

Attached is a copy of Rule 2 of the Minnesota Basic Manual, governing workers' compensation insurance, specifically how payroll impacts how much you pay for coverage.

Payroll is more complicated than simply cutting checks to your employees every other week, and there are many forms of payment (or "remuneration") that either get overlooked or counted by mistake. When these little mistakes add up, they can actually drive up the cost of your workers' compensation insurance.

Simply put, you pay more for mistakes.

I've highlighted in the statute what should (and should not) count towards payroll. I hope this also serves to illustrate the complexity of the workers' compensation system in the state of Minnesota, and why it's important to have expert support on your side. Most agents simply don't have the time or training to deal with payroll errors.

Our team of experts at Minnesota Comp Advisor see these errors all the time and work tirelessly to get them corrected, saving Minnesota employers hundreds of thousands of dollars on their workers' compensation every year.

To say "thanks!" for downloading this report, I'd love to review your payroll audit for errors, so please give me a call at 612-236-1781 or send me an email at mark@andersonagencyins.com.

Sincerely,



Mark Kraemer, CIC, CWCA
Certified Work Comp Advisor

RULE 2—PREMIUM BASIS AND PAYROLL ALLOCATION

A. PREMIUM BASIS

Premium is calculated on the basis of the total payroll paid or payable by the insured for services of individuals who could receive workers' compensation benefits for work-related injuries as provided by the policy.

Exceptions:

Premium for domestic worker classifications is calculated on a per capita basis instead of payroll. Domestic workers are employees who perform household duties. *Refer to Rule 3-C.*

A per capita classification uses the number of workers rather than payroll to measure exposure.

B. PAYROLL *(This is the stuff you should be paying for)*

For purposes of this manual, payroll means money or substitutes for money.

1. Includes:

- a. Wages or salaries (including retroactive wages or salaries).
- b. Total cash received by an employee for commissions and draws against commissions.
- c. Bonuses including stock bonus plans. *(Refer to Rule 2-D.)*
- d. Extra pay for overtime work except as provided in Rule 2-C-2.
- e. Pay for holidays, vacations, or periods of sickness. *(Refer to Rule 2-G for allocation of payroll for employees subject to more than one classification code.)*
- f. Payment by an employer of amounts that would have been withheld from employees to meet statutory obligations for insurance or pension plans such as the Federal Social Security Act or Medicare.
- g. Payment to employees on any basis other than time worked, such as piecework, profit sharing or incentive plans.
- h. Payment or allowances for hand tools or hand-held power tools used by employees in their work or operations for the insured. These tools may be supplied directly by the employee or to the employee through a third party.
- i. The rental value of an apartment or house provided to an employee based on comparable accommodations.
- j. The value of lodging, other than an apartment or house received by an employee as part of their pay to the extent shown in the insured's records.
- k. The value of meals received by employees as part of their pay to the extent shown in the insured's records.
- l. The value of store certificates, merchandise, credits or any other substitute for money received by employees as part of their pay.
- m. Payments for salary reduction, employee savings plans, retirement or cafeteria plans (IRC 125) that are made through employee-authorized salary reduction from the employee's gross pay.
- n. Davis-Bacon wages or wages from a similar prevailing wage law.
- o. Annuity plans.
- p. Expense reimbursements to employees to the extent that an employer's records do not confirm that the expense was incurred as a valid business expense.
- q. Payment for filming of commercials excluding subsequent residuals that are earned by the commercial's participant(s) each time the commercial appears in print or is broadcast.

