Leased Employees (IRC §414(n))

Some employers consider Professional Employer Organizations (PEOs) to be an effective way of managing their "human capital" by leasing employees. Sometimes called "contingent workers", leased employees may have to be treated as employees for purposes of an employer's qualified plan if:

1. they have served the employer (or related employer) on a substantially full-time basis for at least a year, and
2. they have been under the employer's direct control.

In fact, the Internal Revenue Code was amended to prevent employers from changing company structure in order to award benefits to a few highly compensated employees while providing low (or no) benefits to nonhighly compensated employees.

However, the fact that an employer uses leased employees meeting the above two tests does not automatically mean they must become participants under his retirement plan, as at least two circuit courts have held [1]. This view is supported by IRS, stating that IRC §414(n)(1)(A) requires only that leased employees be treated as employees, not that they be participants in the plan.[2]

Nevertheless, relying on a safe harbor, the employer may disregard leased employees for purposes of 412(i) plan participation if they are covered under the leasing company's retirement plan meeting certain IRS specifications[3] . This exemption is available only if the leased employees make up 20% or less of the employer's Non-Highly Compensated work force.

1. *Abraham v. Exxon Corp*, 85 F.3d 1126 (5th Circuit 1996); also *Bronk v. Mountain States Tel. & Tel, Inc*, 21 EBC 2862 (10th Circuit 1998)
2. Notice 84-11, 1984-2 C.B. 469, A-14
3. IRC §414(n)(5)