auditor come to my place of business. Why did the auditor not schedule a visit this year?"

Policies are not always audited at the policyholder's place of business. CompSource has three types of audits.

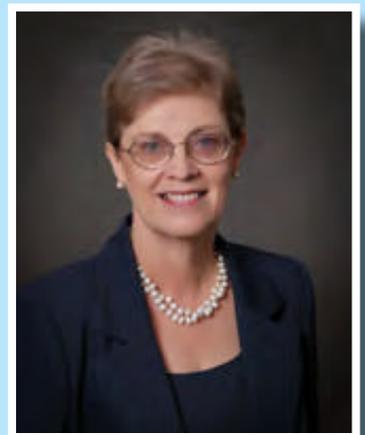
A physical audit involves the CompSource auditor scheduling an on-site visit to review the policyholder's records at their place of business or at the office of their certified public accountant or bookkeeper.

A mail-in audit involves CompSource mailing a premium audit packet to the policyholder to complete and return. This is often much more convenient for the policyholder and saves the time and trouble of a on-site visit.

An interim audit is when the CompSource auditor schedules a quarterly or semiannual on-site visit to review the policyholder's records.

The decision on which kind of an audit is performed is based upon numerous factors and may change depending on the nature of the business.

For additional information please refer to "Understanding the Premium Audit Process" booklet. It is available at www.compsourceok.com./premaud.htm. or you may call 800.347.7663, ext. 5528.



*Sandra Teer
Premium Audit Manager*

Do you have a question for one of CompSource's workers' compensation experts?

Contact us at media_department@compsourceok.com.

1) Important - As the principal employer, you must obtain a current, valid workers' compensation certificate of insurance from all subcontractors who have employees working for you. Otherwise, additional premium may be collected on your audit to cover the earnings paid to subcontractors.

2) If an employee-employer relationship does not exist and you believe the person working for you is an independent contractor, then they may qualify for exclusion from coverage. However, they must provide you a completed Affidavit of Exempt Status Form and Fact Sheet. If the subcontractor provides an affidavit, but you know they don't work alone, then you must also obtain a certificate of insurance from the subcontractor to ensure their employees are adequately covered.

3) Keep copies of all documentation to provide to your workers' compensation auditor. Proof of your due diligence will be helpful should a dispute go before the workers' compensation court.

4) Always check the policy coverage dates of the subcontractor to verify the coverage is in effect. This coverage can be verified through the "NCCI Proof of Verification" tab on the Oklahoma

Workers' Compensation Court website www.owcc.state.ok.us/ncci_coverage.htm. You may also contact the insurance company issuing the certificate to verify coverage.

The topic of employee versus independent contractor status may seem complicated, however, with the proper planning employers can protect themselves from the unnecessary stress often associated with employee misclassification.

For additional information on this issue, contact CompSource's underwriting department at or 800.347.3863, ext. 5102.



Defining employee

Defining independent contractor

For an individual to qualify as an independent contractor, an employee-employer relationship cannot exist. Under Oklahoma's workers' compensation law, an employee cannot be excluded from workers' compensation coverage. In contrast, an independent contractor can qualify for exclusion using an Affidavit of Exempt Status Form if that individual works alone and does not form an employee-employer relationship.

The statements below can be helpful in determining which classification applies. No one statement is controlling in defining a worker's status.

Defining employee

The individual is more likely an employee if they:

- Receive instructions on when, where and how to work. The more instructions they receive, the more likely they are an employee.
- Receive training from the employer.
- Work at the employer's place of business, unless the work is scheduled to be done somewhere else – for example, building a house or painting an office.
- Are told in what order the work is to be done.
- Are reimbursed for any business expenses.
- Have regularly scheduled paydays.
- Can be fired.
- Have no contract with the employer.
- Can quit without being sued for breach of contract.

Defining independent contractor

The individual is more likely an independent contractor if they:

- Have a federal identification number.
- Have a business license.
- Perform work that involves a specialized skill or trade.
- Maintain their own place of business.
- Furnish the majority of their own materials and tools to perform the work.
- Have a written contract that spells out the contractor/subcontractor relationship.
- Have a right to hire and terminate their employees without permission being granted.
- Perform specific jobs for set fees agreed upon in advance.
- Pay expenses incurred in connection with a specified job.
- Provide invoices for work performed.
- Have their own general liability insurance.
- Have their own clientele.
- Work alone.
- Are at risk for losing money on a particular job.



