

BY SAL ALFANO

# SUBS AND WORKERS COMP: AVOIDING THE HIDDEN COSTS



Workers comp costs have skyrocketed in recent years. Since premiums for this type of insurance are based on total payroll, builders everywhere are reducing the number of workers they employ directly in favor of using more subcontractors.

The tax consequences of hiring a sub whom the IRS considers to be your employee are well known — you may end up paying the sub's federal withholding and social security taxes. But hiring a sub who does not carry his own workers comp insurance can be just as costly. Yet many builders who use subcontractors often end up paying workers comp premiums as if the subcontractors were

employees. This usually happens during the insurance company's annual payroll audit.

## Certificates of Insurance

Workers comp premiums are calculated as a percentage of payroll that is based on an elaborate formula (see "Straight Talk About Workers Comp," 2/93). At the start of each policy year, the insurance company estimates the next year's payroll, and applies the rate from the workers comp formula to come

up with your premium. Then, at the end of each policy year, an auditor reviews your account to see if your

**TO HELP CONTROL  
YOUR COMP  
PREMIUMS, GET A  
CERTIFICATE OF  
INSURANCE FROM  
EVERY SUB BEFORE  
THE WORK BEGINS**

**ACORD. CERTIFICATE OF INSURANCE**

ISSUE DATE (MM/DD/YY)

**PRODUCER**Smith Insurance Agency  
Main Street  
Richmond, VT 05477

THIS CERTIFICATE IS ISSUED AS A MATTER OF INFORMATION ONLY AND CONFERS NO RIGHTS UPON THE CERTIFICATE HOLDER. THIS CERTIFICATE DOES NOT AMEND, EXTEND OR ALTER THE COVERAGE AFFORDED BY THE POLICIES BELOW.

**COMPANIES AFFORDING COVERAGE**

CODE

SUB-CODE

**INSURED**Jones Construction  
2 Park Street  
Richmond, VT 05477COMPANY LETTER **A** ABC Insurance Company  
COMPANY LETTER **B**  
COMPANY LETTER **C**  
COMPANY LETTER **D**  
COMPANY LETTER **E****COVERAGES**

THIS IS TO CERTIFY THAT THE POLICIES OF INSURANCE LISTED BELOW HAVE BEEN ISSUED TO THE INSURED NAMED ABOVE FOR THE POLICY PERIOD INDICATED. NOTWITHSTANDING ANY REQUIREMENT, TERM OR CONDITION OF ANY CONTRACT OR OTHER DOCUMENT WITH RESPECT TO WHICH THIS CERTIFICATE MAY BE ISSUED OR MAY PERTAIN, THE INSURANCE AFFORDED BY THE POLICIES DESCRIBED HEREIN IS SUBJECT TO ALL TERMS, EXCLUSIONS AND CONDITIONS OF SUCH POLICIES. LIMITS SHOWN MAY HAVE BEEN REDUCED BY PAID CLAIMS.

CO LTR	TYPE OF INSURANCE	POLICY NUMBER	POLICY EFFECTIVE DATE (MM/DD/YY)	POLICY EXPIRATION DATE (MM/DD/YY)	ALL LIMITS IN THOUSANDS
<b>A</b>	<b>GENERAL LIABILITY</b>	X99999999	1/1/94	1/1/95	GENERAL AGGREGATE \$600,000
	<input checked="" type="checkbox"/> <b>COMMERCIAL GENERAL LIABILITY</b>				PRODUCTS-COMP/OPS AGGREGATE \$600,000
	<input type="checkbox"/> <b>CLAIMS MADE</b> <input checked="" type="checkbox"/> <b>OCCUR.</b>				PERSONAL & ADVERTISING INJURY \$600,000
	<input type="checkbox"/> <b>OWNER'S &amp; CONTRACTOR'S PROT.</b>				EACH OCCURRENCE \$600,000
					FIRE DAMAGE (Any one fire) \$50,000
					MEDICAL EXPENSE (Any one person) \$5,000
	<b>AUTOMOBILE LIABILITY</b>				COMBINED SINGLE LIMIT \$
	ANY AUTO				BODILY INJURY (Per person) \$
	ALL OWNED AUTOS				BODILY INJURY (Per accident) \$
	SCHEDULED AUTOS				PROPERTY DAMAGE \$
	HIRED AUTOS				
	NON-OWNED AUTOS				
	GARAGE LIABILITY				
	<b>EXCESS LIABILITY</b>				EACH OCCURRENCE \$ AGGREGATE \$
	OTHER THAN UMBRELLA FORM				
<b>A</b>	<b>WORKER'S COMPENSATION AND EMPLOYERS' LIABILITY</b>	X99999999999	1/1/94	1/1/95	STATUTORY \$100,000 (EACH ACCIDENT)
	\$500,000 (DISEASE—POLICY LIMIT)				
	\$100,000 (DISEASE—EACH EMPLOYEE)				
	<b>OTHER</b>				

DESCRIPTION OF OPERATIONS/LOCATIONS/VEHICLES/RESTRICTIONS/SPECIAL ITEMS

**CERTIFICATE HOLDER****CANCELLATION**SHOULD ANY OF THE ABOVE DESCRIBED POLICIES BE CANCELLED BEFORE THE EXPIRATION DATE THEREOF, THE ISSUING COMPANY WILL ENDEAVOR TO MAIL 10 DAYS WRITTEN NOTICE TO THE CERTIFICATE HOLDER NAMED TO THE LEFT, BUT FAILURE TO MAIL SUCH NOTICE SHALL IMPOSE NO OBLIGATION OR LIABILITY OF ANY KIND UPON THE COMPANY, ITS AGENTS OR REPRESENTATIVES.