Do: Include This in Your Payroll Audit

Now check out the stuff you should NOT pay for →

2. **Excludes:** *This stuff should be left out, but it gets included all the time (often without the auditor noticing)*
- a. Tips or other gratuities received by employees.
 - b. Payments by an employer to group insurance or group pension plans for employees, other than those covered by Rule 2-B-1-f and Rule 2-B-1-m.
 - c. Payments by an employer into third-party trusts for the Davis-Bacon Act or a similar prevailing wage law provided the pension trust is qualified under IRC Sections 401(a) and 501(a).
 - d. The value of special rewards for individual invention or discovery.
 - e. Dismissal or severance payments except for time worked or vacation accrued.
 - f. Payments for active military duty.
 - g. Employee discounts on goods purchased from the employee's employer.
 - h. Expense reimbursements to employees to the extent that an employer's records confirm that the expense was incurred as a valid business expense.
Reimbursed expenses and flat expense allowances (except for hand or hand-held power tools) paid to employees may be excluded from the audit only if all three of the following conditions are met:
 - (1) The expenses are incurred for the business of the employer
 - (2) The amount of each employee's expense payments or allowances are shown separately in the records of the employer
 - (3) The amount of each employee's expense reimbursement is a fair estimate of the actual expenses incurred by the employee in the conduct of his/her work
 - i. Supper money for late work.
 - j. Work uniform allowances.
 - k. Sick pay paid to an employee by a third party such as an insured's group insurance carrier that is paying disability income benefits to a disabled employee.
 - l. Employer provided perks such as:
 - Use of company provided automobiles
 - Airplane flights
 - Incentive vacations (e.g., contest winners)
 - Discounts on property or services
 - Club memberships
 - Tickets to entertainment events
 - m. Employer contributions to employee benefit plans such as:
 - Employee savings plans
 - Retirement plans
 - Cafeteria plans (IRC 125)These include contributions made by the employer, at the employer's expense, which are determined by the amount contributed by the employee.

Don't Include This In Your Payroll Audit

I want to show you one other costly error we see all the time with payroll audits (it's on page 5 of this report) →

C. OVERTIME

1. Definition

“Overtime” means hours worked for which there is an increase in the rate of pay:

- a. For work in any day or in any week in excess of the number of hours normally worked.
- b. For hours worked in excess of 8 hours in any day or 40 hours in any week.
- c. For work on Saturdays, Sundays, or holidays.

In the case of a guaranteed wage agreement, overtime means only those hours worked in excess of the number specified in that agreement.

Note: Forms of incentive pay commonly referred to as “shift differential” or “premium pay” associated with working other than normal day shift hours during the standard work week are not considered overtime. Refer to Rule 2-C-2-d for more information on premium pay. Refer to the *Minnesota User’s Guide* for an example.

2. Exclusion of Overtime Payroll

a. Payroll Records

The extra pay for overtime is excluded from payroll on which premium is calculated as indicated in the table below, provided that the insured’s books and records are maintained to show overtime pay separately by employee and in summary by classification. Extra pay is the difference between the regular pay rate and the overtime pay rate multiplied by the number of overtime hours worked.

Refer to the *Minnesota User’s Guide* for an example.

Calculating Overtime

| If the records show . . . | Then . . . |
|---|---|
| Extra pay earned for overtime separately... | The entire extra pay is excluded |
| Total pay earned for overtime (regular pay plus overtime pay) in one combined amount, and time and one-half is paid for overtime... | 1/3 of this total pay must be excluded |
| Double time is paid for overtime and the total pay for such overtime is recorded separately... | 1/2 of the total pay for double time must be excluded |

Note: The only portion of the overtime payroll that is deductible is the amount in excess of wages that would have been applied if the overtime were compensated at the regular rate of pay.

Exception to 2-a:

Exclusion of overtime pay does not apply to payroll assigned to any classification under the caption Stevedoring with a code number followed by the letter “F.”

b. Hours Worked

Extra pay for overtime is deducted only if the employee receives extra pay for:

- Working more than 8 hours per day or 40 hours per week, or
- Hours worked in a day or week that are greater than the number of hours usual to the insured or industry. This may permit an overtime deduction if an employee works less than 8 hours per day or less than 40 hours per week (e.g., for a 32-hour workweek, any hours over 32 hours is overtime).

No deduction for overtime is permitted for wages earned by employees who work in excess of 40 hours per week but do not receive an increase in their normal hourly rate of pay for the overtime work.

Refer to the *Minnesota User’s Guide* for examples.

c. Guaranteed Wages

In some industries, guaranteed wage contracts or agreements exist under which the employee receives a guaranteed wage for work up to a specified number of hours per week, such as 50. The guaranteed wage, for example, is calculated on the basis of 40 hours at straight time and 10 hours at 1 ½ times the basic hourly wage. Under guaranteed wage plans of this general type, the full guaranteed wage is included in the premium calculation for any hours that an employee works up to the maximum number of hours covered by the guaranteed wage, regardless of how this wage is calculated. The overtime rule is applicable in the case of guaranteed wages only to earnings in excess of the guaranteed wages.

