

# Employee Benefit Plans

# Explanation No. 8 Employee Leasing

**Note:**

Plans submitted during the 2020 Required Amendment List submission period must satisfy the applicable changes in plan qualification requirements listed in Section IV of Notice 2020-83, 2020-50 I.R.B. 1597 (the 2020 RA List).

This publication contains copies of:  
Form 8386, Worksheet 8  
Form 8398, Deficiency Checksheet 8

These forms are included as examples only and should not be completed and returned to the Internal Revenue Service.

Worksheet Number 8 (Form 8386) and this explanation are designed to aid the specialist in deciding whether any qualification issue arising by reason of section 414(n) of the Code needs to be covered and, if so, whether the requirements of that section are met.

Section 9.08 of Rev. Proc. 2021-4, 2021-1 I.R.B. 157 (as annually revised), provides that that a determination letter submission which also seeks a ruling on the status of leased employees must specifically request that ruling in the submission's cover letter (in addition to providing information set forth in Section 17 therein).

The worksheet and explanation (except for the procedural information in Part I) are based on the statute itself and on various questions and answers in Notice 84-11, 1984-2 C.B. 469 and Rev. Proc. 2002-21, 2002-1 C.B. 911, as amplified by Rev. Proc. 2003-86, 2003-2 C.B. 1211. Until applicable regulations are published, the guidance provided by these questions and answers and procedures may be relied upon to comply with the provisions of section 414(n).



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The technical principles in this publication may be changed by future regulations or guidelines.

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## I. Required Information

Unless the plan provides that all leased employees within the meaning of section 414(n)(2) of the Code are treated as common law employees for all purposes under the plan, a determination letter issued with respect to the plan's qualification under section 401(a) or 403(a) of the Code will be a determination as to the effect of section 414(n) upon the plan's qualified status only if the application includes:

- 1) A description of the nature of the recipient organization;
- 2) A copy of the relevant leasing agreement;
- 3) A description of the function of all leased employees within the trade or business of the recipient organization (including data as to whether all leased employees are performing services on a substantially full-time basis) and whether services are performed under the primary direction or control of the recipient organization; and
- 4) If the recipient organization is relying on any qualified plan(s) maintained by the leasing organization for purposes of qualification of the recipient organization's plan, a description of such plan(s) (including a description of the contributions or benefits provided for all leased employees which are attributable to services performed for the recipient organization, plan eligibility, and vesting).

*Rev. Proc. 85-43, 1985-2 C.B. 501*

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## II. Applicability of Section 414 (n)

If the answers to a., b., c. and d. are "Yes" the plan sponsor is a "recipient" within the meaning of section 414(n)(1) of the Code; the persons performing the services for the recipient pursuant to the agreement are "leased employees" within the meaning of section 414(n)(2); and the person that the recipient has the agreement with is a "leasing organization" within the meaning of section 414(n)(2)(A). Leased employees are considered to be employees of the recipient organization for purposes of the requirements set forth in section 414(n)(3)(A) and (B), even though they are common law employees of the leasing organization, unless (i) they are covered by a safe harbor plan of the leasing organization, and (ii) leased employees (including those covered by a safe harbor plan) do not constitute more than 20 percent of the recipient's nonhighly compensated work force. To constitute a safe harbor the leasing organization's plan must meet the requirements set forth in section 414(n)(5)(B), which are reflected in part III of the worksheet.

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**Line a.** The term "leased employee", as defined in section 414(n)(2) of the Code, specifies that a leased employee is a person who is not an employee of the recipient. This specification was added by Pub. L. 98-369 (DEFRA) in 1984. Section 414(n)(6) defines "related persons" and also states that the rules of section 414(b), (c), (m) and (o) shall apply.

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**Line b.** The agreement between the parties may be oral or written. An individual who is actually a common law employee of the recipient will not become an employee of another entity merely because the recipient enters into a formal "leasing agreement" with the other entity.  
*Notice 84-11 Q&A 6*

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**Line c.** A person is considered to have performed services on a substantially full-time basis for a period of at least one year if: (i) during any 12-consecutive-month period such person has performed at least 1500 hours of service for the recipient, or(ii) during any 12-consecutive-month period such person performs services for the recipient for a number of hours at least equal to 75 percent of the average number of hours that are customarily performed by an employee of that recipient in the particular position. The one-year period includes service of the employee prior to the effective date of section 414(n). In addition, any period of service performed by the employee as a common law employee of the recipient is taken into account for purposes of determining whether the employee has performed services on a substantially full-time basis for a period of at least one year.

