

IRS Releases Black Friday Special: Proposed Regulations on Long-Term, Part-Time Employee Rules for 401(k) Plans

EBIA Weekly (November 30, 2023)

Notice of Proposed Rulemaking: Long-Term, Part-Time Employee Rules for Cash or Deferred Arrangements Under Section 401(k), 26 CFR Part 1, 88 Fed. Reg. 82796 (Nov. 27, 2023)

Available at <https://www.govinfo.gov/content/pkg/FR-2023-11-27/pdf/2023-25987.pdf>

Reflecting statutory changes made by the SECURE Act and the SECURE 2.0 Act, the IRS has proposed regulations that would amend the rules applicable to 401(k) plans with respect to long-term, part-time employees. For plan years beginning before 2025, in accordance with SECURE Act provisions in effect since 2021, the proposed regulations would define a “long-term, part-time employee” as someone who (1) has worked at least 500 hours of service per year for three consecutive years, (2) has attained age 21 by the end of the consecutive three-year period, and (3) is not in an excluded class (e.g., employees covered by certain collective bargaining agreements, nonresident aliens with no U.S.-source earned income, or a job class exclusion that is not a proxy for imposing an age or service requirement). For plan years beginning after December 31, 2024, the consecutive year requirement would drop from three to two years, reflecting SECURE 2.0 Act changes.

For participation purposes, the proposed regulations would clarify that an employee’s initial 12-month period for purposes of determining whether the employee is eligible to participate as a long-term, part-time employee must be based on the employee’s date of hire, but subsequent 12-month periods may be determined by reference to the first day of the plan year (even if the employee didn’t meet the 500 hours of service requirement during their initial 12-month period). The proposed regulations would further provide that a plan may use the same entry date rules for long-term, part-time employees as it does for other eligible employees.

The proposed regulations, however, would not adopt the break-in-service rules for participation purposes that apply to other employees. Therefore, if an employee is eligible to participate as a long-term, part-time employee, that employee’s eligibility to continue to participate would not be affected by their completion of one or more 12-month periods in which they are credited with fewer than 500 hours of service. Additionally, for a former employee who was eligible to participate as a long-term, part-time employee and who is rehired, all prior 12-month periods during which they were credited with at least 500 hours of service would have to be taken into account in determining whether they are eligible to participate anew as a long-term, part-time employee.

For vesting purposes, the proposed regulations would provide that long-term, part-time employees obtain a year of vesting service for each 12-month period during which they are credited with at least 500 hours of service and incur a one-year break-in-service when they have not completed at least 500 hours. This 500 hours of service vesting rule would apply even when a long-term, part-time employee loses that status. [EBIA Comment: The proposed regulations, therefore, are very lenient toward part-time employees because, even if they later become eligible to participate in the plan as a different class of employee (e.g., they take on more work and have at least

1,000 hours of service and now are eligible to participate as a regular employee per the terms of the plan), they would continue to vest so long as they had 500 hours of service in subsequent years, even though 1,000 hours of service would be required for other regular employees.]

The proposed regulations would clarify that for purposes of determining vesting service for long-term, part-time employees, a plan may use any vesting computation period that is used for other employees (e.g., a calendar year, plan year, or other 12-consecutive month period designated by the plan that is not prohibited by the DOL). The proposed regulations would further clarify that 12-month periods beginning before January 1, 2021, are disregarded for purposes of eligibility and vesting. [EBIA Comment: Under the SECURE Act and related IRS guidance, periods beginning before 2021 could be disregarded for purposes of eligibility but not vesting, but the SECURE 2.0 Act extended the disregard of pre-2021 service to vesting.]

Under the proposed regulations, sponsors of 401(k) plans would still have discretion in determining whether to make matching or nonelective contributions on behalf of long-term, part-time employees, even if these contributions are made to other employees. Failure to make matching or nonelective contributions on behalf of all long-term, part-time employees would not cause a 401(k) plan to fail to meet applicable nondiscrimination or minimum coverage requirements, so long as the plan sponsor elects this exclusion (for safe harbor 401(k) plans, the election must be set forth in the plan). SIMPLE 401(k) arrangements, however, would still have to satisfy applicable matching or nonelective contribution requirements, and could not exclude long-term, part-time employees. The proposed regulations generally would further provide that 401(k) plans may exclude all long-term, part-time employees from the application of top-heavy vesting and benefit requirements if the terms of the plan specifically so provide. (Long-term, part-time employees are not excluded in determining whether the plan is a top-heavy plan.)

Although the regulations are proposed to apply for plan years beginning on or after January 1, 2024, taxpayers may rely on them in the interim. Comments on the proposals, as well as requests to speak at a March 15, 2024, public hearing, must be received by January 26, 2024.

EBIA Comment: The proposed regulations provide that an employee is only considered a “long-term, part-time” employee for purposes of these rules if they are subject to plan language that mirrors the statutory service requirement (e.g., pursuant to its terms, a 401(k) plan provides that, in order to participate, an employee is required to complete the applicable number of consecutive 12-month periods during which they are credited with at least 500 hours of service). If a plan provides for more lenient eligibility rules (e.g., immediate participation upon hire), the normal rules concerning eligibility, participation, and vesting (e.g., 1,000 hours of service for a vesting year of service) would apply instead of these proposed rules. This is a double-edged sword because, while a plan with immediate eligibility for part-time employees would not be subject to the unfavorable break-in-service rules for participation purposes, it also could not benefit from the more lenient nondiscrimination and top-heavy testing rules. For more information, see EBIA’s 401(k) Plans manual at Sections VII.C (“Eligibility Condition #2: Participation Limited to Class of Eligible Employees Defined in Plan”), VII.D.2.d (“Minimum Service Requirement: Long-Term Part-Time Employees”), and XI.F (“Crediting Vesting Service Based on Actual or Deemed Hours of Service”).

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