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Jane Armstrong is a partner at Phelps Dunbar LLP, a regional law firm that is headquartered in New Orleans. She has practiced exclusively in the areas of employee benefits and executive compensation for over 30 years. Jane has been listed in all editions of the Best Lawyers in America and “Louisiana Super Lawyers,” and is listed in the Chambers U.S.A. as a leading practitioner in the employee benefits field. She is a frequent speaker and author on retirement plan issues. Jane graduated from Vanderbilt University School of Law, where she was elected to the Order of the Coif.



## Relevance of Worker Classification

- Plan issues:
  - Qualification
  - ERISA coverage issues
- Employment tax issues
- FLSA issues (overtime)
- Workers' compensation coverage

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## Qualification Issues

- Code Sec. 401(a)(2):
  - Exclusive benefit rule
  - Qualified plan may provide benefits to:
    - “Employees” and their beneficiaries; and
    - Self-employed individuals with respect to trade or business maintaining the plan

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# ERISA

Coverage of Plan (DOL Reg. 2510.3-3(c))	Covered Under Title 1 of ERISA
Partners, sole proprietors, shareholders and at least one employee	YES
ONLY partners in partnership (unlimited number) and spouses	NO
ONLY sole proprietor (and spouse)	NO
ONLY a sole shareholder in corporation (and spouse)	NO

## COMMON LAW EMPLOYEES/ INDEPENDENT CONTRACTORS GENERAL RULES

## Definition

- Distinction between CL employee and independent contractor - facts and circumstances
- IRS Form SS-8
- 20-factor test
  - Rev. Rul. 87-41, 1987-1 C.B. 296; Employment Tax Reg. § 31.3121 (d)-1(c)

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## Definition (continued)

- Simplified test – 3 criteria
  - IRS Pub. 15-A (2010 Ed., page 6)
  - **Behavioral control**
    - Instructions and training
    - Whether business has retained right to control details of work
  - **Financial control**
    - Whether business pays employee/contractor expenses

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## Definition (continued)

- Worker's investment
- Services available to other businesses
- Type and manner of compensation; worker's opportunity for profit or loss
- **Type of relationship**
  - Contractual agreements
  - Employee benefits
  - Permanency/duration
  - Integral regular business operations

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## Additional Factors - Independent Contractor

- Historical practice in industry
- Consistent treatment
- Must/should have individual written contractor agreement
- Pay must be consistently reported on IRS Form 1099

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## Consequences of Misclassification

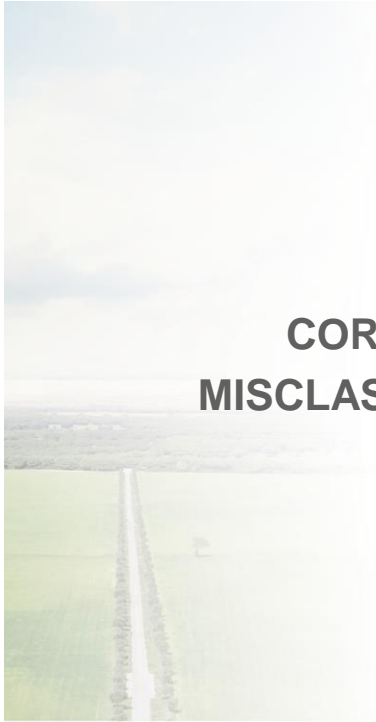
- ERISA Title 1 – Benefit Claims

- *Vizcaino v. Microsoft*, 97 F.3d 1187 (9th Cir. 1996)
- Solution, address misclassification in plan document: (definition of “employee”)

“Employer’s/administrator’s determination of employee status shall be final and determinative and shall not be modified in the event of any re-characterization, whether by judicial proceeding, administrative determination, audit or otherwise.”

