



## Legal and Operational Differences Between PEO and ASO

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This article will discuss the differences and relative risks between providing human resource and insurance services and products via a co-employer relationship (PEO) and *a la carte* through other means, most commonly, via ASO<sup>1</sup> (administrative services organization). By the way, I subscribe to the description of the entire space of outsourced human resources as HRO (human resources outsourcing), and that PEO and ASO are a part of this larger industry. Thus, all references to PEO shall refer to the delivery of human resources and related services and products through a co-employment relationship. The term ASO shall refer to the delivery of the same or similar services and products without the creation of employment. I will focus on the most common and most difficult-to-accommodate differences between components of PEO and ASO.

### Overview

There are a number of assumptions that apply to a PEO and co-employment that do not apply to an ASO, and the lack of these assumptions is critical to understanding the differences, both legally and operationally, between the business models. It is not enough to recognize the lack of an employment relationship in an ASO without also understanding the effect of this characteristic on how the ASO can provide services. Moreover, the provider of services should be careful to be sure a client signing an ASO agreement understands fully the matters for which it will remain responsible. Examples of such matters include: the



client's continuing liability for payroll taxes as a taxpayer; its sole liability for employment laws and compliance; and its responsibility to secure and maintain workers' compensation insurance.

The lack of an employment relationship in delivering ASO services affects a number of matters important to a PEO. For example, an ASO cannot be the sponsor of a group benefit plan to provide health benefits to employees of its clients. The client must be the sponsor. The ASO can administer client-sponsored group plans, but how many different plans can it or will it administer? If the ASO administers client benefit plans, does it need to be licensed

as a third party administrator (TPA) under state law? Can client employees participate in a multiple-employer retirement plan sponsored by the ASO? Workers' compensation insurance is also an issue. It should be obvious that due to the lack of employer status, an ASO cannot provide workers' compensation insurance in its name. Such insurance can only be provided through individual policies in the name of each client.

<sup>1</sup> The term means administrative services organization, but it is used generically to describe the delivery of HR and related services outside an employment relationship. It is also common to refer to ASO services provided to large employers (i.e., 5,000 and above employees) as BPO (business process outsourcing) services.

## Structure

Before discussing how delivery of services differs between an ASO model and a PEO model, there should be an evaluation of how to structure the corporate organization for the delivery of ASO and PEO services. The essential component of ASO rather than PEO is the lack of an employment relationship to sponsor and deliver the services. Thus, when compared to a PEO, there is inherently less risk in operating an ASO.<sup>2</sup> For this reason, the first matter to consider in adding ASO services, in my opinion, is the corporate structure of the organization. More particularly, the PEO

(or HRO) should consider separating the ASO and PEO operations into different corporate entities. I have always believed that the worst place to be is operating a less risky business (i.e., ASO), but continuing to be subject to the risks of PEO by operating both businesses from the same corporate entity.<sup>3</sup>

## Contract

The contract for an ASO arrangement in many ways does not need to be as long or cumbersome as a PEO agreement. With an ASO contract, there is no need to address the division of duties and responsibilities between co-employers.

There are no statutorily required terms and conditions. Thus, the basics of an ASO contract can be much simpler. On the other hand, the details about what services are being offered must be, in my opinion, more particular. The client and service provider both need to understand specifically what services are being provided for the agreed-upon fees. Failure to provide such specificity in the agreement will inevitably lead to problems.<sup>4</sup>

Specificity in the ASO agreement also helps remind the client there is no employment relationship formed with the ASO service provider. This can help minimize claims from a client of deception or failure to advise, and the like. Such claims would only be threatened if the client believed (wrongly or rightly) that it had been relieved of certain employer duties or responsibilities.

One way to address the issue of specificity is to attach an exhibit to the contract that itemizes the services provided. It is much easier to amend or change the exhibit if there is a desire for more or fewer services than to amend and reissue an entire contract.

Other areas of the ASO contract that merit attention are the Consolidated Omnibus Budget Reconciliation Act (COBRA) healthcare continuation administration sections and benefits

2 Less risk in terms of not being an employer and having no direct risk of compliance with employment laws.

3 Each PEO should consult its own legal counsel about how best to separate the operations and organize its respective businesses after taking into consideration its particular circumstances, applicable state law, and other unique considerations. A basic example for structuring would be through a holding company that in turn owns separately incorporated legal entities organized for the purpose of operating a PEO and an ASO, respectively. The organization could also have a shared services company that contracted with the operating companies to provide common services to them.