*Notice 84-11, Q&A 7*

*Notice 84-11, Q&A 8 & 12*

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**Line d.** Whether services are performed by an individual under primary direction or control by the service recipient depends on the facts and circumstances. In general, primary direction and control means that the service recipient exercises

the majority of direction and control over the individual. Factors that are relevant in determining whether primary direction or control exists include whether the individual is required to comply with instructions of the service recipient about when, where, and how he or she is to perform the services, whether the services must be performed by a particular person, whether the individual is subject to the supervision of the service recipient, and whether the individual must perform services in the order or sequence set by the service recipient. Factors that generally are not relevant in determining whether such direction or control exists include whether the service recipient has the right to hire or fire the individual and whether the individual works for others.

*Conference Report 1982-2 C.B. 522, 679*

*IRC 414(n)(2)(C)*

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### III. Safe Harbor

Section 414(n)(5) of the Code provides a safe harbor for a recipient organization if two conditions are met:

- i) The leasing organization maintains a qualified nonintegrated money purchase pension plan that provides for an annual contribution by the employer of 10 percent of total compensation (defined below) for each participant, full and immediate vesting, and immediate participation by each employee of the leasing organization (other than employees who perform substantially all of their services for the leasing organization). The requirement as to immediate participation does not apply to any individual whose compensation from the leasing organization in each plan year during the 4-year period ending with the plan year is less than \$1,000.
- ii) Leased employees do not constitute more than 20 percent of the recipient's nonhighly compensated work force. The term "nonhighly compensated work force" means the aggregate number of individuals (other than highly compensated employees within the meaning of section 414(q) of the Code):
  - A) Who are employees of the recipient (other than leased employees) and have performed for the recipient (or for the recipient and related persons) on a substantially full-time basis for a period of at least one year, or
  - B) Who are leased employees with respect to the recipient (including those excludible if the safe harbor rule applies).

The term "compensation" has the same meaning as when used in section 415, except that it includes:

- A) employer contributions under a qualified cash or deferred arrangement to the extent not included in gross income under section 402(e)(3) or 402(h)(1)(B).
- B) any amount which the employee would have received in cash but for an election under a cafeteria plan, and
- C) any amount contributed to a section 403(b) annuity contract pursuant to a salary reduction agreement.

If both of these requirements are met, the leased employees participating in the safe harbor plan need not be considered employees of the recipient for any purpose pertaining to the requirements listed in section 414(n)(3)(A), (B) and (C).

*Sec. 414(n)(5)(C)(ii) and (iii)*

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### IV. Requirements

**Line a.** How leased employees will be treated under the recipient's plan depends on the terms of the plan. Therefore, if an organization utilizes the services of leased employees the plan must specifically provide how leased employees will be treated under the recipient's plan.  
*Notice 84-11, Q&A 16*

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**Line b.** Although the plan must treat these employees as though they are the recipient's employees, the fact that a leased employee is not covered by the recipient's plan does not necessarily mean the recipient's plan does not qualify. A plan may still meet the coverage requirements of section 410, even though none of those leased employees is covered. Any contributions made or benefits funded by the leasing organization on behalf of a leased employee are deemed to be provided by the recipient at such time as the leased employee is required to be covered under the recipient's plan.

*Notice 84-11, Q&A 14, 15*

*Notice 84-11, Q&A 17*

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**Line c.** All service as an employee (whether by reason of being a leased employee or otherwise) must be credited. Credited service must also include any period of service during which the employee would have been a leased employee but for the requirement that substantially full-time services be performed for at least one year.

*Sec. 414(n)(4)*

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### V. PEOs

**Line c.** Rev. Proc. 2002-21 describes certain relief available to qualified defined contribution retirement plans maintained by professional employer organizations (PEOs) that benefit Worksite Employees, as that term is defined in the 2002 revenue procedure. In general, section 414(n) does not permit PEOs to maintain plans for Worksite Employees who are not the common law employees of the PEO. If a PEO had a retirement plan in existence on May 13, 2002, that benefited Worksite Employees, the PEO had the option of either converting the PEO Retirement Plan to a multiple employer plan or terminating the plan by the last day of the first plan year of the PEO Retirement Plan beginning on or after January 1, 2003.

In addition, Rev. Proc. 2003-86 provides guidance on various transitional issues.

