January 26, 2024

Submitted electronically via regulations.gov

CC:PA:01:PR (REG–104194–23)
Room 5203
Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

RE: Proposed Regulations on Long-Term, Part-Time Employee Rules for Cash or Deferred Arrangements Under Section 401(k) (RIN 1545–BQ70)

Dear Sir or Madam:

The American Benefits Council ("the Council") appreciates the opportunity to comment on the proposed regulations addressing the rules for long-term, part-time (LTPT) employees for cash or deferred arrangements under Internal Revenue Code (Code) Section 401(k).

The recent statutory changes for LTPT employees reflect Congress's careful balancing of two policy priorities. One objective is to expand participation opportunities for LTPT employees. The other objective is to prevent the expanded participation by LTPT employees from imposing onerous costs and administrative burdens on plan sponsors. That is, while the new rules require LTPT employees to have an opportunity to make elective deferrals, they do not require LTPT employees to receive employer contributions and they allow LTPT employees to be excluded from various nondiscrimination rules. The Council has long supported efforts to expand retirement coverage and was pleased when Congress struck this reasonable balance as part of the SECURE Act of 2019 (SECURE 1.0) and again as part of the SECURE 2.0 Act of 2022 (SECURE 2.0).

In recognition of these objectives, the Council is concerned with certain aspects of the proposed regulations that are likely to limit participation opportunities for LTPT employees and, in the absence of additional guidance and changes, increase costs and administrative burdens for employer plan sponsors.

For example, as discussed later in this letter, we are concerned that – in the absence of additional guidance on the interaction of the special rules for LTPT employees and the elapsed time method for crediting service – plans that have never tracked hours for eligibility and vesting purposes may be effectively forced to do so. As another example, we are concerned that the proposed interpretation of the Code provisions that allow employers to exclude employees before they attain age 21 may actually result in more plans electing to exclude employees before they turn 21. Given these concerns, the Council's comments include a series of recommendations that are intended to avoid these negative consequences and promote final regulations that will operate as fairly and efficiently as possible.

Also, as noted below, the proposed applicability date for the final regulations, if finalized, is a clear violation of the Administrative Procedure Act and totally unworkable. Accordingly, the proposed applicability date needs to be delayed.

The Council is a Washington, D.C.-based employee benefits public policy organization. The Council advocates for employers dedicated to the achievement of best-in-class solutions that protect and encourage the health and financial well-being of their workers, retirees and their families. Council members include over 220 of the world's largest corporations and collectively either directly sponsor or support sponsors of health and retirement benefits for virtually all Americans covered by employer-provided plans.

DELAY PROPOSED APPLICABILITY DATE AND PROVIDE RELIEF FOR REASONABLE, GOOD FAITH INTERPRETATIONS OF THE STATUTE PENDING FINAL REGULATIONS

The proposal provides that the final regulations would apply to plan years that begin on or after January 1, 2024, but taxpayers may rely on the proposed rules prior to finalization. Since employers cannot know now what the final rules will require, employers are effectively compelled to comply with these proposed regulations. In other words, if the proposal is finalized with its proposed effective date, it leaves employers without the ability to comply with the final regulations as of the effective date because those final regulations are unknowable as of the effective date. Effectively, that forces employers to implement the proposed regulations, which were issued without notice and comment.

The proposed regulations act as interim final rules in violation of the APA

This circumstance transforms the proposed regulations into an interim final rule and, in turn, constitutes a clear violation of the Administrative Procedure Act (APA), which requires notice and comment prior to the issuance of a legislative rule, subject to

exceptions clearly not applicable here.[1] The APA provides *very* limited exceptions to the notice and comment requirement, such as when the agency finds good cause that notice and comment is "impracticable, unnecessary, or contrary to the public interest."[2] Courts will not hesitate to strike down agency rules promulgated without following these strict notice and comment requirements.[3] The proposed LTPT regulations are subject to this exact same scrutiny because they bind plans sponsors *now*, despite the fact that the regulations are still under consideration. Accordingly, if the proposed applicability date is finalized, the Internal Revenue Service (IRS) will have failed to comply with the APA, without demonstrating good cause for such action.