4 Common items to be sure to cover are benefits administration and what is meant and included by that term. Will the ASO administer any benefit plan or only a finite number? Will the ASO administer COBRA, and if so, what are the obligations of the client to notify the ASO of a qualifying event? Can the client sponsor its own 401(k) plan and if so, will the ASO administer it?

administration. If the ASO agrees to administer COBRA for its clients, and assuming the client is subject to COBRA,<sup>5</sup> the contract must be very clear on these points: that the obligation to actually provide COBRA benefits belongs solely to the client; the ASO is only responsible for administration of COBRA; the ASO's duty to provide notice is based solely on information provided by the client; and the ASO has no independent obligation to notify the client or an employee of COBRA benefits.

### Benefits and Administration

Benefits delivery and administration are among the more important differences in providing ASO services. Without an employer/employee relationship, the ASO cannot offer group benefits through a plan sponsored by the ASO.<sup>6</sup> As a result, each client must sponsor its own plan.<sup>7</sup>

Most ASOs offer to administer each client health insurance policy. The administration of client health insurance policies raises three additional issues:

### Administering client health insurance policies raises three issues:

- TPA licensing
- Section 125
- COBRA administration



- Third party administrator. Many states have laws that require a third party administrator (TPA) to be licensed. What constitutes a TPA is a question an ASO must answer if it is going to administer client health policies. Most states that regulate TPAs contain similar language in defining TPA. Each ASO should consult the TPA statutes in the states in which they intend to operate to find out if a license is required.

- Section 125. Section 125 of the Internal Revenue Code allows an employer to provide a benefit to its employees such that an employee may pay premiums for qualified health insurance on a pre-tax basis. In other words, the employee can

5 Federal COBRA applies to plan sponsors with 20 or more employees. Please note that states have their own versions of COBRA-type benefits that apply to much smaller employers. The ASO and its clients should be aware of each state's COBRA laws as well.

6 Over the years, many have attempted to "construct" so-called association plans that have as members of the association the clients of an ASO. My experience has been that such association plans are not actually permitted under state law or have some other fundamental flaw that makes them at best very risky and not advisable. Before even considering such a plan, the ASO/PEO should consult legal counsel.

7 Because the ASO is not a plan sponsor of a group health plan, there are typically opportunities for sharing commissions (assuming compliance with state insurance licensing laws) not available to a PEO that sponsors a group health plan (due to Employee Retirement Income Security Act (ERISA) restrictions). Each ASO should consult legal counsel regarding how and to what extent it may benefit from marketing and placing health insurance for ASO clients.



pay her premiums with pre-tax dollars, thereby reducing the net cost of health insurance premiums by an amount equal to her federal income tax rate. This author is unaware of any way an ASO can process payroll of client employees and allow such employees to access and benefit from a Section 125 plan sponsored by the ASO (or a commonly owned PEO). Each client has to sponsor its own Section 125 plan. The ASO can arrange to administer each such plan.

- COBRA administration. Only certain clients are subject to federal COBRA laws (those with 20 or more employees), but to the extent the ASO elects to administer COBRA benefits for its clients and their respective plans, the ASO must be clear about its role and obligations, and be equally clear about

the obligations of each client. The most important obligation of the client is the requirement to report a qualifying event. The ASO must be sure to make it clear that its obligation is limited to providing notices required by law based on the information provided by the client.

### Retirement Benefits (401(k))

It is well established that a PEO can only use a multiple-employer plan under Section 413(c) of the Internal Revenue Code to provide retirement benefits to worksite employees. The essence of such a plan is that it is intended for “multiple employers.” These plans are flexible and uniquely suited for use in a PEO and ASO setting. In the event a PEO decides to add ASO services, it should consult its advisers about whether an existing multiple-employer plan used for PEO operations can be modified for use with ASO clients and their employees as well.

### Errors and Omissions Insurance

Finally, both a PEO and an ASO should secure errors and omissions (E&O)

In the ASO model, each client has to sponsor its own Section 125 plan.

insurance that adequately protects against the risks of these business models. The amount of insurance and components of such a policy may be different for an ASO. This is because in an ASO model, the service provider is purely an advisor; it is not an employer. Thus, the E&O policy must cover the forms and types of advice the ASO provides. The ASO should have its insurance agent look at any existing E&O policy to be sure the unique risks associated with an ASO are covered by the policy.

In conclusion, the ASO model presents some very important differences that have legal and practical implications. A human resources outsourcing organization that elects to deliver its services through both a PEO and an ASO model must be careful to appreciate and address these differences. Specificity in the ASO contract and in communications with the ASO client cannot be over-emphasized. Failure to provide specificity could lead to misunderstandings, or worse, claims by the client for relief based on its belief that the ASO failed to disclose all material factors of the relationship. ●

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*This article is designed to give general and timely information on the subject covered. It is not intended as legal advice or assistance with individual problems. Readers should consult competent counsel of their own choosing about how the matters relate to their own affairs.*

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