*Refer to the **Minnesota User's Guide** for examples.*

d. Premium Pay

This rule applies with respect to higher rates of pay that are paid at the traditional overtime hourly rate of pay for work on Saturdays, Sundays, or holidays, even though the employee has not worked the normal workweek, because work on these days has been regarded traditionally as overtime and not as part of the normal workweek.

Premium Pay is extra compensation paid to employees who work nights, holidays, weekends, other special hours or work under unusual conditions. This premium pay is not considered overtime pay when it is the normal pay for working these shifts.

Consider an employee that works a 40-hour night shift at a rate of \$15 per hour. The day shift rate of pay for the same work is \$10 per hour. No overtime deduction is made from the \$15 per hour since this is considered premium pay. If the night shift employee works more than the normal number of hours and receives pay in excess of the normal \$15 per hour, that excess is considered overtime.

*Refer to the **Minnesota User's Guide** for examples.*

D. PAYROLL LIMITATIONS

1. Payroll limitations do not apply to standard employees in Minnesota. Employees subject to payroll limitations are listed below.

Exceptions:

- Specific limitations apply to payroll for Sole Proprietors, Partners, Executive Officers, Members of Limited Liability Companies, Parents, Spouse, and Children of Owners; Code 9178 – Athletic Teams: Non-Contact Sports and Code 9179 – Athletic Teams: Contact Sports; and Players, Entertainers, and Musicians and to classifications with notes that indicate payroll limitations
- Payroll limitation applies after any deductions of extra pay for overtime. Partial weeks are considered full weeks when determining average weekly pay
- Bonuses are to be allocated according to the date paid

For additional information regarding payroll limitations for Sole Proprietors, Partners, Executive Officers, or Members of LLC's, *refer to Rule 2-E.*

*Refer to the **Minnesota User's Guide** for an example.*

E. EXECUTIVE OFFICERS, MEMBERS OF LIMITED LIABILITY COMPANIES, PARTNERS, AND SOLE PROPRIETORS

1. Executive Officers

Executive Officers of a corporation or unincorporated association are the president, vice president, secretary, treasurer, or any other officer appointed in accordance with the charter or bylaws of such entity. In general, executive officers are automatically included for coverage in Minnesota except certain executive officers of closely held corporations. Executive officers of closely held corporations who are automatically excluded may elect to be covered under the law.

To include executive officers in Minnesota, attach the Standard Sole Proprietors, Partners, Officers and Others Coverage Endorsement (WC 00 03 10).

When executive officers are covered under the workers' compensation law, they have the same status as employees under the policy. For additional election of coverage information, refer to Minnesota Statute 176.041, and the *Election of Coverages Reference Table and Rule C-1 in the Minnesota User's Guide*.

Executive officers may be paid by one or more corporations. In some cases, the multiple corporations may be insured by a single carrier under one or more policies. If so, the multiple corporations are considered a single unit with respect to the application of the executive officer rule. In all other cases, the rule applies on a policy basis. Refer to Rule 3-A-15 regarding majority interest. Refer to *Minnesota Experience Rating Plan Manual* for rules regarding combination of entities.

a. Classification Assignment

Executive Officers must be assigned to the classification that applies to the principal operations in which the executive officer is engaged.

Exceptions:

- Payroll of an executive officer who regularly and frequently engages in duties that are ordinarily performed by a superintendent, foreperson, or worker must be assigned to the governing classification.
- Payroll of an executive officer who performs construction, erection or stevedoring operations must be divided and assigned to the classifications that apply to the different operations of the executive officer, subject to the requirements of Rule 2-G.

b. Premium Determination

The payroll of all executive officers covered by the policy shall be included in the statement of payroll and premium charged subject to the following limitations:

- (1) minimum individual per week payroll equal to the minimum individual payroll value for this rule stated in the Miscellaneous Values of the current *Minnesota Ratemaking Report*.
- (2) maximum individual per week payroll equal to the maximum individual payroll value for this rule stated in the Miscellaneous Values of the current *Minnesota Ratemaking Report*.
- (3) The payroll limitations in b(1) and b(2) apply to the average weekly payroll of each executive officer for the number of weeks the officer was covered under the policy. A part of a week is considered as a full week in determining the average weekly payroll.