The retroactive applicability date of the final regulations would violate the APA

Another way to analyze the proposal's effective date under the APA is that, if finalized, it would include a retroactive effective date that is prohibited under the APA, under 5 U.S.C. Section 553(d), again subject to exceptions clearly not applicable here. Section 553(d) of the APA provides that, unless an exception applies, the required publication of a substantive agency rule must be made not less than 30 days before its effective date. Further, a "rule" as defined in the APA is described as having a "future effect."[4] Accordingly, courts have held that, absent an express grant from Congress allowing an agency rule to have a retroactive effect, such rules are "not favored in the law" and violate the APA.[5]

As a recent example, a circuit court held that an Environmental Protection Agency rule regulating the production and importation of certain chemicals had an impermissible retroactive effect because it attempted to reduce companies' chemical production in years prior to finalization of the rule.[6] In its decision, the court noted that the "critical question" with respect to retroactivity was whether the agency's rule "changes the legal landscape."[7] As demonstrated by the Council's several requests for relief and recommendations for changes to the proposal in this letter, the proposal without question changes the legal landscape for plan sponsors with respect to the treatment of LTPT employees.

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[1] 5 U.S.C. § 553.

[2] *Id.*

[3] *See, e.g., Texas v. United States*, 809 F.3d 134 (5th Cir. 2015) (finding the APA's notice and comment exceptions inapplicable and therefore issuing injunction against Department of Homeland Security rule involving immigration policy where no notice and comment period was provided).

[4] 5 U.S.C. § 551(4).

[5] *Bowen v. Georgetown University Hosp.*, 488 U.S. 204, 208-209 (1988); *Cal-Almond, Inc. v. U.S. Dept. of Agriculture*, 14 F.3d 429, 442 (9th Cir. 1993).

[6] *Arkema Inc. v. E.P.A.*, 618 F. 3d 1, 10 (D.C. Cir. 2010).

[7] *Id.* at 7.

The proposed regulations are "legislative" rules subject to the APA

The proposed regulations are "legislative" rules subject to the APA's notice and comment requirements; not "interpretive" rules. This is because the proposed regulations bind plan sponsors to taking certain actions that are not compelled by the statute. As one court has put it, "[a]n agency action that purports to impose legally binding obligations or prohibitions on regulated parties—and that would be the basis for an enforcement action for violations of those obligations or requirements—is a legislative rule."[8] In the absence of any regulatory guidance, the Code's new rules for LTPT employees have been the subject of many reasonable interpretations that differ from the interpretations reflected in the proposed regulations. Thus, under the framework quoted above, the proposed regulations necessarily function as a legislative rule because they bind plan sponsors to taking certain actions and remove the IRS's discretion to interpret the statutory provisions in accordance with reasonable interpretations that are not reflected in the proposal.[9]

For example, under a highly technical reading of the statute, the proposed regulations include provisions that would require employers to include in nondiscrimination testing any LTPT employees who become eligible to participate in the plan before reaching age 21. As discussed below, this result is not compelled by the statutory provisions and therefore, if finalized, the proposed regulations would bind the public to comply with these rules. As another example, the proposed regulations provide that, if an employer elects to exclude LTPT employees from the nondiscrimination and coverage testing requirements covered by Code Section 401(k)(15)(B)(i)(II), the employer must exclude LTPT employees from all such tests and the election must apply to all LTPT employees who are eligible to participate in the CODA. Similarly, this proposed interpretation binds the public, as plan sponsors would not be subject to this limitation in the absence of the proposed regulations.

Practical concerns regarding the effective date and recommendation for the IRS

Aside from the APA issue, the Council is also concerned that plan sponsors have had almost no time to review and implement the LTPT employee rules as proposed. For instance, a plan sponsor may currently be at risk of being out of compliance with the proposal's interpretation of the LTPT rules if the plan sponsor has applied a different, but reasonable, interpretation of the statutory text.

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[8] *Nat'l Min. Ass'n v. McCarthy*, 758 F.3d 243, 251 (D.C. Cir. 2014).

[9] *See Texas v. United States,* 809 F.3d 134, 171 (5th Cir. 2015) (explaining that the two criteria that distinguish policy statements from substantive rules are: "whether the rule (1) imposes any rights and obligations and (2) genuinely leaves the agency and its decision-makers free to exercise discretion").