## Consequences of Misclassification

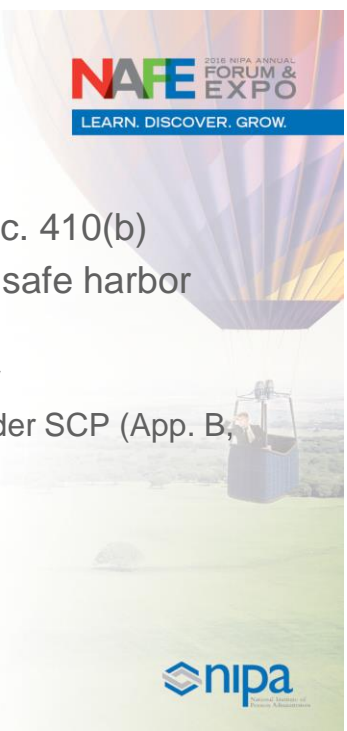
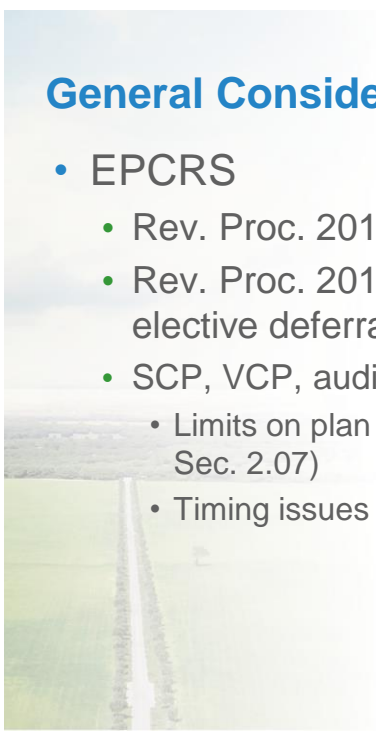
- Code Sec. 410(b)
- Code Sec. 401(a)(26)
- ADP/ACP
- Code Sec. 401(a)(4)



# CORRECTION FOR MISCLASSIFIED WORKERS

## General Considerations

- EPCRS
  - Rev. Proc. 2013-12, Code Sec. 410(b)
  - Rev. Proc. 2015-28 (relief for safe harbor elective deferrals)
  - SCP, VCP, audit cap may apply
    - Limits on plan amendments under SCP (App. B, Sec. 2.07)
    - Timing issues under SCP



## Correction – Exclusion of Otherwise Eligible Employee

FAILURE	CORRECTION
Exclusion of eligible employee – profit sharing (Appendix A)	Make contributions and earnings
Exclusion of eligible employee – profit sharing (pro rata allocation of contribution) (Appendix B)	<ul style="list-style-type: none"> <li>Recalculate and reallocate contribution by debiting accounts</li> <li>If accounts of NHCEs primarily debited, no adjustment for earnings required (reallocate principle only) or may calculate earnings using lowest rate of return</li> </ul>

## Correction – Exclusion of Otherwise Eligible Employee

FAILURE	CORRECTION
Exclusion of eligible employee – deferral non-safe harbor	<ul style="list-style-type: none"> <li>50% of missed deferrals</li> <li>Calculate using HCE/NHCE average rate of deferral</li> <li>Contribute missed match</li> <li>Earnings</li> </ul>
Exclusion of eligible employee – deferral safe harbor match	<ul style="list-style-type: none"> <li>50% of missed deferrals</li> <li>Calculate deferrals at <u>greater</u> of 3% or average rate</li> <li>Match</li> <li>Earnings</li> </ul>



## Correction – Exclusion of Otherwise Eligible Employee

FAILURE	CORRECTION
Exclusion of eligible employee – safe harbor nonelective	<ul style="list-style-type: none"> <li>• 50% of missed deferrals, calculated as 3% of compensation</li> <li>• Contribute non-elective</li> <li>• Earnings</li> </ul>
Exclusion of eligible employee – deferrals Rev. Proc. 2015-28	<ul style="list-style-type: none"> <li>• NO QNEC for missed deferrals if corrected no later than 9 ½ months after end of year in which failure occurs</li> <li>• Matching contributions</li> <li>• Earnings determined using QDIA rate of return</li> <li>• Notice required</li> </ul>
Other deferral failures Rev. Proc. 2015-28	<ul style="list-style-type: none"> <li>• If exclusion more than 3 months, 25% of missed deferrals and earnings</li> <li>• Missed match and earnings</li> <li>• Notice required</li> <li>• Correction no later than last day of second plan year after failure or notice (earlier of)</li> </ul>