AUTHORIZED REPRESENTATIVE

ACORD 25-S (3/88)

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Before work starts, obtain a certificate of insurance from each subcontractor. The top half of the form names the subcontractor, his insurance agent, and the insurance company providing coverage. The workers comp section at the bottom of the form shows the dates and amounts of the sub's coverage (circled).

actual payroll was higher or lower than estimated. If your payroll was higher, you are billed for the difference in premium; if lower, you get a rebate.

Auditors treat subs as if they were employees when the builder has paid for work done by a sub, but cannot provide a certificate of insurance showing the dates and amounts of the sub's own workers comp coverage (see sample certificate, facing page). If you don't have a certificate of insurance for a sub — or if you have the wrong one — here's what will happen.

First, your premium will go up because the auditor will increase your total payroll for the current year — as well as the estimated payroll for next year — by the amount you paid to the subcontractor. Strictly speaking, only the *labor* portion of payments made to an uninsured subcontractor are subject to workers comp premiums. But unless you can produce an invoice or other record that breaks down the sub's costs into labor and material, you will have no way to convince the auditor to add less than the total amount.

Second, since the workers comp formula matches premium amounts to the type of work performed — the so-called *manual rate* — you may pay more for the sub than for regular employees. If the sub is a roofer, for example, you could pay 10% to 20% more than the rate for general carpentry.

As if all this weren't bad enough, your general liability insurance premium will go up because it's also based on payroll. And the additional liability premium will also be based on the manual rate for the kind of work the uninsured sub does.

### Exempt Subs

In many states, a sole proprietor is exempt from workers comp requirements and won't have a certificate of insurance. You can still keep them off your workers comp payroll, but you'll have to prove they meet IRS criteria for exemption (see "Sub or Employee," 10/92). Among other factors, the IRS requires that the sub is self-directed on the site, that he performs the same kind of work for other contractors, that he works with his own tools, and that he supplies his own materials.

Some auditors will accept a printed

invoice bearing the sub's company name and logo as proof of exemption. Others may require a trade name registration form or other document that shows the sub has registered with the state to do business.

**Uninsured subs.** When an uninsured sub doesn't meet the exemption criteria, some builders carry the cost of covering the sub under their own workers comp policy. They estimate how much their own insurance company will charge to cover the uninsured sub and deduct that amount from the sub's bill. While this may appear to solve the problem, it actually compounds it.

For one thing, while you may be able to estimate the amount to withhold from the sub's bill to cover the current year, the insurance company will include this year's payments to the sub in the estimate of your *next year's* pre-

## IF A ROOFER DEVELOPS A BAD BACK, HE COULD CLAIM THE AILMENT STARTED WHILE HE WAS LIFTING SHINGLES ON YOUR JOB — AND YOU MIGHT BE LIABLE

mium. This is the case even if you have no plans to use the uninsured sub in the coming year. As always, the manual rate may be higher, depending on the kind of work the sub performs, and the calculations will probably be based on the total amount you paid the sub, not just the labor portion.

The real danger in accepting liability for an uninsured sub, however, is that it leaves you vulnerable to claims if the sub is injured. Strictly speaking, you are liable only for injuries that occur on your job. But not all injuries occur at a specific time or place. If a roofer develops a bad back, for example, he could claim that the ailment started while he was lifting shingles or tiles onto the roof of one of your jobs. The same is true of repetitive motion injuries, like carpal tunnel syndrome. The sub could make a case that his injury started or was compounded by work done on one of your jobs. Unless you can prove otherwise, you are liable for medical costs and

wage reimbursements, both of which will raise your workers comp premiums.

Remember, too, that when you accept liability for a sub, you also accept liability for the sub's employees. A sole proprietor may not have employees when you subcontract the work to him, but if he falls behind schedule, he may hire help. Without a certificate of insurance, it will be hard to prove that the sub's employees are not your own.

### Get Proof Early

The best time to ask a sub for his certificate of insurance is before work begins, but you should at least be sure to get one before you make final payment. Once the job is over and the sub is paid, your chances of getting a certificate in time for your annual audit are slim. And even though you can make adjustments after the audit, it's much easier to prevent being charged for a sub in the first place than it is to have charges rebated later.

**Read the certificate.** When you do receive a certificate of insurance from a sub, don't just file it away — read it. The workers compensation section near the bottom of the sample form lists the "Policy Effective Date" and the "Policy Expiration Date." These dates must include the calendar dates when he performed his work for you. It's especially important to check this information if, instead of an original, the sub gives you a photocopy of his certificate, which may apply to a prior year.

Also check to see that the *amounts of coverage* match or exceed your coverage. The series of numbers — 100/500/100 — on the right hand side of the workers compensation section of the sample form corresponds to thousands of dollars of coverage for each accident, the total policy limit, and the limit per employee, respectively. Injuries to a sub or one of his employees are covered to the limits of the sub's workers comp policy. If medical treatment and wage reimbursements exceed those limits, however, his insurance company will look for higher limits on your policy to make up the difference. The excess costs will then be charged against your workers comp record. ■

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