The Council has two requests to address the above concerns. First, the Council strongly urges the IRS to modify the applicability date of the final regulations so that they would apply no earlier than plan years beginning at least 18 months after the publication of final regulations. Second, prior to the applicability date of the final regulations, we strongly urge the IRS to permit plans to rely on reasonable, good faith interpretations of the statutory language relating to LTPT employees as enacted by SECURE 1.0 and amended by SECURE 2.0. A delay of the applicability date and the addition of good faith relief are needed to allow plan sponsors to adequately prepare and make the necessary modifications to their plans to account for the rules for LTPT employees in the proposed regulations.

CONFIRM FLEXIBILITY FOR ELIGIBILITY COMPUTATION PERIODS & PROVIDE TRANSITION RELIEF FOR PLANS THAT DID NOT PERMIT LTPT EMPLOYEES TO MAKE DEFERRALS PRIOR TO JANUARY 1, 2024

Incorporating a concept from the longstanding minimum participation rules,[10] Section 1.401(k)-5©(2)(ii) of the proposal provides that an employee's initial 12-month period for purposes of determining eligibility as a LTPT employee begins on the first day for which the employee is entitled to be credited with an hour of service, but the terms of the plan "may" provide that, beginning with the plan year that begins within that initial 12-month period, subsequent 12-month periods are determined by reference to the first day of the plan year. These initial and subsequent 12-month periods are commonly referred to as eligibility computation periods (ECPs).

The proposal also stipulates that, if a plan provides that the 12-month periods after an employee's initial 12-month period are determined by reference to the first day of the plan year and the employee is credited with at least 500 (but less than 1,000) hours of service during each of those two 12-month periods, the employee has completed two consecutive 12-month periods with at least 500 hours of service. The preamble confirms that this is the case "even though an employee may be credited with certain hours of service for both the initial 12-month period and the second 12-month period."[11] Thus, under the proposal, the same hour of an employee's service could count twice for both the first and second ECP.

Based on the statutory provisions and the proposed regulations, the Council understands that: (1) plans are permitted, but *not required*, to "switch" the plan's ECP for LTPT employees from a 12-month period beginning on the anniversary of the first date for which they are entitled to be credited with an hour of service to 12-month periods that begin with the first day of the plan year; (2) plans are *retroactively* permitted

[10] *See* Code §§ 401(k)(15)(D)(ii), 410(a)(3)(A).

[11] 88 Fed. Reg. 82,796, 82,802 (Nov. 27, 2023).

to "switch" from a plan year-based ECP to an anniversary date-based ECP; and (3) plans are *not required* to "switch" ECPs for purposes of determining LTPT employee eligibility merely because they separately "switch" ECPs for purposes of determining eligibility pursuant to the 1,000-hour rule.

Confirm that: (1) plans are not required to "switch" to a plan year ECP; and (2) plans are not required to use the same ECPs for purposes of the 1,000-hour rule and the LTPT rules

As noted above, the Council understands that plans are permitted, but not required, to "switch" from a date-of-hire-based ECP to a plan year-based ECP. On this issue, however, the Council requests express confirmation that a plan is not required to "switch" the plan's ECP for LTPT employees from a 12-month period that begins on the anniversary of the first date for which they are entitled to be credited with an hour of service to 12-month periods that begin with the first day of the plan year.

In addition, as noted above, it is our understanding that the law does not require a plan to "switch" ECPs for purposes of determining LTPT employee eligibility in order to align with the plan's separate "switch" of ECPs for determining eligibility under the 1,000-hour rule. In this regard, we also request confirmation that if a plan "switches" its ECP for purposes of the rule under Code Section 410(a)(3)(A) — i.e., the definition of a year of service for purposes of the 1,000-hour rule — then the plan is not required to also switch its ECP for purposes of determining eligibility for LTPT employees under Section 1.401(k)-5(c)(2)(ii)(B) of the proposal. The same should also be confirmed for the reverse. The proposed regulations do not indicate that "switching" in this case would be required, but clarification on this point would be helpful because the current Department of Labor regulations, which are the basis for the proposed ECP switching rule, provide that, for ECPs after the initial ECP, a plan's ECPs must "either" be based on an employee's commencement date or the start of the plan year.[12] Accordingly, there have been questions about whether a plan could use both ECPs for different purposes.