## Inclusion of Ineligible Employee

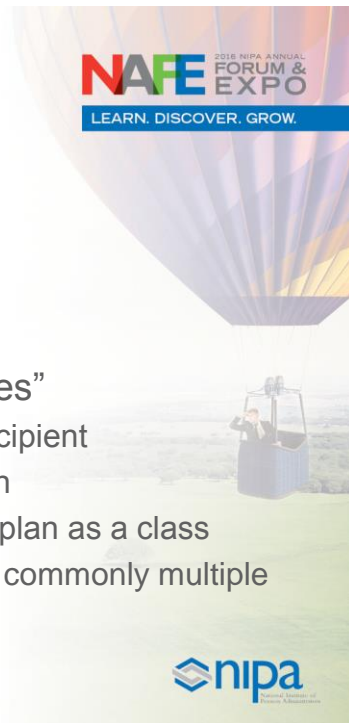
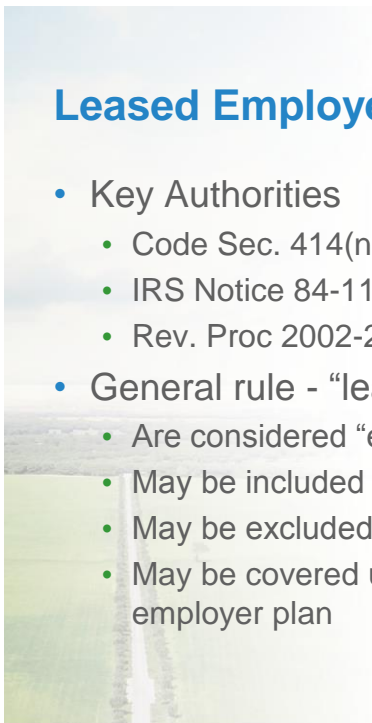
- Account balance treated as forfeiture
  - Includes deferrals and employer contributions
  - May be required to “make whole” for deferrals outside plan
- For deferrals, may refund to employee with earnings
  - IRS Form 1099 reporting



## TREATMENT OF LEASED EMPLOYEES

### Leased Employees

- Key Authorities
  - Code Sec. 414(n)
  - IRS Notice 84-11, 1984-2 CB 469
  - Rev. Proc 2002-21
- General rule - “leased employees”
  - Are considered “employees” of recipient
  - May be included in recipient’s plan
  - May be excluded from recipient’s plan as a class
  - May be covered under PEO plan, commonly multiple employer plan



## Leased Employees

- Leased employee deemed employee of recipient if:
  - Services provided for fee (agreement between leasing organization (PEO) and recipient)
  - Services performed on substantially full-time basis for one year
    - 1,500 hours in 12-month period; or
    - 75% of hours customary for the position, but at least 500
    - Status change - consider service as CL employee

## Leased Employees

- Services performed under primary direction and control of recipient
- Leased employee must be common law employee of PEO
  - Independent contractors of PEO not considered

## Leased Employees - Definitional Issue

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- Leased employee actually common law employee of recipient
  - Leasing arrangement disregarded if leased employee actually a CL employee of recipient
  - Not eligible to participate in PEO plan (unless multiple employer adopted by PEO/recipient)
  - Recipient testing may fail
  - Problematic fact patterns
    - Leased employees who are never reassigned by PEO
    - When owners of recipient treated as leased employees
    - When officers of recipient treated as leased employees

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## Consequences of Deemed Employee Status

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- All service taken into account under recipient's plan, including service during 12-month period
- Contributions/Allocations under/to PEO plan "credited to" recipient IF attributable to services performed for recipient
  - Issue if recipient does not maintain a plan and HCE's are leased employees
- Contributions to recipient plan for leased employees deductible by recipient

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## 401(k) Issues

- Recipient's 401(k) that covers leased employees
  - Procedure for deducting deferrals
- Recipient's 401(k) that excludes leased employees
  - ADP/ACP may take into account deferrals made under PEO 401(k) plan (aggregate)
  - Matching may be made to recipient's plan (when PEO plan deferral only)

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## Status Change Issues

- From CL to leased:
  - Take into account service as CL for deemed employee status
  - No interruption of coverage, unless leased employees excluded as class
    - Last day, hour of service allocation conditions
  - No separation from employment; no distribution right

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## Status Change Issues

- From leased to CL
  - Eligibility/Vesting – consider service as leased employee
    - Result uncertain if 12-month service requirement not satisfied
  - Hours as leased employee count towards 1,000 hour allocation condition

