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IRS Issues Proposed Regulations On Long-Term, Part-Time Employee Participation In ??401(K) Plans?

Labor & Employment Workforce Watch

WRITTEN BY

Lori A. Basilico

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The Internal Revenue Service ("IRS") recently released proposed regulations addressing the eligibility requirements for long-term, part-time ("LTPT") employees to participate in employer-sponsored 401(k) plans. Rules governing the eligibility of LTPT employees were first introduced in the Setting Every Community Up for Retirement Enhancement Act of 2019 ("SECURE Act") and later modified by SECURE 2.0 Act of 2022 ("SECURE 2.0 Act"). The SECURE Act required employers to allow certain employees who had worked a total of 500 hours in the previous three consecutive years to make deferral contributions to 401(k) plans. SECURE 2.0 further modified the eligibility requirements by reducing the measurement period from three years to two years and expanded the LTPT eligibility rules to include 403(b) tax-advantaged retirement plans beginning January 1, 2025.

The proposed regulations provide much needed guidance on how to implement the LTPT employee eligibility rules for plan years beginning on or after January 1, 2024, the highlights of which are summarized below.

Who is a LTPT Employee?

- Under the proposed regulations, an employee may be classified as an LTPT employee, and therefore eligible to participate in the 401k plan, if the employee is credited with 500 hours of service during the applicable 12-month periods and reaches age 21 by the last of the 12-month periods. LTPT employees do not include (i) certain employees who are covered by a collective bargaining agreement, (ii) certain nonresident aliens, and (iii) employees who satisfy different participation requirements for eligibility (i.e., immediate eligibility or completion of one year of service).
- The proposed regulations confirm that a plan may exclude an employee based on a job classification that is unrelated to age or service, and that the employee would be ineligible to participate as an LTPT employee.

When must LTPT employees start participating in the plan?

- The proposed rules confirm that the entry date rules that apply to other eligible employees also apply to LTPT employees. In other words, LTPT employees must become eligible to make a salary deferral election no later than the earlier of (i) the first day of the plan year beginning after the LTPT employee satisfied the eligibility requirements or (ii) six months after the LTPT employee requirements are met.

How Does a Plan Determine the 12-month Periods?

- The proposed regulations make it clear that the initial 12-month period must begin on the employee's date of hire. Thereafter, the plan may provide that subsequent 12-month periods will be determined by reference to the plan year.
- As the 12-month periods with 500 hours of service must be consecutive, the proposed regulations provide that if an employee works more than 500 hours in the first year, but less than 500 hours the next year, the employee does not satisfy the requirements to be an LTPT employee and the counting begins again. However, once the employee satisfies the LTPT requirements, the employee will always be a LTPT employee, even if the employee works less than 500 hours in subsequent years, and even if the participant's employment terminates and is later re-hired.

How is Vesting of Employer Contributions Calculated for LTPT Employees?

- Although employers may not restrict an LTPT employee's right to make elective contributions, employers are not required to make non-elective or matching contributions on behalf of LTPT employees, even if those contributions are made on behalf of other employees.
- If an employer chooses to make contributions to a plan on behalf of an LTPT employee, the employer must credit the employee with a year of vesting service for periods in which the employee provides at least 500 hours of service (excluding periods beginning before January 1, 2021) and was not otherwise ineligible under the plan.

May LTPT Employees be Excluded from Nondiscrimination, Coverage Testing, Safe-Harbor, and Top-Heavy Requirements?

- The proposed regulations permit plans to exclude LTPT employees when determining whether the plan satisfies the Code's nondiscrimination and minimum coverage requirements. A plan may also exclude LTPT employees from receiving safe harbor contributions and for purposes of determining whether a plan satisfies the Internal Revenue Code's top-heavy benefit requirements.

When Must 401(k) Plans be Amended for These Rules?

- 401k plans must begin operating consistently with the new rules, including any elective features, starting in 2024. The proposed regulations provide that amendments to reflect the new LTPT employee rules must be adopted by the end of 2026.

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