

## Leased Employees

The Leased Employee rules are very multifaceted and they can vary the proper administration of the plan. Step one in the process is to determine whether any employees are "Leased Employees" as defined by the IRS. In order to meet that definition, the employees must be performing services for the client company for a fee, they must be common law employees of the leasing company and not of the client company, they must provide services for the client company on a substantially full time basis for at least a year, and they must be under the primary direction or control of the recipient. If these requirements are not met, the employees must be completely disregarded for all retirement plan purposes.

If the employees do meet the Leased Employee definition, they must either be considered for retirement plan purposes under the client company's plan or under a certain safe harbor plan sponsored by the leasing company with contribution percentages of at least 10% and immediate vesting. In addition, Leased Employees may not make up more than 20% of the company's workforce. If the leasing company does not provide a safe harbor plan or if Leased Employees make up more than 20% of the workforce, the client company must consider these Leased Employees for all plan purposes. It is still possible to exclude Leased Employees from participation in the plan as long as the plan is able to pass a required coverage test. In general, the coverage test requires the percentage of Non-Highly Compensated Employees benefiting under the plan to be at least 70% of percentage of Highly Compensated Employees benefiting under the plan. If the company employs a large percentage of Leased Employees, it will be difficult to pass this test. However, any contributions or benefits provided under the leasing company's retirement plan that can be attributed to services performed for the client company can be included by the client company for all required testing. Therefore, it may be possible to exclude the Leased Employees from the client company's plan and pass the required annual testing if the Leased Employees participate in a plan sponsored by the leasing company.

As part of determining whether employees meet the Leased Employee definition, it is necessary to take a very close look at who is the common law employer - the leasing company or the client company. Numerous court cases have found that Leased Employees may in fact be common law employees of the client company despite the leasing arrangement. This is determined on a facts and circumstances basis. If the employees are determined to be common law employees of the client company, they should be treated the same as all non-Leased Employees for qualified plan purposes. Some of the items considered by the courts when deciding who is the common law employer include who has primary direction or control of the employee's services, the right to hire or fire the employee, who determines the method, order or sequence of the duties to be performed, and who supervises the employee. These items are reviewed in operation, regardless of the terms of the leasing agreement. These items are very similar to those used to determine if the employees are under the primary direction or control of the client company. Leased Employees are most frequently found to be common law employees of the client when a company's entire workforce is coordinated through a Professional Employer Group. Owners and other Highly Compensated Employees are rarely accepted as common law employees of the leasing company. The company can file a letter of determination with the IRS to ensure who the leased employees belong.

If the Leased Employees are determined to be common law employees of the client company and not the leasing company, the leasing company's plan could be disqualified for covering individuals who are not employees of the plan sponsor as this violates the exclusive benefit rule of ERISA. Many professional employer organizations and leasing companies with long term contract employees expect the client company to become a participating sponsor in the leasing company's plan to avoid this potential defect.