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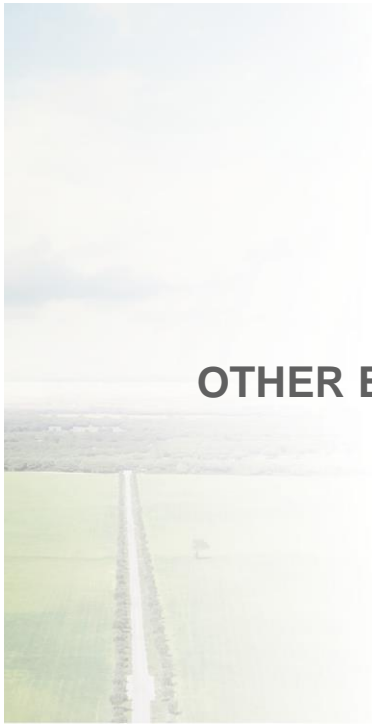
## Status Change Issues

- Compensation while leased employee:
  - Taken into account if leased employees covered
  - Exclude if leased employees excluded as class
- Status change is not a separation; no distribution right

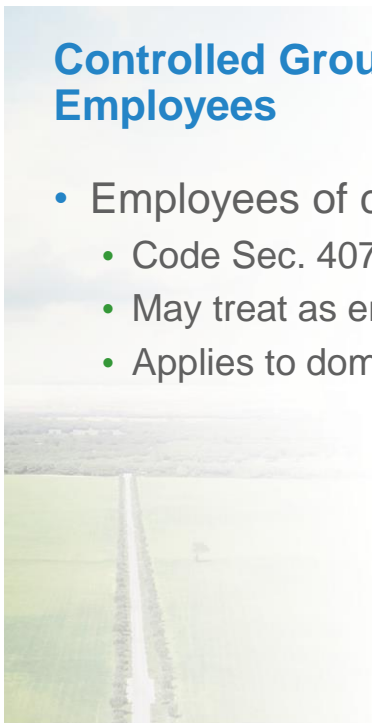
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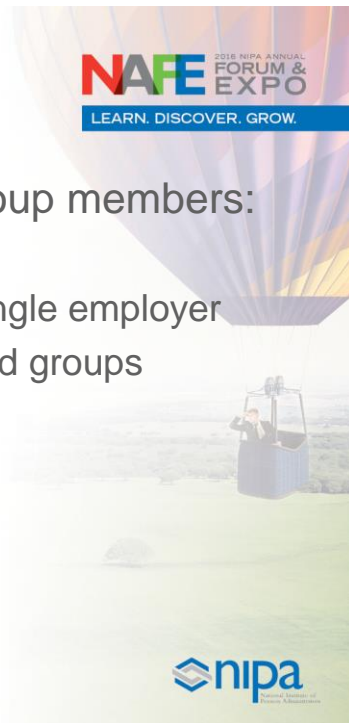


## OTHER EMPLOYEE ISSUES



## Controlled Group Employees

- Employees of controlled group members:
  - Code Sec. 407(a)
  - May treat as employed by single employer
  - Applies to domestic controlled groups



## Owners vs. Employees

- Plan must be supported by trade or business
  - Check passive activities, such as collection of rents and royalties (see UBIT rules, Code Sec. 512)
- Passive ownership is not employment
  - Facts and circumstances

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## Aliens

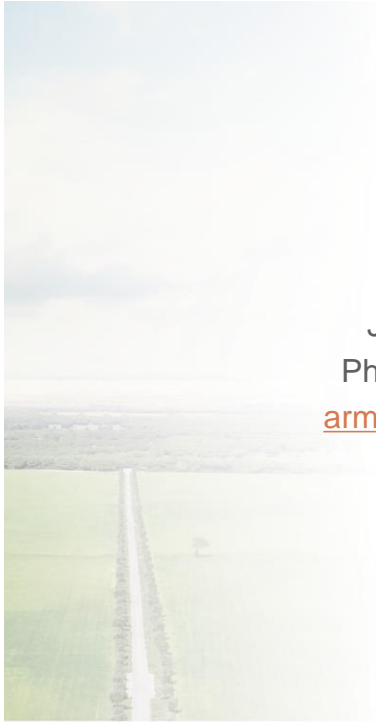
- Resident aliens
  - Green card
  - Performing services in U.S.
  - Treated as an employee
- Non-resident aliens with no U.S. source income
  - Excludable class
  - Work for foreign affiliate, may come to U.S. intermittently for training, meetings

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