***Professional & Executive Leasing, Inc. v. Commissioner of Internal Revenue*, 89 T.C. 225 (1987)**

For retirement plans to qualify for tax-exempt status, they must be for the exclusive benefit of the employer's employees, and the determination of 'employee' status for leased workers hinges on common law principles of control, not merely contractual labels.

**Summary**

Professional & Executive Leasing, Inc. (PEL) sought a declaratory judgment that its pension and profit-sharing plans qualified under section 401 of the Internal Revenue Code. PEL leased professionals back to their former businesses, claiming they were PEL's employees, thus eligible for PEL's retirement plans. The Tax Court held that these leased professionals were not common law employees of PEL because PEL lacked sufficient control over their work. The court emphasized that the professionals, often owners of the recipient businesses, controlled their work details and that PEL primarily served a payroll and benefits administration function. Consequently, PEL's retirement plans failed the 'exclusive benefit' rule, as they improperly benefited individuals not genuinely employed by PEL.

**Facts**

Professional & Executive Leasing, Inc. (PEL) was formed to lease management and professional personnel to businesses and practices.

PEL entered into 'Contracts of Employment' (COE) with professionals (workers) and 'Personnel Lease Contracts' (PLC) with operating businesses/practices (recipients).

Workers were often previously employed by and held ownership interests in the recipient businesses to which they were leased.

Recipients provided equipment, tools, and office space for the workers.

Workers controlled the details of their service performance, including assignment selection.

PEL handled payroll, withholding taxes, and provided benefits and retirement plans for the workers.

Recipients paid PEL setup fees, monthly service fees, and worker compensation.

The IRS determined that the workers were not employees of PEL and thus PEL's retirement plans did not qualify under section 401.

**Procedural History**

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PEL submitted its pension and profit-sharing plans to the IRS for determination of qualified status.

The IRS issued a final adverse determination letter, stating the plans did not meet section 401 requirements because the workers were not PEL's employees.

PEL petitioned the Tax Court for a declaratory judgment under section 7476, alleging the plans were qualified.

The case was submitted to the Tax Court without trial based on the administrative record.

**Issue(s)**

1. Whether the workers leased by Professional & Executive Leasing, Inc. to recipient businesses are considered 'employees' of Professional & Executive Leasing, Inc. for purposes of section 401(a) of the Internal Revenue Code.
2. Whether Professional & Executive Leasing, Inc.'s pension and profit-sharing plans qualify under section 401(a) if the covered individuals are not considered its employees.

**Holding**

1. No, the workers are not common law employees of Professional & Executive Leasing, Inc. because PEL does not exercise sufficient control over the details of their work.
2. No, because the plans cover individuals who are not employees of Professional & Executive Leasing, Inc., they fail to meet the 'exclusive benefit' rule of section 401(a)(2) and thus do not qualify under section 401(a).

**Court's Reasoning**

The Tax Court applied common law principles to determine employer-employee status, referencing Treasury Regulations and the Restatement (Second) of Agency.

The court emphasized the 'right to control' test: "Generally such relationship exists when the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished."

The court considered several factors from *United States v. Silk*, including:

1. Degree of control exercised by the purported employer.
2. Investment in work facilities.
3. Opportunity for profit or loss.
4. Whether the work is part of the principal's regular business.

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5. Right to discharge.
6. Permanency of the relationship.
7. The parties' perceived relationship.

Applying these factors, the court found:

PEL exercised minimal control; workers controlled their work details and assignments.

Recipients, not PEL, invested in work facilities.

PEL's profit was limited to setup and service fees, not the profits from the workers' services.

PEL's right to discharge was deemed illusory, especially given workers' ownership in recipient businesses.

Despite contractual language, the economic reality was that PEL functioned as a payroll service, and the workers remained essentially self-employed or employed by the recipients.

The court concluded the arrangement lacked objective economic substance and that the workers were not common law employees of PEL. Therefore, the retirement plans failed the exclusive benefit rule of section 401(a)(2).

**Practical Implications**

This case clarifies that labeling workers as 'leased employees' does not automatically qualify them as employees of the leasing organization for retirement plan purposes.

It reinforces the importance of the common law 'control test' in determining employer-employee relationships in tax law, particularly concerning employee benefits.

Businesses cannot merely interpose a leasing company to provide retirement benefits to owners and key personnel while circumventing employee benefit rules for other staff.

Subsequent cases and IRS guidance continue to apply common law factors to scrutinize worker classification in leasing arrangements, especially in professional service contexts, ensuring that retirement plans genuinely benefit the employees of the sponsoring employer.

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