

## Important Notice of Change in Coverage and Premium

### Coverage

Tennessee law requires individuals engaged in the construction industry to carry workers' compensation insurance for their workers in most circumstances. The policy you have and the premium you pay will likely change effective December 31, 2009. **On this date, sole proprietors and partners in the construction industry must carry workers' compensation insurance on themselves, even if they are independent contractors.**

According to the Department of Labor and Workforce Development (DOLWD), there is only one limited exception: a sole proprietor or partner in the construction industry (with no employees) does not have to cover themselves if they are only getting paid directly by the property owner. **Please note:** If you are a sole proprietor or partner doing any work as an intermediate contractor or subcontractor, then this limited exception does not apply.

In all other circumstances, sole proprietors and partners must carry workers' compensation insurance on themselves and on any of their workers who are not otherwise covered by a workers' compensation insurance policy.

**In Tennessee, Limited Liability Companies (LLCs) are recognized by the DOLWD as partnerships for workers' compensation coverage purposes.**

Consistent with the new law, your policy will be automatically adjusted to include the newly required coverage, effective on December 31, 2009, regardless of your policy's effective date. **Your anticipated premium will be adjusted during the applicable policy term to cover the new exposure created by the change in the law.** The exact details of each adjustment will, of course, depend on each policyholder's particular circumstances.

### Premium

For the construction industry, premium determination for each partner and sole proprietor treated as an employee is based on the actual payroll amount (when qualifying tax forms are supplied), subject to the minimum and maximum payroll amounts for partners and sole proprietors in the Tennessee rating manual. The minimum and maximum amounts are as follows:

- The minimum annual payroll for sole proprietors and partners is \$15,600;
- The maximum annual payroll for sole proprietors and partners is \$49,200\*.

**\*For policies with effective dates of 3/1/2009 through 2/28/2010, the maximum amount is \$51,200.**

These minimum and maximum payroll amounts include annual amounts of wages, salary, emoluments, or profits for each such partner or sole proprietors. IRS tax forms for sole proprietorships and partnerships may be used to determine the actual payroll amounts, as follows:

#### Sole Proprietorships and Single Member LLCs\*\* – IRS Schedule C

- If the net profit (loss) amount is less than the minimum payroll amount (\$15,600); then the minimum payroll amount applies.
- If the net profit amount falls between the minimum (\$15,600) and maximum (\$49,200 or \$51,200) payroll amounts; then use the net profit amount.
- If the net profit amount is greater than the maximum payroll amount (\$49,200 or \$51,200); then the maximum payroll amount applies.

#### Partnership and Multiple Member LLCs\*\* – IRS Form 1065 with Schedule K-1

- If the net earnings (loss) from self employment amount is less than the minimum payroll amount (\$15,600); then the minimum payroll amount applies. "Net earnings (loss) from self employment" is found under Part III of the 2008 Schedule K-1, 14.a (see page 2 for details).

**\*\* On the rare occasion where LLCs choose to file corporate tax returns, base "members" remuneration upon actual payroll for the period in question, subject to minimum (\$300) and maximum (\$2,600, or \$2,700 for policies with effective dates of 3/1/09 through 2/28/2010) average weekly payrolls.**

- If the net earnings from self employment amount falls between the minimum (\$15,600) and the maximum (\$49,200 or \$51,200) payroll amounts; then use the net earnings from self employment amount.
- If the net earnings from self employment amount is greater than the maximum payroll amount (\$49,200 or \$51,200); then the maximum payroll amount applies.

However, in both examples, if the IRS Schedule C (sole proprietors), or IRS Form 1065 with a Schedule K-1 (partners) **is not provided to an insurance company representative by October 1, 2009**; then the Tennessee rating manual rule requires that the payroll amount used for sole proprietors and partners (except for when Corporate tax filings were made) applicable to the non-construction industry (\$49,200 or \$51,200 – see asterisk under first paragraph of “**Premium**”, page one) will be used in computing the premium. You will have another opportunity to submit this documentation after the expiration date when your policy’s premium is being audited.

**WARNING:** The IRS tax forms reviewed for premium determination for partners and sole proprietors will be the most current available. Tax forms more than two years from the effective date of your policy will not be accepted for premium determination.

**The additional premium bill for the sole proprietor, partnership, or LLC policies affected by this change in the law on December 31, 2009 will be delivered on or around November 1, 2009. These additional premium amounts will be due and payable by December 31, 2009. If additional premiums are over \$1,000, installments will be made available for this billing.**

**Example:**

Policy effective **7/1/2009**, and John Doe, sole proprietor, is not included. Mr. Doe is a painter and the appropriate classification code (5474) has a rate of **\$11.84 per \$100** of payroll.

Effective **12/31/09**, the sole proprietor’s status changes under the Tennessee Workers’ Compensation Act. Mr. Doe’s policy is endorsed effective **12/31/09** to include John Doe. The remuneration (payroll) used to determine the premium charge will be based on John Doe’s most current available (within two years of the policy effective date) IRS Schedule C (sole proprietor), subject to the state’s minimum (\$15,600) and maximum (\$51,200). In this example, Mr. Doe’s **net profit** is \$35,000, falling between the minimum and maximum; therefore, the \$35,000 applies.

A pro-rata factor will be applied for the remainder of the policy term, **12/31/09 – 7/1/2010 (the timeframe Mr. Doe is covered)**, in this case the factor is **.504 (# days left until expiration / 365, or in this example, 184 / 365 = .504)**. This remuneration divided by 100 times the appropriate classification’s rate will determine the additional premium charge (see below).

**Calculation of additional premium:**

$$\begin{array}{l} \$35,000 \times .504 = \$17,640. \qquad \qquad \qquad \$17,640 / 100 \times \$11.84 = \underline{\underline{\$2,089}} \\ \text{[Remuneration X Pro-Rata Factor = Subject remuneration]} \quad \text{[Subject remuneration / 100 x rate = Additional Premium]} \end{array}$$

**However, if the proper Schedule C is not filed and furnished to the carrier**, the additional premium charge would be as follows:

$$\begin{array}{l} \$51,200 \times .504 = \$25,805. \qquad \qquad \qquad \$25,805 / 100 \times \$11.84 = \underline{\underline{\$3,055}} \\ \text{[Remuneration X Pro-Rata Factor = Subject remuneration]} \quad \text{[Subject remuneration X 100 x rate = Additional Premium]} \end{array}$$

Please contact your agent to discuss the details of your specific circumstances and the impact this change may have on your policy, if you have questions.

**Note:** Executive Officers (including the construction industry) of corporations may continue to exclude themselves from coverage by properly completing an I-6 form (available at <http://www.state.tn.us/labor-wfd/forms/i-6.pdf>), obtaining a stamped copy from the Department of Labor and Workforce Development, and forwarding the same with the request to the insurance carrier. A corporate officer electing non-coverage does not reduce the number of employees for the purpose of determining whether an employer must have a workers' compensation policy [see T.C.A. Section 50-6-103(b)].