↑ Officer wages should get capped at a certain amount, but we still see errors here all the time.

(4) Payroll is subject to minimum and maximum limitations and *included* when:

- The executive officer does not perform any duties but frequently visits the premises.
- The executive officer frequently visits the premises of the risk for business conferences, directors' meetings or similar duties, even if the officer is an employee or officer of another risk in the operations of which he/she takes an active interest.
- The officer receives no salary; however, a regular salary is credited to him or her on the books. In this instance the amount credited must be included in payroll.
- The officer receives no salary, either drawn or credited, or the audit records fail to disclose the salary. In this instance the amount to be included in the payroll is the applicable minimum.

(5) Payroll is *excluded* when:

- The executive officer is elected for the value of his/her name or because of stock holdings, has no duties and does not visit the premises, except perhaps to attend directors' meetings.
- The executive officer ceases to perform any duties and does not visit the premises, except perhaps to attend directors' meetings.

c. Executive Officers Performing Flight Duties

Payroll of an executive officer who is a pilot or member of the flying crew of an aircraft used in the insured's business must be assigned as follows:

- (1) For each week that the executive officer did not perform flight duties, assign the executive officer's payroll to the classification that applies to the principal operations in which the executive officer is engaged.
- (2) For each week that the executive officer performed flight duties, assign the officer's payroll for that week to the appropriate aviation classification. However, if the executive officer's non-flying duties in that week are subject to a higher rated classification, assign that higher rated classification for that week.

Note: The above rules apply on the basis of the pilot's logbook, which is required under federal regulations, or on the basis of other verifiable records.

- (3) If verifiable records are not kept to indicate those weeks during which flying is performed by the executive officer, assign the executive officer's payroll to the highest rated classification that applies to any of their duties.

2. Members of Limited Liability Companies

a. Treatment

For purposes of this rule, any references to members or managers will collectively be referred to as *members* of limited liability companies.

To determine if a member of a limited liability company is to be treated as an executive officer or partner for premium purposes, refer to *Minnesota Statute 176.041* and *Rule C-1* in the **Minnesota User's Guide**. For election of coverage information, refer to the *Election of Coverages Reference Table* in the **Minnesota User's Guide**.

b. Premium Determination

Members of a limited liability company who are covered by workers' compensation insurance will be treated the same as an executive officer for premium determination purposes and are subject to the maximum and minimum payroll limitations listed on the Miscellaneous Values Pages in the current **Minnesota Ratemaking Report**. Refer to *Rule 2-E-1*.

3. Partners or Sole Proprietors

Partners and Sole Proprietors are automatically excluded from coverage under Minnesota's workers' compensation law but may elect coverage. To include Partners or Sole Proprietors in Minnesota, attach the Standard Sole Proprietors, Partners, Officers and Others Coverage Endorsement (WC 00 03 10). Partners and Sole Proprietors who are covered by workers' compensation insurance will be treated the same as an executive officer for premium determination purposes and are subject to the same maximum and minimum payroll limitations listed on the Miscellaneous Values Pages in the current **Minnesota Ratemaking Report**.

When partners or sole proprietors are covered under the workers' compensation law, they have the same status as employees under the policy. For additional election of coverage information, refer to *Minnesota Statute 176.041*, and the *Election of Coverages Reference Table and Rule C-1 in the Minnesota User's Guide*.

a. Premium Determination

The entire payroll of each partner or sole proprietor covered by a policy will be included in the statement of payroll and premium charged subject to a maximum individual payroll per week and a minimum individual payroll per week equal to the minimum and maximum individual payroll values for this rule as stated in the Miscellaneous Values Pages of the current **Minnesota Ratemaking Report**. These limitations shall be applied to the average weekly payroll of each covered partner or sole proprietor determined on the basis of the total number of weeks employed during the policy term. A part of a week shall be considered as a full week in determining the average weekly payroll.

b. Classification Assignment

Payroll of partners or sole proprietors are assigned to classifications under the rules that apply to employees.

Payroll of a partner or sole proprietor who is a pilot or member of the flying crew of an aircraft used in the insured's business must be assigned as follows:

- (1) For each week that the partner or sole proprietor did not perform flight duties, assign the partner or sole proprietor's payroll to the classification that applies to the principal operations in which the partner or sole proprietor is engaged.
- (2) For each week that the partner or sole proprietor performed flight duties, assign the partner or sole proprietor's payroll for that week to the appropriate aircraft classification. However, if the partner or sole proprietor's non-flying duties in that week are subject to a higher rated classification, assign that higher rated classification for that week.