Provide transition relief prior to January 1, 2024

The LTPT rules included as part of Section 112 of SECURE 1.0 are generally effective for plan years beginning after December 31, 2020. Taken together with the SECURE 1.0 rule that requires LTPT employees to complete three consecutive years of service in which the employee completes at least 500 hours of service, many plan sponsors believed that the earliest a LTPT employee would be eligible to join the plan would be January 1, 2024 — i.e., the earliest date occurring three consecutive years after the earliest potential application of Section 112 of SECURE 1.0. The use of the word

[12] *See* DOL Reg. § 2530.202-2(b).

"consecutive" in the statute, on its face, indicated that ECPs for LTPT employees could be calculated one right after another, without any overlap.

Contrary to this interpretation, however, the proposal's "double counting" rule creates situations where an employee could become eligible to participate in a plan as a LTPT employee *prior* to January 1, 2024. To illustrate this potential result, consider an employee who was hired on May 1, 2021. The employer's 401(k) plan has a non-calendar plan year, which begins on June 1, and the plan switches its ECP for purposes of the 1,000-hour rule to the plan year. Assuming the plan would similarly switch ECPs for purposes of the LTPT rules, the employee's ECPs would be determined as follows: (1) the first ECP would run from May 1, 2021, to April 30, 2022; (2) the second ECP would run from June 1, 2021, to May 31, 2022; and (3) the third ECP would run from June 1, 2022, to May 31, 2023. Thus, assuming the employee was credited with at least 500 hours of service (and less than 1,000 hours) for each of the three ECPs, the employee would have satisfied the LTPT eligibility rules as of May 31, 2023. Under the proposal, the employee must be permitted to participate in the plan no later than the first day of the first plan year beginning after the date on which the employee satisfies the eligibility requirements — i.e., June 1, 2023.

The possibility of overlapping ECPs and employees becoming eligible to enter the plan prior to January 1, 2024, was an unexpected result for many of the Council's members who, in the absence of regulatory guidance, relied on a reasonable, good faith interpretation of the statutory text to determine eligibility for LTPT employees. To prevent this unanticipated interpretation from penalizing employers who adopted a contrary, yet reasonable, position, the Council requests that the IRS provide transition relief for plans that did not apply the "double counting" rule and, therefore, did not allow LTPT employees to make deferrals prior to January 1, 2024. One way in which the IRS could do this is to provide reasonable, good faith relief for any interpretation of the statutory provisions that conditions eligibility for LTPT employees upon three consecutive — i.e., non-overlapping — 12-month periods of service. As another option, the IRS could also provide guidance indicating that, notwithstanding any other applicable guidance or plan rules, a plan is permitted to retroactively use an ECP for impacted employees that begins on the anniversary of the first day that an employee is credited with an hour of service, rather than shifting to an ECP based on the plan year. As another potential option, the IRS could also amend the provisions of the proposed regulations regarding entry dates so that no LTPT employees are required to be eligible to make elective deferrals prior to January 1, 2024.

ELAPSED TIME METHOD

Treasury Regulation Section 1.410(a)-7 provides the rules for the elapsed time method of crediting service, under which an employee's eligibility to participate in the

plan, vesting rights and benefit accrual may be determined by reference to the total period of time which elapses while the employee is employed, rather than by reference to the actual completion of a specified number of hours of service within a 12-month period. The proposal's preamble specifically addresses the elapsed time method for crediting service in the context of the LTPT employee rules:

> In general, this proposed regulation would permit a plan to use the elapsed time method to determine an employee's eligibility to participate in a qualified CODA. However, under the elapsed time method, an employee's eligibility to participate is not based upon the actual completion of a specified number of hours of service during a 12-month period. Therefore, an employee who becomes eligible to participate in a qualified CODA under the elapsed time method would not be eligible to participate solely by reason of completing the applicable number of consecutive 12-month periods with at least 500 hours of service during each period and would not be a long-term, part-time employee.
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> In addition, this proposed regulation does not include an amendment to the elapsed time rules under § 1.410(a)-7. Therefore, a plan may not require an employee, including an employee who is classified as a part-time employee, to complete more than a 1-year period of service under the elapsed time method in order to be eligible to participate in a qualified CODA.[13]

Based on this text, as well as the example provided in Section 1.401(k)-5(b)(2)(iv) of the proposal, we understand that an employee who becomes eligible to participate in the plan under the elapsed time method will not be treated as a LTPT employee for purposes of the relief under Code Section 401(k)(15)(B). We are concerned, however, that the proposal does not expressly clarify that plans that use the elapsed time method for service crediting will necessarily satisfy the eligibility requirements for LTPT employees in Code Section 401(k)(2)(D)(ii). Additionally, we are concerned that the proposal overlooks the possibility that some plans may use the actual count method for determining eligibility and the elapsed time method for determining vesting.

