Office of Chief Counsel
Internal Revenue Service
memorandum

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to: Sarah Sandusky
Attorney
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from: Neil Sandhu
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(Employee Benefits)

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subject: Service Crediting Under a Qualified Plan for Individuals Who Worked Under a Leasing Arrangement

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

This is in reply to a request by your office regarding the calculation of years of service under a qualified retirement plan of a company (Company) with respect to individuals who initially worked for Company for four months pursuant to a leasing arrangement and were subsequently hired by Company as common law employees. Specifically, you asked whether the service period prior to these individuals being hired as common law employees would be taken into account in calculating years of service for purposes of plan eligibility and vesting.

Facts

Company uses a staffing agency to hire workers who work for a period of time through a leasing arrangement between Company and the staffing agency. Some of these workers are subsequently hired by Company as common law employees after the terms of the contract between Company and the staffing agency have been satisfied, typically after a 4-month period of work through the leasing arrangement. The workers perform services for Company on a full-time basis during all relevant periods. Company sponsors Plan for its employees. Plan is a qualified defined benefit retirement plan with

a traditional defined benefit formula. Plan requires 1 year of service (elapsed time) to become a participant and 5 years of service (elapsed time) for participants to be 100% vested in their benefits.

Law and Analysis

Section 414(n)(1) states that, for purposes of the requirements listed in section 414(n)(3), with respect to any person (hereinafter in section 414(n) referred to as the "recipient") for whom a leased employee performs services the leased employee is treated as an employee of the recipient, but contributions or benefits provided by the leasing organization which are attributable to service performed for the recipient are treated as provided by the recipient.

Section 414(n)(2) provides that, for purposes of section 414(n)(1), the term "leased employee" means any person who is not an employee of the recipient and who provides services to the recipient if--

(A) such services are provided pursuant to an agreement between the recipient and any other person (in section 414(n) referred to as the "leasing organization"),

(B) such person has performed such services for the recipient (or for the recipient and related persons) on a substantially full-time basis for a period of at least 1 year, and

(C) such services are performed under primary direction or control by the recipient.

Section 414(n)(3) provides, in part, that for purposes of section 414(n), the requirements listed in section 414(n)(3) include section 410 (minimum participation standards) and section 411 (minimum vesting standards).

Section 414(n)(4)(A) provides that, in the case of any leased employee, section 414(n)(1) applies only for purposes of determining whether the requirements listed in section 414(n)(3) are met for periods after the close of the period referred to in section 414(n)(2)(B).

Section 414(n)(4)(B) provides that, in the case of a person who is an employee of the recipient (whether by reason of section 414(n) or otherwise), for purposes of the requirements listed in section 414(n)(3), years of service for the recipient are determined by taking into account any period for which such employee would have been a leased employee but for the requirements of section 414(n)(2)(B).

Section 414(n) was added to the Code under the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), P.L. 97-248. Section 1146(a)(2) of the Tax Reform Act of 1986 (TRA '86), P.L. 99-514, titled Clarification of Years of Service, amended section 414(n)(4) to add new section 414(n)(4)(B) (and slightly revise the existing language of section 414(n)(4) and denote that as section 414(n)(4)(A)). Prior to amendment by TRA '86, section 414(n)(4) provided that, in the case of any leased employee, section 414(n)(1) applies only for purposes of determining whether the pension requirements listed in section 414(n)(3) are met for periods after the close of the 1-year

period referred in section 414(n)(2); except that years of service for the recipient are determined by taking into account the entire period for which the leased employee performed services for the recipient (or related persons).

Company argues that the 4 months of service worked by the now-common law employees under the leasing arrangement prior to being hired by Company are not counted for determining years of service for purposes of minimum participation and vesting because those employees were never leased employees and, thus, section 414(n)(4) does not apply. We disagree. In contrast to section 414(n)(4)(A), section 414(n)(4)(B) does not limit its application to section 414(n)(1). In addition, the opening language of section 414(n)(4)(B) provides that it applies to employees other than leased employees. Finally, the language at the end of section 414(n)(4)(B)--by taking into account any period for which such employee would have been a leased employee but for the requirements of section 414(n)(2)(B)--supports this position. If Company's assertion were correct, the additional period required to be taken into account under section 414(n)(2)(B) would always be one year (the period of service required to attain status as a leased employee). But the statute does not reference this one-year period, or any period, suggesting that there is no requirement to meet the one-year requirement and be a leased employee for the paragraph to apply. For all these reasons, we conclude that section 414(n)(4)(B) applies to all individuals who worked under a leasing arrangement, including those individuals who never met the definition of leased employee because they did not meet the requirements of section 414(n)(2)(B).

As a result, in this case, pursuant to section 414(n)(4)(B), the 4-month period of work under the leasing arrangement must be counted for purposes of minimum participation and vesting, notwithstanding the fact that the now-common law employees never satisfied the requirements to be leased employees.

We note that this analysis only applies for purposes of the requirements listed in section 414(n)(3). For example, the benefit accrual formula under the Plan need not necessarily take into account the period of service under the leasing arrangement.

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call 202-317-5151 if you have any further questions.

By: _____

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