

Long-Term Part-Time Employee Eligibility Rules Now in Effect – Are You Ready?

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Synopsis

The Setting Every Community Up for Retirement Enhancement Act (SECURE 1.0) requires plans to permit employees who work at least 500 hours but less than 1,000 hours in three consecutive 12-month periods to make elective deferrals to 401(k) plans. SECURE 1.0 refers to these workers as long-term part-time employees (LTPT employees). The rules require service from and after January 1, 2021 to be counted, making 2024 the first year that LTPT employees can become eligible to participate under SECURE 1.0. The Securing a Strong Retirement Act of 2022 (SECURE 2.0) modified these rules to require only two consecutive 12-month periods of service for LTPT employees, beginning January 1, 2025. The proposed regulations answer many questions about the application of these rules, such as what 12-month periods count, how different methods for counting service apply to the rules, and the requirements that apply to an employee who becomes eligible solely as an LTPT employee. This advisory highlights key features of the new rules under the proposed regulations and notes next steps that companies sponsoring 401(k) plans should be taking now.

Background

Tax-qualified 401(k) plans must satisfy certain minimum age and service eligibility requirements per Section 410(a) of the Internal Revenue Code of 1986, as amended. Under these rules as in effect before SECURE 1.0, employers could design their 401(k) plans to exclude part-time and temporary employees, so long as the employee did not perform 1,000 hours of service during a specified “eligibility year.”

To expand the population of workers eligible to save for retirement, SECURE 1.0 added a new minimum eligibility rule requiring that 401(k) plans permit LTPT employees, defined as employees who worked at least 500 hours but less than 1,000 hours per year for three consecutive years, to make elective deferrals under such plans.

SECURE 2.0 modified the SECURE 1.0 LTPT employee eligibility rules by reducing the number of consecutive years with at least 500 hours of service but less than 1,000 hours of service from three to two, making it easier for an LTPT employee to become eligible to participate.

SECURE 1.0 provides that service before January 1, 2021 does not count for the LTPT employee eligibility requirements, meaning that the first time an employee could become eligible as an LTPT employee under SECURE 1.0 is January 1, 2024.^[1] SECURE 2.0's modified rules for LTPT employee eligibility do not go into effect until January 1, 2025. Employers need to be able to administer the SECURE 1.0 rules for 2024 and then be

ready to shift to the more generous SECURE 2.0 rules starting in 2025.

In anticipation of these requirements, the IRS published proposed regulations^[2] in November 2023 addressing various details about the application of the LTPT employee eligibility rules under both SECURE 1.0 and SECURE 2.0. This article discusses key aspects of the proposed regulations in a Q&A format.

Are Any Groups of Employees Not Covered by the LTPT Employee Eligibility Rules?

Yes. The proposed regulations clarify that any employee covered by a collective bargaining agreement or any employee who is a nonresident alien with no U.S. source income is excluded from the LTPT employee eligibility requirements.

What if a 401(k) Plan Has a More Generous Eligibility Requirement?

While Section 401(a) sets the limits on age and service eligibility requirements for 401(k) plans, employers can be (and often are) more generous. Some employers allow all employees, including part-time and temporary employees, into the 401(k) plan immediately upon initial employment or after only a short waiting period without any minimum hours of service requirement. These employers do not have to worry about the new LTPT employee eligibility rules because those new rules apply only to employees who are eligible to participate solely due to their LTPT employee status. If a part-time employee is eligible to participate under a 401(k) plan's more generous regular eligibility rules, the employee will not be treated as an LTPT employee for purposes of the SECURE 1.0 and SECURE 2.0 special rules.

As a result, one possible approach to comply with the new LTPT employee eligibility rules is for employers to adopt a more generous regular eligibility requirement, such as eliminating any required minimum number of hours of eligibility service.

What Computation Periods Apply for LTPT Employee Eligibility?

The SECURE 1.0 and SECURE 2.0 consecutive years of service^[3] with at least 500 but not more than 1,000 hours of service is calculated based on specified 12-month periods. The proposed regulations provide that the consecutive 12-month periods begin on an employee's hire date. After that first 12-month period, however, the plan may provide that the computation periods shift to the plan year, starting with the first plan year beginning after the hire date.

Computation periods beginning before January 1, 2021 are not considered for these eligibility rules. For this reason, the first time an employee could have three consecutive 12-month eligibility periods with at least 500 but less than 1,000 hours of service is 2021, 2022, and 2023, making 2024 the first year that an employee could become eligible as an LTPT employee under SECURE 1.0. After 2024, the more generous provisions of SECURE 2.0 will control.

EXAMPLE. Assume an employee is hired on October 1, 2023, and the employer sponsors a 401(k) plan with a calendar year plan year. The first LTPT employee eligibility computation period will be October 1, 2023 – September 30, 2024. The 401(k) plan could keep subsequent computation periods on the same cycle.

Alternatively, the proposed regulations allow the computation periods after the first one to be based on plan years, starting with the January 1, 2024 – December 31, 2024 plan year. Under the alternative approach, there will obviously be some overlap in service. If the employee worked 500 hours from January 1, 2024 to September 30, 2024, the employee would be credited with two consecutive 12-month eligibility computation periods by December 31, 2024, even though the employee had only completed 15 months of employment. The employee would have to be treated as an eligible LTPT employee under the SECURE 2.0 requirements starting January 1, 2025.