## Employee Benefit Plan Employee Leasing

### (Worksheet Number 8 – Determination of Qualification)

**Instructions** – All items must be completed unless otherwise indicated. In the absence of further instructions, a “Yes” answer generally indicates a favorable conclusion is warranted (subject to Part V), while a “No” answer indicates a problem exists. Please use the space on the worksheet to explain any “No” answer. See Publication 7003 Explanation 8, for guidance in completing this form.

The technical principles in this worksheet may be changed by future regulations or guidelines

Name of plan

I. Required Information	Plan Reference	Yes	No	N/A
a. Does the employer's plan provide that all leased employees within the meaning of section 414(n)(2) are treated as common law employees for all purposes under the plan? (If the answer is “Yes”, go to Part V of this worksheet)				
b. Has the applicant submitted all of the information needed for a determination covering section 414(n) of the Code? (If the answer is “No”, go to Part V of this worksheet.) [813, 814, 815]				
II. Applicability of Section 414(n)	Plan Reference	Yes	No	N/A
a. Are services performed for the plan sponsor, or for an entity that must be aggregated with the sponsor, by a person or persons who are not employees of such plan sponsor or aggregated entity? [801]				
b. Are such services performed pursuant to an agreement between the plan sponsor and any other person? [802]				
c. Have such services been performed for the plan sponsor or aggregated entity, or for the plan sponsor or aggregated entity and a related person, on a substantially full-time basis for a period of at least a year? [803]				
d. Are services performed under the primary direction or control of the plan sponsor? [804]				
(If the answer to question a, b, c or d is “No,” go to Part V of this worksheet)				
III. Safe Harbor	Plan Reference	Yes	No	N/A
a. Does the leasing organization (see explanation) maintain a qualified money purchase pension plan? (805, 806)				
b. If so, does such plan provide for:				
(i) A nonintegrated employer contribution rate for each participant of at least 10 percent of compensation? [805, 806]				
(ii) Immediate participation by each employee other than:				
A. Employees who perform substantially all of their services for the leasing organization, and				
B. Employees whose compensation from the leasing organization in each plan year during the 4-year period ending with the plan year is less than \$1,000? [805, 806]				
(iii) Full and immediate vesting? [805, 806]				
c. Do leased employees constitute 20 percent or less of the recipient's nonhighly compensated work force?				
(If the answers to questions a, (b)(i), (b)(ii), (b)(iii), and c above are “Yes,” go to Part V of this worksheet)				
IV. Requirements	Plan Reference	Yes	No	N/A
a. Does the recipient's plan specifically provide how leased employees will be treated under the plan? [818]				
b. Is each leased employee considered in determining whether the plan meets the coverage and other requirements? [836, 837]				

IV. Requirements – Continued	Plan Reference	Yes	No	N/A
c. For purposes of the applicable requirements under section 414(n)(3), is the entire period for which the employee has performed services for the recipient (whether as a leased employee or otherwise) taken into account, including any period for which the employee would have been a leased employee but for the requirement that the person has performed services for the recipient (or for the recipient and related persons) on a substantially full-time basis for a period of at least one year? [812]				
d. Does the recipient's plan meet the requirements as to:				
(i) Participation, including the minimum participation requirements?				
(ii) Vesting, including the special rules for top-heavy plans?				
(iii) Nondiscrimination?				
(iv) Limitations on benefits and contributions?				
(v) IRC 401(a)(17) limit on compensation?				
V. Professional Employer Organizations	Plan Reference	Yes	No	N/A
a. Is the plan a plan other than a defined contribution plan? (If the answer is "Yes", do not complete the rest of this worksheet.)				
b. If the answer to question a is "No": Is the plan a professional employer organization retirement plan?				
c. If the answer to question b is "Yes": Were remedial actions taken in accordance with section 5 of Rev. Proc. 2002-21 as amplified by Rev. Proc. 2003-86? [838]				

This form is provided as an example only and should not be completed or returned to the Internal Revenue Service

