



(ALMOST) EVERYTHING YOU WANT TO KNOW ABOUT PEOS

Marcia S. Wagner, Esq.
President & Founder

THE
WAGNER LAW GROUP
A PROFESSIONAL CORPORATION



Introduction

- PEO Landscape
 - 2-3 million workers “co-employed”
 - Approximately 700 PEOs
- Retirement Plans
 - PEO Sponsored
 - Multiple-employer plans
- Welfare Plans



PEO Functions

- PEO takes over existing workforce
 - Responsible for:
 - Paying wages
 - Withholding and tax filings
 - Providing benefits
 - Unemployment / disability
- Staffing agency furnishes workers for limited duration



Employment-Based Benefits and PEOs

- Exclusive benefit rule
 - Participant of retirement plan must be employee of plan sponsor
 - Co-employment doctrine developed in order to meet exclusive benefit rule
 - Shared employment responsibilities and liabilities
 - Legal support for co-employment is minimal

Factors Determining Common Law Employment Relationship

- Supreme Court *Darden* case established 20 factors to determine existence of common law employee relationship
 - Theoretically, no one *Darden* factor is determinative and all factors are to be balanced
 - Practically speaking, touchstone is the power to direct and control the worker
 - IRS position: actual exercise of power is unnecessary

Co-Employment as Seen by PEO Industry

- Co-employment
 - Covers all existing worksite employers
 - Long-term relationship
 - Certain obligations belong solely to one party
 - E.g., Human resource services and provision of benefits are allocated to PEO
 - Other obligations shared
 - Allocation of other obligations is on a case by case basis
- Little support for co-employment in ERISA or Internal Revenue Code



PEO as the Common Law Employer

- PEO's authority may be so strong that the PEO is held to be the common law employer
 - Revenue Ruling 75-41: PEO possessed the contractual right to evaluate and discharge support staff for professional firms
 - Revenue Ruling 70-360: sales clerks were subject to PEO supervisor placed in store and only PEO could fire the clerks
- Similar examples are not widely found in the PEO industry



Support for Co-Employment Under Tax Law

- Co-employment held to exist in a few revenue rulings
 - Revenue Ruling 66-162: sales clerks were employees of both store and concessionaire that ran a department within store
 - Co-employment applies only if one employer is not abandoned in favor of another
 - Abandonment would occur unless worksite employees perform services for the PEO



AHEAD
OF THE
CURVE

2015 ASPPA ANNUAL
CONFERENCE



Client Company as Sole Common Law Employer

- PEO's formal authority to hire, supervise or control workers will be treated as irrelevant if subject to limitations in practice
 - TAM 1999180 – Worksite employees held to be common law employees of client firm, even though PEO reserved right to control and supervise workers, because client firm instructions could override PEO
 - *Burnetta v. Commissioner* – 1977 Tax Court case held that even though PEO could select, hire and train personnel of medical corporation, the medical corporation was the common law employer, because it determined pay rates



AHEAD
OF THE
CURVE

2015 ASPPA ANNUAL
CONFERENCE



Potential Disqualification of PEO Sponsored Retirement Plans

- PEO-sponsored retirement plan will be disqualified if it covers workers who are not employees of PEO
- Consequences of Disqualification
 - PEO loses deduction for plan contributions
 - Plan trust incurs income tax liability on investment earnings
 - Participants will be taxed on benefit accruals
- IRS Revenue Procedure 2002-21 provides limited relief for defined contribution plans
 - IRS avoids stating how worksite employees should be classified
 - Revenue Procedure does not state that no worksite employee could ever be a PEO employee



AHEAD
OF THE
CURVE

2015 ASPPA ANNUAL
CONFERENCE



IRS Relief – Termination Option

- Conditions for Relief under Revenue Procedure 2002-21
 - Terminate PEO plan
 - Must give client employer options:
 - Transfer plan assets to client employer's plan
 - Transfer plan assets to spin-off plan and terminate the spin-off plan
 - Alternative: set up multiple employer plan



AHEAD
OF THE
CURVE

2015 ASPPA ANNUAL
CONFERENCE



IRS Relief – MEP Option

- Relief under Revenue Procedure 2002-21 can be obtained by converting PEO plan to a MEP
 - Variable plan features may be selected by each participating worksite employer
 - Non-discrimination tests performed employer by employer
 - Under PEO-sponsored plan, nondiscrimination would have been tested in the aggregate



AHEAD
OF THE
CURVE

2015 ASPPA ANNUAL
CONFERENCE



Separate Employer Treatment under MEP Rules

- Separate employer treatment
 - Multiple contributing employers
 - Multiple benefit structures applying to different participants
 - Separate accounting for cost allocation (not for providing benefits)
 - Deduction limitations
 - Minimum coverage and participation
 - Nondiscrimination testing