Plans have long used the elapsed time method for service crediting purposes. While the elapsed time method is not expressly authorized by statute, the 1980 Treasury Regulation addressing elapsed time makes clear this rule's crucial purpose: it is "designed to enable a plan to lessen the administrative burdens associated with the maintenance of records of an employee's hours of service by permitting each employee to be credited with his or her total period of service with the employer or employers maintaining the plan, irrespective of the actual hours of service completed in any 12-consecutive-month period."[14] Courts

[13] 88 Fed. Reg. 82,796, 82,800-01 (Nov. 27, 2023).

[14] Treas. Reg. § 1.410(a)-7(a)(ii).

throughout the years have upheld the use of this alternative method by plans because the application of the elapsed time regulation with respect to service crediting is as equitable as service crediting under the 1,000-hour rule. In a 2004 decision, for instance, the Ninth Circuit Court of Appeals held that the elapsed time method was not contrary to the 1,000-hour rule "solely because it transforms the 'hour of service' requirement into a 'period of time' requirement."[15]

In practice, the elapsed time method requires employers to credit service to their employees based on full years of service, even if they work less than 1,000 hours, in exchange for relief from the rules that would otherwise require employers to track hours. In many circumstances, the elapsed time method is *more* advantageous to employees than the actual count method for crediting service. While it is true that some employees that work 1,000 hours but are not employed for the full year may not be credited with a year of service, the elapsed time method nevertheless provides that many employees will receive a year of service when they work much less than 1,000 hours in the year. The eligibility and vesting rules for LTPT employees enacted by SECURE 1.0 and SECURE 2.0 are built upon these longstanding rules and implicitly recognize the elapsed time method as an alternative to determining eligibility and vesting credit based on actual hours of service. Nothing in the statute, regulations, or legislative history indicates that Congress intended to upset or in any way interfere with the elapsed time method as an alternative to counting hours.

Confirm that plans using the elapsed time method satisfy the LTPT eligibility requirements in Code Section 401(k)(2)(D)(ii)

The Council requests that the IRS confirm that plans using the elapsed time method for determining participant eligibility are deemed to satisfy the eligibility requirements for LTPT employees in Code Section 401(k)(2)(D)(ii). One possible way to confirm this point would be to provide that, in the case of plans that use the elapsed time method, the "12-month periods" described in Code Section 401(k)(2)(D)(ii) equate to the "one-year periods of service" referenced in Treasury Regulation Section 1.410(a)-7(c)(1)(ii). Thus, a plan would automatically satisfy the eligibility conditions imposed by Code Section 401(k)(2)(D)(ii) as long as it does not condition eligibility upon an employee completing more than a "one-year period of service." Based on the preamble and the example provided in Section 1.401(k)-5(b)(2)(v) of the proposed regulations, the Council believes that it may

[15] *Johnson v. Buckley*, 356 F.3d 1067, 1075 (9th Cir. 2004). *See also Swaida v. IBM Ret. Plan*, 570 F. Supp. 482, 484 (S.D.N.Y. 1983), aff'd, 728 F.2d 159 (2d Cir. 1984) (stating that, by limiting the costs of mandated recordkeeping, "the elapsed time rules go far to ensure the maximum distribution of pension benefits, consistent with Congress' intentions in enacting ERISA").

have been the IRS's intention to interpret the statute in accordance with this position. However, on such a critical point, confirmation is very much needed.

