EMPLOYEE BENEFITS AND EXECUTIVE COMPENSATION
INFORMATION MEMO
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Long-Term, Part-Time Employee Contribution Roll-Out

ERISA at 50

Bond celebrates 50 years helping clients navigate ERISA—the Employee Retirement Income Security Act of 1974.

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Under the Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act), plan sponsors with 401(k) plans are required to allow their "long-term part-time employees" to make elective salary deferral contributions beginning as of the first day of the plan year beginning on or after Jan. 1, 2024.

A "long-term part-time employee" is defined under the SECURE Act as any part-time employee who performed work for at least 500 hours of service, but less than 1,000 hours of service, over the preceding three consecutive 12-month periods. Accordingly, an employer with a calendar year 401(k) plan will have to allow any of its employees who worked 500 hours during 2021, 2022 and 2023 to make 401(k) elective deferrals beginning as of the first plan entry date in 2024 (e.g., Jan. 1, 2024). (Note: beginning in 2025, the SECURE Act of 2022 (SECURE Act 2.0) reduces the consecutive year requirement from three years to two).

Late last year, the IRS issued proposed regulations that sought to address certain lingering questions sponsors and practitioners had about how to implement the new long-term part-time employee requirement. Until the proposed regulations are finalized, taxpayers may rely on the proposed rules. Below is a summary of important provisions in the new proposed regulations:

Excludable Employees

Under the proposed rules, any employee who failed to complete 500 hours of service during each of the preceding three consecutive 12-month periods is excludable, as well as collectively bargained employees, employees who are nonresident aliens with no U.S. source income, and employees otherwise excludable under the plan as a result of a nondiscriminatory classification (e.g., employees in a particular employer division or geographic location).

Measuring the Consecutive Twelve-Month Period

The proposed regulations clarified that the 12-month measurement period during which an employee must work 500 hours is the 12-month period beginning as of the employee's employment

commencement date. However, after the end of the first 12-month period, the employer may shift the measurement period to the first day of the plan year.

Counting Hours

There is no requirement under the proposed regulations for 401(k) plan sponsors to count actual hours worked to determine whether an individual is an eligible long-term part-time employee. Rather, plans applying "hours equivalency" method to measure hours of service may continue to do so to determine whether an individual is eligible to participate as a long-term part-time employee. Plans using an "elapsed time method" to measure years of service are cautioned, however. The new proposed rules clarify that because employee eligibility under the elapsed time method is based on completion of ***no more*** than a one-year period of service, without regard to completion of a specific number of hours worked in such one-year period, a plan cannot require a long-term part-time employee to complete more than a one-year period of service under an elapsed time method before becoming eligible to make 401(k) contributions. In other cases, if a plan is silent as to how to count hours of service for eligibility purposes, the sponsor may have to count actual hours to determine whether an employee has met the 500 hours of service requirement over the prior three years.

Once in Never Out

Once a participant is found to be a long-term part-time employee with at least 500 hours of service over the preceding consecutive three-year period they must be made an eligible participant indefinitely. That is, if a long-term part-time employee, in a subsequent year (or years) performs less than 500 hours of service, that employee must still be allowed to make salary deferral contributions to the plan. Put differently, under the proposed regulations, the break-in-service rules do not apply to long-term part-time employees once eligible.

401(k) Contributions Only

The proposed regulations clarify that the long-term part-time employee mandate applies to normal elective salary deferrals under Code Section 401(k). Long-term part-time employees may be excluded from making catch-up contributions or Roth deferrals under a plan.

Employer Contributions

The long-term part-time employee provision in the SECURE Act applies only to determine eligibility for purposes of making salary deferral contributions. There is no requirement that a sponsor make any employer-matching (including safe-harbor matching) or non-elective contributions on behalf of long-term part-time employees.

Notably, if an employer chooses to make employer contributions on behalf of long-term part-time employees, the proposed rules provide that such employees must be credited with a year of vesting service for all 12-month periods during which 500 or more hours of service were performed. The 500-hour vesting year requirement is irreversible if a long-term part-time employee subsequently performs more than 1,000 hours of vesting service in a later year. That is, such "former long-term part-time employee" must be credited with a year of vesting service if they complete 500 hours or more in a later year. For this reason, plan sponsors should closely review their eligibility requirements for employer contributions.

Plan Testing

Because of the separate treatment of long-term part-time employees, plan sponsors may opt to exclude long-term part-time employees from several nondiscrimination tests (e.g., the ADP, ACP, minimum coverage and top-heavy test under 410(b) and 416 respectively). Importantly, however, if a plan sponsor wishes to exclude long-term part-time employees from any of the tests above for a safe-harbor plan, it must elect to do so expressly via a plan amendment. Non-safe harbor plans must also elect to opt out of the above tests, but the proposed regulations are less clear as to how to evidence such an election. To be safe, sponsors may want to consider amending their non-safe harbor plans as well.

What to do Now:

Plan sponsors should:

- Consult with their plan administrators to identify any of its long-term part-time employees eligible for plan participation and inform them of their eligibility under the plan. Plans with automatic contribution arrangements should have long-term part-time employees enrolled in accordance with the terms of the plan.
- Consider amending their plans to opt-out of the nondiscrimination tests as noted above.
- Address plan design issues, such as whether long-term part-time employees will be eligible for matching contributions, catch-up contributions or Roth deferrals.
- Watch this space for further developments as the deadline for final comments to the proposed regulations expired on Jan. 26, 2024, and more guidance (including potential final regulations) is to be expected in the weeks and months ahead. Until the final regulations are issued, plan sponsors and practitioners may rely on the proposed rules from the IRS.

If you have any questions related to the information presented in this memo, please do not hesitate to contact Devin M. Karas, any attorney in Bond's employee benefits and executive compensation practice or the Bond attorney with whom you are regularly in contact.

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