What if a 401(k) Plan Counts Hours Using Elapsed Time?

A 401(k) plan must choose from among three permitted alternatives for counting service:

- **Actual Hours of Service:** The general rule is that service is based on actual hours worked. This approach requires an employer to be able to track actual hours worked.
- **Hours Equivalency:** Under Department of Labor regulations,^[4] a plan may count hours of service based on certain specified “equivalencies,” such as a deemed number of hours based on a specified period of service. For example, the regulations allow a plan to treat a day of service as ten hours of service, or a week of service as 45 hours of service.
- **Elapsed Time:** IRS regulations permit a plan to count service based on beginning and end date of employment, without regard to hours worked, referred to as the “elapsed time” method.^[5]

The LTPT employee eligibility rules depend on counting hours of service, which may be based on either actual hours worked or the hours equivalency alternative. But because hours of service are not counted under the elapsed time alternative, the LTPT employee eligibility rules do not apply to a plan that uses the elapsed time method. Instead, a part-time or temporary employee will become eligible under the plan’s regular eligibility rules, i.e., if the employee accrues a period of service (based on hire date and period of service) that meets the plan’s regular eligibility service requirement.

What if a 401(k) Plan Excludes Certain Groups of Employees (Not Based on Service)?

An employer does not have to extend its 401(k) plan to all employees. The plan can exclude from participation groups of employees based on a reasonable classification that is not based on age or service. For example, an employer might exclude all employees at a particular business location or who work for a specific subsidiary.

An employee who would otherwise qualify for eligibility solely as an LTPT employee may also be excluded from participation based on any such reasonable classification. For example, an LTPT employee working at a location where all employees are excluded from participation would likewise be excluded from participation, even if the employee completed the relevant consecutive 12-month periods with at least 500 but less than 1,000 hours of service.

However, if the LTPT employee who has met the minimum LTPT employee service requirement is no longer excluded based on the applicable reasonable classification – for example, if the employee transfers to a location that is not excluded from the plan – then the LTPT employee must immediately be made eligible to participate as an LTPT employee. The service while in an excluded classification still counts for determining LTPT employee eligibility status if the employee later moves into a non-excluded category.

A classification that effectively stands in for service cannot be treated as a reasonable classification. For this reason, plans cannot generally exclude part-time or temporary employees, although plans can exclude such employees until they have received credit for at least 1,000 hours of service for the relevant eligibility computation period. Under the proposed regulations, if a 401(k) plan wants to generally exclude part-time or temporary employees, the plan will need to include a “safety valve” feature that allows the employee to participate if either (i) the employee works at least 1,000 hours in an eligibility computation period, or, if earlier, (ii) the employee qualifies as an LTPT employee by working at least 500 hours but less than 1,000 hours in the relevant (two or three) consecutive 12-month eligibility computation periods.

What Plan Entry Date Applies to an LTPT Employee?

A 401(k) plan must specify the entry date for employees who first meet the plan’s eligibility requirements, and that entry date cannot be later than six months after meeting the plan eligibility requirement, or the start of the next plan year if earlier. Many 401(k) plans apply earlier entry dates, such as 30 or 60 days after meeting the eligibility requirements. A 401(k) plan may use these same entry dates for an employee who becomes eligible as an LTPT employee.

If an LTPT employee leaves employment and later is rehired, the employee generally must be allowed back into the 401(k) plan as an LTPT employee immediately – i.e., once eligible, always eligible.

What if an LTPT Employee Later Works 1,000 Hours?

An employee who becomes eligible solely as an LTPT employee may later meet the 401(k) plan’s regular eligibility requirements, in which case the employee will cease to be treated as an LTPT employee. As we will see in a moment, status as an LTPT employee or regular employee matters for various purposes, including eligibility for employer contributions and treatment for purposes of qualified plan nondiscrimination testing.

EXAMPLE. Assume a plan requires 1,000 hours of service as its regular eligibility requirement. If an employee has 500 hours of service in two consecutive 12-month periods in 2024 and 2025, the employee must be treated as eligible as an LTPT employee beginning in 2026 under the SECURE 2.0 requirements. But if the employee works 1,000 hours in 2026, the employee will become eligible in 2027 under the plan’s regular eligibility rules and would no longer be treated as an LTPT employee.

Does an LTPT Employee Receive Matching or Other Employer Contributions?

An employee who is eligible to make elective deferrals in a 401(k) plan solely as an LTPT employee may be excluded from eligibility for employer contributions. The exclusion may apply to non-elective employer contributions and matching contributions, as well as safe harbor matching or non-elective employer contributions for a safe harbor 401(k) plan.

Excluding LTPT employees from eligibility for employer contributions is a choice, however. The choice applies only if the employee is eligible to participate in the 401(k) plan solely by reason of the LTPT employee eligibility rules. For safe harbor plans, the election to exclude LTPT employees from the safe harbor employer contributions will need to be reflected in an amendment to the 401(k) plan. The treatment of LTPT employees under a safe harbor

plan may also need to be reflected in the applicable safe harbor notice.