Rules (1) and (2) apply on the basis of the pilot's logbook, which is required under federal regulations, or on the basis of verifiable records. If verifiable records are not kept to indicate those weeks during which flying is performed by the partner or sole proprietor, assign the partner or sole proprietor's payroll to the highest rated classification that applies to any of their duties.

F. WAGES FOR TIME NOT WORKED

1. Idle Time

Some employers pay employees for time not worked. All wages paid to the employee for such idle time must be included in payroll. These wages are assigned to the classification for work normally performed by the employee under the following circumstances:

- Suspension or delay of work due to weather conditions
- Delays while waiting for materials
- Delays while waiting for another party to complete certain work
- Delays arising from breakdown in equipment
- “Stand-by” time where employees such as operators of cranes, hoists or other equipment are on the job but their active services are not required continuously
- Special union requirements or agreements between employer and employees calling for pay for idle time under specific circumstances
- Inability of non-striking employees to perform normal duties due to other employees who are on strike. If non-striking employees perform absolutely no work for their employer and are not present at their employer’s premises or job sites during a strike period, their payroll must be assigned to Code 8810—Clerical Office Employees, provided adequate records are maintained by the employer.
- All other causes of a similar nature

Refer to the *Minnesota User’s Guide* for an example.

Refer to *Rule 2-F-2* for the treatment of idle time by construction, erection or stevedoring risks.

2. Wages Paid to Key Employees

Wages paid to key employees of construction, erection or stevedoring risks, such as superintendents, forepersons or engineers, must be assigned to the classification applicable to the work that each one actually performs during any period where no jobs are in progress.

Exception to F-2 above:

If such work consists exclusively of drafting or other office work, or if such employee is completely idle, the wages must be assigned to Code 8810. However, Code 8810 is not available for office time of an executive supervisor who qualifies for Code 5606. It is normally expected that such an employee will spend a considerable portion of time engaged in office work.

G. INTERCHANGE OF LABOR

Some employees may perform duties directly related to more than one properly assigned classification according to Rule 1-D-3. Their payroll may be divided among the properly assigned classifications as follows:

Minnesota Statute 79.211, subd. 2 (1980), provides that the insurer shall permit an employer to divide his payroll among the rating classifications most closely fitting the work actually performed by each employee in a four-hour block or more for purposes of premium calculation when the employer's records provide adequate support for a division.

An insurer is not required to divide an employer's payroll unless the employer requests or demands that it do so and notifies the insurer of its election or desire to have its payroll divided.

To the extent the provisions of this manual, specifically but not limited to Rule 1-A-1, Rule 1-B-2-a(2)(a), Rule 1-B-2-b, Rule 1-B-5, Rule 1-D-1, Rule 1-D-3, and Rule 1-E, and classification phraseologies dealing with the division of payroll are inconsistent with the provisions of Minnesota Statute 79.211 which provide under what circumstances payroll shall be divided, the provisions of that statute shall control.

The division of payroll permitted by Minnesota Statute 79.211 pertains both to the computation of an employer's premium and also to the proper statistical reporting of premiums and losses to the Minnesota Workers' Compensation Insurers Association subject to the following provisions:

- The numeric classification code used to rate the risk must be valid in Minnesota — i.e. the classification code number reported must be included in the current **Minnesota Ratemaking Report**.
- The classification definition contained in the **Minnesota Basic Manual** for the classification code being reported must include, either generally or specifically, the definition used by the carrier to rate the risk under that classification code.

Note: Estimated or percentage allocation of payroll is not permitted. If payroll records do not show the actual payroll applicable to each classification, the entire payroll of the individual employee must be assigned to the highest rated classification that represents any part of his or her work.

- When a division of payroll exists for an individual employee, payroll for holiday, vacation, sick pay, overtime and all other forms of payroll not directly attributable to a specific classification code shall be allocated to the classification code with the greatest amount of payroll applicable to the individual employee. If no one classification code applicable to the employee has the greatest amount of payroll, the payroll for holiday, vacation, sick pay, overtime and all other forms of payroll not directly attributable to a specific classification code shall be allocated to the highest rated classification code applicable to the employee.

