



## Employee Leasing – Pros & Cons

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Employee leasing firms (also called PEOs or Professional Employer Organizations) have become increasingly popular as companies search for ways to decrease their administrative burden and the liability associated with hiring new employees. Before deciding on turning over your staff to an outside administrator, here are some important factors to consider:

### **Who has the ultimate responsibility for the employees?**

The courts have consistently ruled that “joint employment” status exists when you lease employees, which means that you and the leasing company are both liable for all aspects of the employment relationship. For example, if you leave the task of hiring new employees or investigating complaints to the leasing company, you may still be found liable if your PEO does an inadequate job of properly screening applicants or responding to a sexual harassment claim. Although PEOs assume much of the administrative responsibility for complying with labor laws, joint employment leaves you, the co-employer, with potentially greater liability where you often have little control. To protect against employment-related claims, make sure that any PEO you consider has adequate Employment Practices

Liability Insurance (EPLI). Ask what the deductible is, inquire about the aggregate coverage amounts, find out how many total employers and employees are covered under that umbrella, and see if their policy will allow you to select your own attorney in the event of a lawsuit. You should additionally require that your company be named as an additional insured on their policy.

### **What about payroll?**

Some PEOs advertise that by turning your employees over to them, you are no longer responsible for payroll and payroll taxes. This is simply untrue. The employee leasing company will be making those payments on your behalf. Because of joint employment status, you may still be found liable for failure to pay and/or withhold taxes. If considering using a PEO, make sure that it’s a reputable company with solid financial standing. If a PEO goes out of business and has not paid your payroll taxes, you will ultimately be held responsible for any unpaid amounts as well as penalties and interest. In addition, you are responsible for violations of state and federal wage and hour laws.

### **What about employment law compliance?**

Once again, joint employment status means that both you and the leasing company remain liable for

compliance with all aspects of the employment relationship. In addition to making sure that the PEO you are considering will assign a representative to your account who is well versed in all applicable federal and state labor law requirements, you need to consider that this new relationship will do your company in terms of compliance issues. Many labor laws are based on the number of employees that you have on staff.

For example, the federal Family and Medical Leave Act as well as the California Family Rights Act entail a great deal of administrative burden and legal restraints for the employer, requiring, amongst other things, that qualifying employees be granted up to 12 weeks of leave with their job guaranteed upon their return. These laws, however, only apply to companies who have more than 50 employees at a worksite. Even if your firm is under this size, you would likely end up having to comply due to being part of the larger employee leasing firm. Another example would be that in California, as of 2005, companies with 50 or more workers are required to provide 2 hours of sexual harassment training to all of their supervisors and managers. There continue to be benefits to remaining a smaller employer, many of which might be lost in an employee leasing arrangement.

## Can PEOs offer better benefits?

Employee leasing firms often claim they can provide a superior employee benefits package for your employees. While in some situations this may be true, small companies can offer competitive benefits if they take the time to shop around. Consult with a knowledgeable insurance broker who will market your company's needs at no cost to you. Group medical and dental rates are available to California employers starting with only 2 employees. Medical insurance consortiums (HIPC, California Choice) give small companies the advantage of grouping with other employers to have better leverage on plan designs and premiums. Additionally, there are companies who will help design and administer simple, affordable retirement plans for small companies. Remember that the PEO is not going to pay for employee benefits out of its own pocket; the costs will be passed along to you. You may be able to do just as well or better on your own.

## What about workers' comp?

Workers' compensation is certainly one of the most expensive insurance requirements on the part of employers. Sometimes, PEOs are able to obtain better rates for you because of their size. However, before making any decision, consult with a reputable broker who will obtain quotes from several insurance companies to get you the best price possible. Be aware that if the PEO is getting a lower rate by avoiding the appropriate experience rating and rate code classification for your workers, you may be guilty of insurance fraud. Additionally,

existing case law indicates that even if you lease all of your employees, you are still fully responsible for all aspects of occupational health and safety laws. And finally, look at the amounts the PEO is going to charge you for your workers' comp insurance. Will they charge the same rate on all your employees? Will you or the PEO benefit from any premium discounts or experience modifications? Check the math carefully! If you're an owner of your company, you can exclude yourself from coverage and save the cost of paying premiums on your earnings. However, you may not be able to be excluded from coverage under the PEOs policy. Additionally, you only pay premium up to a certain threshold (approx. \$85,000) on officers of your company. Since those individuals will not be officers of the PEO entity, you may end up having to pay premium for them on their entire salaries. If highly compensated, the amounts can be considerable. Also, once you enter into employee leasing, you lose your status as an employer in the eyes of workers' comp. insurance companies. If some day you exit leasing, you may not have an "experience rating" to take along with you to the next carrier. Depending upon your loss history, this could be a good or a bad thing.

## How much does it really cost?

It is often difficult to assess the actual cost of employee leasing. Many PEOs claim that they only charge their clients for payroll and benefit costs, plus a nominal per-employee service fee. Some firms even advertise that you no longer pay any payroll taxes and claim that

these savings help offset the cost of their services. They then go on to say that all of their other services (employee handbooks, sexual harassment training, etc.) are free. Make sure you work with a reputable company who is willing to provide you with a detailed, written proposal that allows you to compare apples to apples. Look at exactly how much you are currently paying on an annual basis for payroll taxes. Remember that higher paid employees max out on Social Security after you've paid 6.2% on the first \$90,000 they earn. Keep in mind that whatever percentages you are paying for SUI and FUTA only apply to the first \$7,000 paid to the employee. If a PEO is going to charge you 10% of payroll for taxes, you may be paying a great deal of money for their services. If you really know the true costs of leasing and are willing to pay them, competent PEOs can provide you with relief from the administrative burden of providing HR services to your employees.

## What are other options?

Get some good outside help with managing your employees: a resourceful broker, a reputable payroll processing company, and an experienced human resource consultant or firm. You should definitely consider obtaining employment practices liability insurance ("EPLI") to cover your employment-related liability. With the right team, you can better manage your own employees, minimize your liability, and have the time and money left over to dedicate to running your business.

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