Perspectives

National trends

According to the U.S. Department of Labor, the misclassification of employees as independent contractors is expected to cost the U.S. Treasury Department more than \$7 billion in lost payroll tax revenue over the next decade. Below are examples of an increased effort to enforce existing employment laws across the nation, both at the federal and state level.

Feds push for employment law compliance

Internal Revenue Service

In February, the Internal Revenue Service (IRS) launched the Employment Tax National Research Project, a three-year initiative to examine tax-reporting compliance by employers. Each year for the next three years the IRS will randomly select 2,000 taxpayers for an employment tax reporting review. The examinations will be comprehensive in scope and will primarily focus on payroll tax reporting, fringe benefits, expense reimbursements and worker classification.

David Stell, IRS spokesman, recommends employers use the “Employers Supplemental Tax Guide 15A” as a guideline to determine proper reporting requirements including proper employee classification. This guide provides specific details to assist employers in determining if a worker is an employee or an independent contractor based on the IRS guidelines. Access the IRS guide at tinyurl.com/2g6h7c2.

Department of Labor

The U.S. Department of Labor is adding 150 new investigators to focus on enforcement responsibilities. This comes on the heels of a report to Congress by the Government Accountability Office which made recommendations on additional measures aimed at ensuring proper employment tax reporting. Some of the recommendations included:

- Enact laws that would make misclassification itself a violation of the nation’s wage-and-hour laws.
- Narrow the “safe harbor” provisions in the federal tax laws.
- Enhance IRS compliance programs.
- Improve coordination and information sharing between federal and state agencies.

For information from the U.S. Department of Labor about the employer’s responsibility as it relates to accurate employee classification go to www.dol.gov.

Note: The definition of employee defined under Oklahoma workers’ compensation statutes may be different than the definition for employee classification under the IRS tax code.

Revisions to workers' compensation statute adds light duty clause

Effective Nov. 1, 2010, entitlement to Temporary Total Disability (TTD) has been modified. It now specifies that an employee is not entitled to TTD benefits if he or she rejects a light duty assignment after:

- The treating physician has released the employee to light duty work with written restrictions, and
- The employer makes a good faith offer in writing to provide a light duty position at the claimant's same rate of pay.

Offering light duty to an injured employee can be beneficial to both the employer and the employee. It helps the employer retain a worker and it provides the employee much-needed time to heal while still being productive at work. Additionally, it increases the likelihood that the employee will heal sooner and will return to work full time, ideally working in his or her usual full-time position.

Contact your CompSource claims adjuster if you would like additional information or have questions about a specific claim. You may also contact CompSource at 800-347-3863 and ask to speak with a claims representative.

CompSource rate structure changes

CompSource Oklahoma Board of Managers approved an adjustment of rates on certain job classification codes for new and renewal policies effective on or after Nov. 1, 2010 (12:01 a.m.). Adjustments are based upon the past loss experience of each job classification code. Therefore, while certain job classification codes may have a rate decrease, others may increase or remain unchanged.

In addition, CompSource Oklahoma adopted new payroll limitations to be applicable on new and renewal policies effective on or after Nov. 1, 2010 (12:01 a.m.). The new payroll limitations are outlined below:

- For covered Sole Proprietors, Partners and Limited Liability Members the payroll limitation is \$37,300 annually.
- For covered Executive Officers the payroll limitations are a minimum of \$18,200 and a maximum of \$150,800 annually.

If you should have any questions contact the underwriting department at 800-347-3863, ext. 5102.



The Source for Workers' Compensation Insurance

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Phone system changes for Tulsa area

Tulsa's local phone system is changing. An additional area code (539) is being added to accommodate local population growth. In addition to the area code, Tulsa is transitioning to 10-digit dialing (the area code plus the 7 digit number).

Beginning March 5, 2011, all calls within the 918 and 539 area codes will require use of the new 10-digit dialing system even when placed as local calls.

CompSource's Tulsa office numbers will remain the same at this time. The main number for the Tulsa office is (918) 295-1500.

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