*Refer to the **Minnesota User's Guide** for examples.*

H. SUBCONTRACTORS

1. In Minnesota, the workers' compensation law provides that a contractor is responsible for the payment of compensation benefits to employees of its uninsured subcontractors. The subcontractor must furnish satisfactory evidence that the subcontractor has workers' compensation insurance in force covering the work performed for the contractor. *For additional information, refer to Minnesota Statute 176.215 and the **Minnesota User's Guide**.*

The following documents may be used to provide satisfactory evidence:

- Certificate of insurance for the subcontractor's workers' compensation policy
- Copy of the subcontractor's workers' compensation policy

- For each subcontractor not providing such evidence of workers' compensation insurance, additional premium must be charged on the contractor's policy for the uninsured subcontractor's employees according to Subcontractor Table 1 and 2 below.

Subcontractor Table 1

| If the contractor has not furnished evidence of workers' compensation insurance and... | Then to calculate the additional premium... |
|--|--|
| Furnishes complete payroll records of the subcontractor's employees... | Use the payroll detailed in the records |
| Does not furnish complete payroll records and the subcontract price does not reflect a definite payroll amount... | Use the full subcontract price of the work performed during the policy period by the subcontractor as payroll |
| Does not furnish complete payroll records, but documentation of a specific job discloses that a definite amount of the subcontract price represents payroll... | Use the payroll amount indicated by the documentation as the payroll, subject to the minimums in Subcontractor Table 2 below |

Subcontractor Table 2

| If the job involves: | Then the minimum to calculate additional premium is: |
|---|---|
| Mobile equipment with operators (such as but not limited to earth movers, graders, bulldozers, or log skidders) | Not less than 25% of the subcontract price |
| Labor and material | Not less than 50% of the subcontract price |
| Labor only | Not less than 90% of the subcontract price |
| Piecework | Not less than 100% of the subcontract price (The entire amount paid to pieceworkers must be the payroll.) |

- Vehicles with drivers, chauffeurs, or helpers entitled to benefits under workers' compensation insurance law may be engaged under verbal or written contract. The amount used to calculate the premium is determined in the following manner:

Subcontractor Table 3

| If the owner of such vehicles has not furnished evidence of workers' compensation insurance and... | Then ... |
|--|--|
| Payroll can be obtained | The total payroll of these drivers must be included as payroll of the insured employer that contracted for the vehicles. |
| Payroll cannot be obtained or the driver is an owner-operator and does not receive a set payroll | 25% of the total contract price for the vehicles must be included as payroll of the drivers. |
| The contract price does not include the cost of fuel, maintenance, or other services provided to the owner or the owner-operator of a vehicle under contract | The value of these goods and services must be added to the contract price before determining the 25% amount. |

- In all cases, the payroll determined for subcontractors is assigned to the classification that would have applied if the individuals had been employees of the contractor.
- In all cases, if an experience modification has been established for the contractor, this experience modification must be applied to the premium developed for the uninsured subcontractor.

I. VOLUNTARY COMPENSATION INSURANCE

Premium is determined on the basis of the workers' compensation rules, classifications, and rates as filed for use by each carrier with the Minnesota Department of Commerce. When necessary, use the Voluntary Compensation and Employers' Liability Coverage Endorsement (WC 00 03 11 A).

When Voluntary Compensation Insurance is provided for a group of employees, separate payroll records must be maintained by the insured for the designated group of employees.

For details, *refer to the Additional Coverages Summary Table found on F-7 of the **Minnesota User's Guide**.*

J. VOLUNTEER WORKERS

Premium must be determined on the basis of the payroll normally received by and the classification assigned to non-volunteer employees doing the same or similar work. *Refer to the **Minnesota Basic Manual Classification Section** for exceptions.*

For additional information, *refer to Rule 2-1 above and the Additional Coverages Summary Table found on F-7 of the **Minnesota User's Guide**.*

K. MIGRANT AND SEASONAL AGRICULTURAL WORKERS

Premium must be determined by the carrier from its evaluation of the exposures presented by the risk. For details on the Migrant and Seasonal Agricultural Workers Protection Act, *refer to Additional Coverages Summary Table located in F-7 of the **Minnesota User's Guide**.*