AHEAD
OF THE
CURVE

2015 ASPPA ANNUAL
CONFERENCE



Single Plan Treatment of MEPs

- Single plan treatment
 - All MEP assets to be available to pay benefits to all MEP participants
 - Service with all MEP participating employers counted for purposes of eligibility and vesting
 - Annual additions from all participating employers aggregated for purposes of contribution limits



DOL Treatment of Retirement Plan MEP

- DOL Advisory Opinion 2012-04A
 - 401(k) MEP adopted by unrelated employers held to be series of separate plans
- Consequences of multiple plan status
 - Form 5500 filing for each plan
 - Annual audit for plans with 100 or more participants
- DOL Reasoning
 - Participating employers had no pre-existing ties
 - Participating employers lack control over plan sponsor



Consequences of Revenue Procedure 2002-21

- End of reliance on determination letters for PEO plan covering worksite employees
 - Most PEO plans terminated or converted to MEPs
 - Single-employer PEO plans covering worksite employees become obsolete
 - Risks of maintaining plan for worksite employees
 - Disqualification
 - Taxable rollovers
 - Improper non-discrimination testing
- MEP conversion provided definitive result
- Co-employment theory was uncertain and relied on case by case analysis



AHEAD
OF THE
CURVE

2015 ASPPA ANNUAL
CONFERENCE



Leased Employee Definition

- Leased employees not counted in nondiscrimination testing if safe harbor conditions met
 - PEO maintains 10% money purchase plan
 - Full and immediate vesting
 - Immediate participation by all worksite employees
- Definition of “leased employee”
 - Worker not the employee of service recipient
 - But worker is under primary direction and control of service recipient
 - Test to be applied only after determination that the worker is a common law employee of PEO
 - At least one court sees the test as internally inconsistent



AHEAD
OF THE
CURVE

2015 ASPPA ANNUAL
CONFERENCE



Leased Employee Safe Harbor Plans

- PEO must have significant control over worksite employees to qualify for safe harbor
- Revenue Procedure 2002-21 states that safe harbor not applicable if worker determined to be a common law employee of worksite employer
- Consequences of failing qualify under safe harbor
 - Leased employees to be tested under plan of worksite employer
 - PEO plan violates exclusive benefit rule and is disqualified



Proper Drafting of Section 414(n) Exclusion

- Proper drafting of exclusion for leased employees requires avoiding references to the statutory definition
- Exclusion ineffective if definition incorporates Code reference and employee is determined to be a common law employee of PEO client
- Definition of excluded employees should specifically describe the affected group



Mirror Plan Strategy

- PEO and client firm adopt identical plans so that leased employees and client firm employees get same level of contributions
- Does not address exclusive benefit rule and leaves PEO plan exposed
- Plan of client firm could potentially fail nondiscrimination



AHEAD
OF THE
CURVE

2015 ASPPA ANNUAL
CONFERENCE



Health Plan Transition Issues

- Health plan coverage issues when PEO relationship begins or ends
 - Notice to participants triggered when PEO takes over with new insurance carrier
 - COBRA notice required when old insurance terminated
 - PEO or client employer potentially liable for medical expenses if notice requirements not met



AHEAD
OF THE
CURVE

2015 ASPPA ANNUAL
CONFERENCE



MEWA Rulings

- Welfare benefit arrangement exempt from state regulation if not a MEWA
 - PEO must show that it is common law employer
 - Federal common law factors apply to determine employee status
- Rationale extended to PEO facts
- Plans with more than one employer sponsor not covered by ERISA preemption



Staffing Agency/PEO Rulings

- Federal common law factors apply to determine employee status
 - Right to control and direct
 - Right to fire
 - Worker's economic dependency on employer
- PEOs have usually failed to demonstrate employer-employee relationship
- State law deeming workers to be PEO employees disregarded at federal level



Alternatives for Avoiding MEWA Status

- PEO asserted to be a member of a controlled group with client firms for tax purposes
- PEO and client firms are members of affiliated service group for tax purposes
- PEO's have generally failed to qualify under these exceptions which require an ownership relationship with client firms



Establishing Controlled Group with Options

- PEO's have generally failed to qualify under exceptions which require an ownership relationship with client firms
 - PEO-held options in client firms likely to be disregarded
 - Must show business purpose for PEO to hold options in client firms
 - Avoiding state regulation as a MEWA is not viewed as a sufficient business purpose



(ALMOST) EVERYTHING YOU WANT TO KNOW ABOUT PEOS

Marcia S. Wagner, Esq.

