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IRS Proposes Long-Term Part-Time Rule

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The IRS and the Department of the Treasury published a proposed regulation on November 27, 2023, clarifying certain points relating to the coverage of long-term part-time employees ("LTPTE") in defined contribution plans under the requirements of the SECURE Act of 2019 ("SECURE 1.0"), as modified by the SECURE 2.0 Act of 2022 ("SECURE 2.0").

The LTPTE rules affect 401(k) plans that require a minimum service condition to make elective deferrals or that have an exclusion for part-time, seasonal, or other classifications of employees that may be viewed as a proxy for a service requirement, unless the service requirement is based on elapsed time rather than hours worked (including an hours worked equivalency method).

The LTPTE rules generally apply only for purposes of eligibility to make elective deferrals. However, if a plan provides for employer matching or nonelective contributions to be made on behalf of an LTPTE, service may be required to be taken into account for purposes of vesting these contributions.

Background

Retirement plans generally may exclude employees who have not attained age 21 and performed one year of service. If a plan credits service based on hours worked rather than elapsed time, then an employee must be credited with at least one year of service if they earn at least 1,000 hours of service during a 12-month computation period.

Under SECURE 1.0, 401(k) plans are no longer permitted to exclude employees based on their period of service for elective deferral purposes once they have worked at least 500 hours in each of three consecutive years. Service before 2021 is not counted for this requirement, so an employee could first qualify as an LTPTE based on service through 2023, which would make them eligible to participate in 2024.

Under SECURE 2.0, the service requirement for LTPTEs was reduced from three years to two years. SECURE 2.0 started counting service in 2023. As a result, the first possible entry date under SECURE 2.0 is January 1, 2025.

Employees are treated as LTPTEs only if they are eligible to participate in a plan *solely* as a result of meeting the LTPTE requirements. If a plan has more generous eligibility criteria than required by the LTPTE rules, or if a participant becomes eligible to participate in the plan after accruing 1,000 hours of service during a 12-month computation period, then the employee is not treated as an LTPTE. Thus, for example, plans that permit all employees to participate within their first year of employment regardless of their hours of service are not treated as having any LTPTEs subject to the new proposed regulation.

Excluded Classes of Employees

The proposed regulation clarifies that plans may continue to exclude groups of employees based on their job classifications or other criteria (including employees who are covered by a collective bargaining agreement or who are nonresident aliens who receive no US-source earned income from the employer), so long as the criteria are not a proxy for an impermissible age or service requirement, such as a

part-time employee exclusion.

However, hours of service must be counted while an employee is excluded from the plan, as that service must be taken into account in applying the LTPTE eligibility and vesting rules if the employee ever ceases to be in an excluded category.

Entry Date

An LTPTE must become permitted to begin making deferrals into a plan no later than the earlier of (1) the first day of the first plan year after the date on which the 12-month period ends in which the employee completes the LTPTE requirement or (2) the date that is six months after the end of such 12-month period.

The proposed regulation clarifies that the first 12-month period begins on the first day that an employee accrues an hour of service. The second 12-month period may begin on the anniversary of that date or on the first day of the next plan year.

Employer Contributions, Vesting, and Nondiscrimination Testing

If a person is treated as a LTPTE, they must be permitted to make elective deferrals, but they can be excluded from employer contributions, including matching or nonelective contributions under a safe harbor 401(k) plans.

But if an LTPTE is permitted to receive employer contributions, those contributions are subject to a special vesting rule that requires service crediting for any year after 2021 in which the 500 hour requirement is met.

The proposed regulation clarifies that LTPTEs can be excluded from coverage and nondiscrimination testing (including ADP/ACP and top-heavy testing) even if they receive some employer contributions.

Comments

The IRS is accepting comments on this proposal until January 26, 2024. A hearing is scheduled for March 15, 2024.