## Employee Plan Deficiency Checklist

### Attachment Number 8

### Employee Leasing

For IRS Use	Please furnish the amendment(s) requested in the section(s) checked below.
813, 814, 815 I.b.	Your application indicates that you received services provided by leased employees. However, your plan does not provide that all such employees are treated as common law employees for all purposes under the plan. In order to receive a determination letter under section 401(a) or 403(a) of the Code that will be a determination as to the effect of section 414(n) upon the plan's qualified status, the following information must be submitted: <ol style="list-style-type: none"> <li>(1) A description of the nature of the business of your organization;</li> <li>(2) A copy of the relevant leasing agreement(s);</li> <li>(3) A description of the function of all leased employees within your trade or business (including data as to whether all leased employees are performing services on a substantially full-time basis and whether services are performed under the primary direction or control of the recipient organization).</li> <li>(4) If your organization is relying on any qualified plan(s) maintained by the employee leasing organization for purposes of qualification of your plan, a description of such plan(s) (including a description of the contributions or benefits provided for all leased employees which are attributable to services performed for your organization, plan eligibility and vesting). Rev. Proc. 85-43, 1985-2 C.B. 501.</li> </ol>
801 II.a.	Please tell us if you (including any entity required to be aggregated with you under IRC section 414(b), (c), (m) or (o)) receive services of a person who is not your employee and who is leased to you by another employer. IRC sections 414(n)(2) and 414(n)(6).
802 II.b.	Please tell us whether the services of employees provided by another organization are provided according to an agreement between the recipient and the leasing organization. IRC section 414(n)(2)(A) and Notice 84-11, 1984-2 C.B. 469, Q&A 6.
803 II.c.	Your application shows that you are the recipient of services provided by employees leased to you by another employer. Such employees are not covered by the plan. Please tell us if any of these employees have performed, during a consecutive 12-month period, either 1,500 hours of service or 75 percent of the average number of hours customarily performed by an employee of the recipient in that particular position. IRC section 414(n)(2)(B) and Notice 84-11, 1984-2 C.B. 469, Q&A 7.
804 II.d.	Your application shows that you are the recipient of services provided by employees leased to you by another employer. Such employees are not covered by the plan. Please show that the service performed by such leased employees are not performed under the primary direction or control of the recipient organization. IRC section 414(n)(2)(C).
805, 806 III.a., b. and c.	Section 414(n)(5) of the Code provides a safe harbor for a recipient organization if the leasing organization maintains a qualified, nonintegrated money purchase pension plan that provides for immediate participation, full and immediate vesting, and an annual contribution of 10 percent of total compensation for the leased employee. If these requirements are met and leased employees do not constitute more than 20 percent of the recipient organization's nonhighly compensated workforce, the leased employee does not need to be considered an employee of the recipient for any purpose pertaining to the qualified plan of the recipient organization. Please tell us whether these requirements are met. If so, furnish a copy of the plan maintained by the leasing organization and show that leased employees constitute 20 percent or less of your nonhighly compensated workforce. IRC section 414(n)(5) and Notice 84-11, 1984-2 C.B. 469, Q&A 18 and 19.
818 IV.a.	A plan maintained by the recipient of services of leased employees must specifically provide how leased employees will be treated under the recipient's plan. Your application indicates that you receive services provided by leased employees. Your plan should be amended. Notice 84-11, 1984-2 C.B. 469, Q&A 16.
836, 837 IV.b.	Section _____ of the plan should be amended to provide that each leased employee must be considered in determining whether the recipient's plan satisfies the minimum coverage requirement of section 410(b) of the Code. The leased employee is considered the recipient organization's employee for purposes of Code sections 401(a)(3), (4), (7), (16), (17) and (26) and sections 408(k), 408(p), 410, 411, 415 and 416, as well as sections 79, 106, 117(d), 120, 125, 127, 129, 132, 137, 274(j), 505 and 4980B, after performing services for the recipient (or related organizations) on a "substantially full-time basis" for at least one year. A person has performed services on a substantially full-time basis within the meaning of section 414(n)(2)(B), if that person is credited with the lesser of 1,500 hours of service or 75 percent of the hours that are customarily performed by an employee of that recipient in the particular position. IRC sections 414(n)(1), (2), (3) and (4) and Notice 84-11, 1984-2 C.B. 469, Q&A 7.

812	Section _____ of the plan should be amended to provide that all service performed for the recipient by a
IV.c.	leased employee (including any creditable service performed prior to the existence of the employee leasing agreement and service during any period for which the employee would have been a leased employee but for the fact that the employee did not perform services for the recipient on a substantially full-time basis for at least one year) will be credited under the recipient's plan. IRC sections 414(n)(1), (2), (3) and (4) and Notice 84-11, 1984-2 C.B. 469, Q&A 8 and 12.
838	If the plan was not timely amended to (1) terminate the plan or (2) cause the plan to become a multiple
V.c.	employer plan, plan qualification issues other than the exclusive benefit rule, may be resolved under the Employee Plans Compliance Resolution System, Rev. Proc. 2019-19, 2019 I.R.B. 674 (or its successors).

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