

Who is Considered an Employee for Retirement Purposes?



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Who is considered an employee for retirement purposes? Why is it important?

COVID-19 has changed the way everyone is doing business because of the constantly changing business environment. Some companies have gone to alternative work arrangements such as a mostly part-time employee base or independent contractors. Some are using leased employees, seasonal employees, and interns to fill in the gaps. All of these types of workers are often referred to as contingent workers. Alternative work arrangements present some unique challenges, and it takes careful planning to ensure benefit plans cover employees that are legally considered to be common law employees and thus eligible to participate in the retirement plan. I will focus on common law employees. Independent contractors and leased employees.

So, who are considered employees for retirement purposes? The answer to this question can be very complex and cause issues when not done correctly. The exclusive benefit rule limits participation in retirement plans to employees of the employer. Some employers will simply include all workers in their benefit plans to make sure they include the employees that need to be included. Unfortunately, that option violates the exclusive benefit rule, which mandates that plans be maintained and operated for the exclusive benefit and in the best interest of employees and beneficiaries. By covering workers that are not employees, a plan sponsor violates this rule.

It is up to each employer to ensure all of its workers are properly classified. However, employers may want to enlist help from experts to ensure it is done correctly.

So how do employers determine who is an employee? There are several factors, a company should consider. As a general rule, an employee is someone that an employer has the right to control and direct the work of the employee. This control includes not only what is to be done, how it is to be done but also where it is to be done. If the employee is receiving a W-2 then it is a good chance they are an employee.

By contrast, an independent contractor can have the tasks specified by the employer, but the employer does not direct how it is done. They are usually paid through a 1099. An agreement between the company and the person as contract labor does not automatically make that person an independent contractor. The three general factors used are behavioral control, financial control and relationship of the parties to determine if the employee is truly an independent contractor. In the past the "Twenty Factor Test" (Revenue Ruling 87-41) was used to determine if the employee is actually an independent contractor.

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I have found that the following is a good test in which to make that determination:

- If the employee has significant investment in facilities, equipment, etc. that are used for performing services;
- Realizes a profit or loss;
- Provides similar services for more than one firm at a time; and
- Makes his or her services available to the general public.

Many people think of leased employees as a generic term that refers to any worker that comes from some sort of staffing agency; however, the law includes a very specific and lengthy definition.

Although a true Leased Employee is, by definition, a common law employee of the leasing organization, he or she may also be treated as an employee of the company for which services are performed if all of the following conditions are met:

- The recipient company must pay a fee for the services of the individual;
- The worker must have performed services for at least one year on a substantially full-time basis (at least 1,500 hours in a 12-month period); and
- The recipient company must have primary direction over the services rendered by the worker.

Leased employees can have a significant impact on the employer's retirement plan. The leased employees are required to be counted in the nondiscrimination coverage tests (IRC section 410(b)) even when the leased employees are excluded from the plan.

As you can see, there is quite a bit that goes into properly classifying employees. The way an employee is classified affects the plan operations, participation, service determination, compensation included for plan purposes, coverage and discrimination testing, plan design options and payroll/corporate taxes. Proactive planning in the beginning can prevent unintended consequences down the road. It is very important for employers to work with knowledgeable experts who can provide guidance every step of the way.



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