



## EMPLOYER BULLETIN: RE-EMPLOYING YOUR RETIREES

The recent economic climate has left both public and private sector employers scrambling to reduce costs and find efficiencies, especially in the arena of employee salaries and related overhead expenses. Aside from wage freezes or concessions, attacking fringe benefit costs, and reducing the workforce through attrition or layoffs, many employers offer early retirement incentives in order to reduce the number of highly compensated employees from the payroll. These “retirees” move on to start up their retirement distributions under employer sponsored retirement plans and then return to work for the old employer on a part-time basis or as “consultants” or “independent contractors” to perform some portion or all of their former duties. This scenario seems like an economical win-win situation to all parties involved, except the IRS.

This scenario is a matter of concern for some public sector employers as well. As noted in a recent Michigan Attorney General’s Opinion, the Michigan Legislature established the State Employees’ Retirement System as a qualified pension plan under the Internal Revenue Code.

The Internal Revenue Code specifies limited employment-related scenarios under which distributions can be made from a qualified retirement plan. For the purposes of this discussion, these scenarios include the employee’s death, disability or severance from employment. It is the severance from employment requirement that threatens the tax qualified status of retirement distributions made to so-called retirees who return to work for their former employers as part-time employees or under agreements to act as consultants or independent contractors. Loss of tax qualified status threatens deductions taken for employer contributions to a retirement plan as well as the favorable tax treatment of distributions made to the retiree.

In a fairly obvious scenario, the U.S. Tax Court ruled that an employee’s reduction from full-time to part-time employment for the same employer did not constitute a valid employment separation sufficient to receive a favorable tax treatment for retirement distributions. Much more cloudy are the cases of retirees retained by employers under consultant or independent contractor agreements. One thing is absolutely clear, a contract that merely labels the retiree as an “Independent Contractor” or denominates compensation as fees or 1099 payments, standing alone, will have no impact on an IRS or Court determination of whether employment severance occurred.

The determination of employee versus independent contractor status turns on a fact intensive inquiry into the actual nature of the relationship under a multi-factor analysis. Under this multi-factor analysis, Courts and the IRS pay particular attention to the similarities between the former employment and the new relationship and the degree of control that the former employer exercises over the contractor/consultant’s performance of services. For example, employment severance and independent status were found where a retiree agreed to remain available as a consultant with no specified schedule of service, duties or assignments and there was no supervision of the services provided by the consultant. On the other hand, the IRS rules that a “consultant” had not severed employment, where the retiree regularly performed all of his services on the company’s premises, the services performed were an integral part of the company’s business, the retiree received expense reimbursements, and assignments were directed and reviewed by the company’s president.

As discussed above, any workforce reduction plan that involves the use of retirees must be carefully planned in advance of implementation. It remains possible to use retired employees as consultants or independent contractors as part of a cost containment strategy. However, this planned use should be carefully scrutinized to ensure that a separation from employment occurs in order to avoid the disastrous consequences of a retirement plan’s loss of qualified status or the loss of favorable tax treatment for retirement distributions.

**We are experienced, proactive and aggressive legal counsel providing superior service in all areas of employment law. If you would like further information regarding the issues raised in this newsletter or any other employment related issues, please contact Heather G. Ptasznik at (313) 259-8586, John T. Below at (313) 259-8597, or Matthew S. Derby at (313) 259-8653. For more information about Kotz Sangster, please visit us at [www.kotzsangster.com](http://www.kotzsangster.com). This newsletter is provided as general information service and should not be construed as and does not contain legal advice on any specific matter, nor does this message create an attorney-client relationship.**