OBSERVATION. While safe harbor 401(k) plans are explicitly called out as requiring amendments to reflect the exclusion of LTPEs from eligibility for those contributions, as well as their exclusion from testing, non-safe harbor plans also appear to be subject to this requirement. The preamble to the proposed regulations requires a plan to contain “enabling” language to permit the exclusion. Accordingly, we would expect that a non-safe harbor plan, out of an abundance of caution, should be amended in the same manner as a safe harbor plan regarding LTPE eligibility for employer contributions and exclusion from testing.

Do LTPT Employees Count for Nondiscrimination Testing?

A 401(k) plan may elect to exclude employees who participate in the plan solely by reason of the LTPT employee eligibility rules from various nondiscrimination testing requirements, such as the ADP/ACP tests for non-safe harbor 401(k) plans and the minimum coverage test under Section 410(b). This election to exclude from testing must be reflected in the plan provisions. In addition, if an LTPE is excluded from one of the above tests, they must be excluded from all such nondiscrimination tests.

LTPT employees are still counted in determining whether the 401(k) plan is considered top heavy under Section 416. But if the 401(k) plan otherwise excludes LTPT employees from nondiscrimination testing, the LTPT employees do not have to receive top heavy contributions (if the plan is top heavy).

Can LTPT Employees Make Catch-up Contributions? How About Roth Contributions?

LTPT employees can be eligible to make catch-up contributions and/or Roth contributions for 401(k) plans that more generally offer those contributions to participants. But if the plan elects to exclude LTPT employees from nondiscrimination testing, the plan can choose to not offer catch-up contributions and/or Roth contributions to LTPT employees. Again, this exclusion can apply only to employees who participate in the plan solely by reason of the LTPT employee eligibility rules.

Do Special Vesting Service Rules Apply for LTPT Employees?

Yes. Vesting service for LTPT employees may be counted on the 401(k) plan’s usual vesting computation period (typically, the plan year), but must provide one year of vesting service for any such year that the LTPT employee has at least 500 hours of service (as opposed to the 1,000 hours of service requirement that typically applies to employees). This special rule does not apply to service before January 1, 2021.

Importantly, this friendly, lower vesting service rule continues to apply even if the employee ceases to be an LTPT employee, such as if the LTPT employee later satisfies the plan’s regular eligibility rules and moves from being an LTPT employee to a regular employee. In that case, vesting service while participating as a regular employee would still be based on the 500 hours requirement, even if other regular employees have to work at least 1,000 hours to receive a year of vesting service. This will likely add significant administrative complexity to 401(k) plans.

Vesting service for LTPT employees may not ever actually matter, for example, if the LTPT employees are not eligible for employer contributions, or if all employer contributions are always 100% vested (such as in a safe

harbor 401(k) plan). But employers with employer contributions that are subject to a vesting schedule will need to work closely with their 401(k) plan recordkeeper to make sure that this special vesting service rule is properly implemented and tracked.

Do These Rules Apply to 403(b) Plans?

Not yet. For now, the proposed regulations solely address 401(k) plans. But SECURE 2.0 does apply the LTPT employee eligibility rules to 403(b) plans starting in 2025. We hope the IRS will provide additional guidance before then.

When Do 401(k) Plans Have to be Amended for These Rules?

The proposed regulations generally allow 401(k) plans to adopt amendments to reflect the new LTPT employee rules, including any amendments reflecting elective features of the new rules, by the end of 2026.^[6] However, plans must begin operating consistently with the new rules, including any such elections, starting in 2024.

What Should Employers Do Now?

Employers should work with their legal and other advisors, along with their 401(k) plan recordkeeper, to ensure that their 401(k) plans are now operationally compliant with the LTPT employee rules reflected in the proposed regulations. The potential impact will depend greatly on each employer's business model, demographics, and workforce dynamics. Some employers may consider adopting more generous eligibility rules, or move to an elapsed time service counting method, to largely avoid the LTPT employee special rules. Others may need to adapt to those new rules and ensure that service is being properly tracked. Those employers will also need to make decisions permitted by the new rules, such as whether to exclude LTPT employees from nondiscrimination testing. Finally, employers should monitor for final regulations when adopted for any changes and be prepared to adopt plan amendments by the end of 2026.

[1] See, also, [IRS Notice 2020-68](#), which clarified that all 12-month periods before January 1, 2021 are excluded only for eligibility purposes.

[2] The proposed regulations can be found [here](#). The public comment period ends January 26, 2024, and a public hearing is scheduled for March 15, 2024. Taxpayers may rely on the proposed regulations effective as of January 1, 2024.

[3] Years of service must be consecutive. For example, if a part-time employee completes 500 hours of service in 2021, but only completes 400 hours of service in 2022, counting of hours must begin again in 2023 for purposes of the LTPT employee eligibility rules.

[4] See Department of Labor Regulation 29 CFR § 2530.200b-3.

[5] See Treas. Reg. Section 1.410(a)-7.

[6] See Section 501 of IRS Notice 2024-2.

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