THE
WAGNER LAW GROUP

A PROFESSIONAL CORPORATION

99 Summer Street, 13th Floor

Boston, MA 02110

(617) 357-5200

www.wagnerlawgroup.com

marcia@wagnerlawgroup.com



**AHEAD
OF THE
CURVE**

**2015 ASPPA ANNUAL
CONFERENCE**



(ALMOST) EVERYTHING YOU WANT TO KNOW ABOUT PEOS

James M. Kais

Senior Vice President

Transamerica Retirement Solutions



**AHEAD
OF THE
CURVE**

**2015 ASPPA ANNUAL
CONFERENCE**



Professional Employer Organizations (PEOs)

- What is a PEO?
- Services offered
- Retirement Plan structure
- Co-employment vs. Temporary/Leasing
 - Retirement plan considerations
 - Business implications for TPAs/Recordkeepers
- Considerations for small employers



PEO Defined

- Co-employment relationship with small employer
- Client is common law employer
 - Hire, fire and operate business
- PEO is denoted as “administrative employer”
 - File taxes under PEO FEIN
 - Contractually has “say” in EE terminations
 - Carries risk (EPLI, Worker’s Comp, leave admin)



Co-employment v. Temp/Leasing

- Common law employer



PEO Services

- Payroll
- HR compliance and consulting
- Retirement Plan
- Health and Welfare Plan
- Worker's Compensation
- FLSA/FMLA compliance
- Tax :: SUI, SUTA, FUTA compliance, etc.
- Recruiting and succession planning



Payroll

- I-9 and w-4 collection/verification
- Accurate tax reporting for worksite ER
- Garnishments, hardship freezes, limitation tracking
- Full census data
- Job costing/Job coding
- Specialized reporting for not for profits etc.



HR Compliance

- State requirements
 - Termination processing
 - Progressive discipline process
 - Pink slips in CT
 - Payment same day as termination in CA
 - Communicates termination to worksite employee
- Disability management
 - Light duty
- FLSA/FMLA
 - Leave management
 - Wage and hour violations



Retirement Plan

- MEP (mostly)
- Serves as plan sponsor, trustee and fiduciary
- Files form 5500, etc.
- Relies heavily on service partners
- Direct downloads from HRIS to Recordkeeper
- Outsourcing is prevalent (.5 to 3.5 FTEs @ PEO)
- Plan design flexibility



Health & Welfare

- Single group health or individually underwritten, HSAs
- Underwriting within “bands” or “tiers” in single group
 - Prevents adverse selection
 - Prevents subsidization of cost
 - Review BCR, ASI
- Community rated depending on state
- Voluntary benefits
- Group Life/Disability



Worker's Compensation

- Multiple Coordinated, master policy or pay-as-you-go individually underwritten
- PEOs in blue collar or medical markets sensitive to worksite conditions
- Provide inspections, loss control training
- Shock claims can cripple the PEO's balance sheet
- May earn arbitrage ("rate vig")



PEO Billing

- How do PEOs charge/generate revenue?
 - Percentage of payroll
 - Flat fee per check
 - Arbitrage on Worker's Compensation
- Retirement plan cost/billing?
 - PEO FTEs may be covered in admin rate
 - ERISA budget account (audit)
 - Rarely a flat fee to the worksite employer



Retirement Plan Structure

- Multiple Employer Plan (MEP)
 - Rev. Proc. 2002-21
 - DOL
 - Volume Submitter or IDP
- Aggregation Programs (individual SEPs)
 - 5500s by adopter
 - VS doc. (usually)



AHEAD
OF THE
CURVE

2015 ASPPA ANNUAL
CONFERENCE



Servicing the (MEP)

- Geographically dispersed
 - Enrollment/Education
 - Local plan design/sales support



AHEAD
OF THE
CURVE

2015 ASPPA ANNUAL
CONFERENCE



Why Use a PEO?

- Focus on revenue producing tasks
- Achieve buying power
- Mitigate Risk (Tax, FLSA, FMLA, Unemployment)
- Recruiting and succession planning
- Job costing
- Tax reporting (accurate)
- Enhance employee experience (large co. benefits)



Bad Candidates for PEO

- Rate shoppers
 - Can't run away from your experience
- Place no value on strategic HR
- Not willing to make an investment to outsource
- Financially unstable (post a bond)
- Prior shock claims or EPLI claims



Choosing the Right PEO

- ESAC – Employer Service Assurance Corp,
 - \$10M bond
 - Audits
 - Financial requirements
- Registered or licensed in state (model legislation recently passed)
- Active with NAPEO or in the community
- Well established service partners



AHEAD
OF THE
CURVE

2015 ASPPA ANNUAL
CONFERENCE



(ALMOST) EVERYTHING YOU WANT TO KNOW ABOUT PEOS

Marcia S. Wagner, Esq.
President & Founder
The Wagner Law Group

James M. Kais
Senior Vice President
Transamerica Retirement Solutions



AHEAD
OF THE
CURVE

2015 ASPPA ANNUAL
CONFERENCE

