***Professional & Executive Leasing, Inc. v. Commissioner, 89 T. C. 260 (1987)***

An employer-employee relationship must be established by common law principles for a pension plan to qualify under section 401(a).

**Summary**

In Professional & Executive Leasing, Inc. v. Commissioner, the Tax Court addressed whether the petitioner's pension and profit-sharing plans qualified under section 401(a) of the Internal Revenue Code. The court determined that the plans did not qualify because the individuals covered by the plans were not common law employees of the petitioner, despite contractual agreements suggesting otherwise. The case hinged on the application of common law factors to assess the existence of an employer-employee relationship, ultimately ruling that the workers remained self-employed or employees of their professional practices, not the petitioner. This decision reinforces the importance of actual control and economic substance in determining employment status for tax purposes.

**Facts**

Professional & Executive Leasing, Inc. (petitioner) was a corporation leasing management personnel and professionals to other businesses. The petitioner established pension and profit-sharing plans for individuals under "Contracts of Employment" (COE) and "Personnel Lease Contracts" (PLC) with recipients. These workers, including medical doctors, lawyers, and other professionals, were often former employees or owners of the recipients to which they were leased. The petitioner handled payroll and provided benefits, but the recipients controlled the workers' professional activities and provided the necessary equipment and office space. The Internal Revenue Service (IRS) issued an adverse determination, asserting that the workers were not employees of the petitioner, thus disqualifying the plans under section 401(a).

**Procedural History**

The petitioner sought a declaratory judgment from the Tax Court after the IRS issued a final adverse determination letter on May 27, 1986, denying qualification of the plans under section 401(a). The case was submitted without trial based on the administrative record and pleadings. The petitioner argued that a valid employer-employee relationship existed with the workers, while the IRS maintained that the workers were not employees of the petitioner.

**Issue(s)**

1. Whether the workers under the COE and PLC arrangements with the petitioner are common law employees of the petitioner, thereby qualifying the pension and profit-sharing plans under section 401(a).

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## Holding

1. No, because the common law factors demonstrate that the workers were not employees of the petitioner but rather remained self-employed or employees of their professional practices.

## Court’s Reasoning

The Tax Court applied common law principles to determine the existence of an employer-employee relationship, focusing on factors such as control over work details, investment in work facilities, opportunity for profit or loss, and the permanency of the relationship. The court found that the petitioner exercised minimal control over the workers, who were assigned to recipients in which they had an ownership interest. The recipients controlled the work details, provided facilities, and bore the profit and loss from the workers’ efforts. The court emphasized that the economic reality of the arrangement was that the petitioner acted merely as a payroll and bookkeeping service, not an employer. The court cited precedents like Bartels v. Birmingham and Edward L. Burnetta, O. D. , P. A. v. Commissioner, which stressed the importance of actual control and economic substance over contractual labels. The court concluded that the plans failed to meet the “exclusive benefit” rule of section 401(a)(2), as the workers were not common law employees of the petitioner.

## Practical Implications

This decision underscores the necessity of establishing a genuine employer-employee relationship for pension plans to qualify under section 401(a). Legal practitioners must ensure that their clients’ arrangements reflect actual control over workers and not just contractual labels. For businesses, this case highlights the risk of using leasing arrangements to circumvent tax laws, potentially leading to disqualification of retirement plans. Subsequent cases, such as Rev. Rul. 87-41, have reinforced this ruling, emphasizing that the substance of the relationship, not the form, determines employment status for tax purposes. This case continues to guide the analysis of similar arrangements in tax law, affecting how businesses structure their employee leasing and retirement plans.

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