Absent such confirmation, there could be circumstances — albeit relatively uncommon — where an employee will have at least 500 hours of service in two consecutive ECPs (as defined in Section 1.401(k)-5(c)(2)(ii) of the proposed regulations) *prior* to becoming eligible under the elapsed time method. To illustrate this possibility, consider a 25-year-old employee who begins employment on January 1, 2026, and terminates employment on May 31, 2026, having accrued 500 hours of service during that time. The employee is re-hired on October 1, 2027, and accrues 500 hours of service by the close of the year. In this case, the employee would not be eligible to participate under the elapsed time method at the end of 2027 because the employee has not accrued a "one-year period of service," and the gap between the periods of service would not trigger the service spanning rules. However, if the elapsed time method for determining participant eligibility is not clearly deemed to satisfy the eligibility requirements for LTPT employees and the ECPs described in Section 1.401(k)-5(c)(2)(ii) of the proposal are the only applicable "12-month periods," the employee would have worked two consecutive 12-month periods each with 500 hours of service and, assuming the plan is a calendar year plan, the plan would be required to allow the employee to participate as a LTPT employee as of January 1, 2028. Assuming continued employment, the employee would also attain one year of service under the elapsed time method, but not until later in 2028. At such time, the employee would become eligible to participate in the plan under the elapsed time method based on a one-year period of service and would apparently become a former LTPT employee.

Although the scenario described in the preceding paragraph would be relatively rare, if the final regulations do not confirm our requested interpretation, the Council is very concerned that plans will be forced to begin tracking hours to guard against this uncommon occurrence. Otherwise, plans would risk violating the special eligibility rules for LTPT employees. Furthermore, if this occurs, we believe that many plans, once they are required to track hours, will also switch part-time employees to an eligibility requirement that is based on hours of service rather than elapsed time. This will result in fewer part-time employees becoming eligible to participate.

As noted above, the elapsed time method for crediting hours is intended "to enable a plan to lessen the administrative burdens associated with the maintenance of records of an employee's hours of service."[16] Unless the IRS confirms our requested interpretation, the Council is concerned that plans would

[16] Treas. Reg. § 1.410(a)-7(a)(1)(ii).

lose this administrative simplification, even though, as described above, the elapsed time method will, except in very rare cases, be more favorable to LTPT employees than the rule requiring consecutive years with 500 hours of service. Furthermore, not only do we believe that the elapsed time method will actually result in more LTPT employees becoming eligible to participate, LTPT employees who become eligible under the elapsed time method will also be eligible to receive employer contributions, unlike LTPT employees who are exempt under Code Section 401(k)(15)(B). Contrary to the intent of SECURE 2.0, failure to confirm our requested interpretation would increase administrative burdens for plan sponsors and reduce the number of LTPT employees that have an opportunity to participate in a workplace retirement plan.

Permit plans to continue using the elapsed time method for vesting purposes

In addition to determining eligibility, the elapsed time method rules in Treasury Regulation Section 1.410(a)-7 are also used by plans to determine vesting rights. Some plans, for example, base plan eligibility on an employee's actual hours of service, but use the elapsed time method to determine vesting.

Under the proposed regulations, it appears that if these plans have participants come into the plan as LTPT employees, they may no longer be able to use the elapsed time method to determine vesting service. Because Code Section 401(k)(15)(B)(iii) requires plans to credit LTPT employees with a year of vesting service for each 12-month period for which the employee has at least 500 hours of service, it appears that plans could be required to newly track actual hours of service for these employees to determine vesting, rather than using the elapsed time method. There is no evidence that the special rules for LTPT employees were intended to disturb the elapsed time method for crediting service — whether for eligibility or vesting purposes. Accordingly, the Council requests that the final regulations clarify that plans that determine eligibility based on actual hours of service may always use the elapsed time method vesting rules in Treasury Regulation Section 1.410(a)-7(d), even for participants who become eligible as LTPT employees.

As discussed above, the elapsed time method for crediting service was developed to balance the administrative benefits of an alternative service crediting method with the need to ensure that such a method is as equitable as the actual hours method for crediting service.[17] Without our requested clarification regarding the use of the elapsed time method for vesting purposes, the Council is

[17] *See Swaida*, 570 F. Supp. at 488 (approving the use of the elapsed time method because the Treasury Department and IRS, using their regulatory authority, have determined that it is as equitable as the hours of service crediting method).

concerned that the LTPT employee regulations could interfere with the well-established use of the elapsed time method, which many plan sponsors have relied on for decades.

Congressional intent behind the LTPT rules was to increase retirement coverage for part-time employees. The Council's request is not only consistent with this purpose, it also furthers it. A rule permitting the elapsed time method for vesting for LTPT employees is likely to result in more LTPT employees accruing vesting credit than under the actual count method for crediting service.

As an example, consider a plan that determines eligibility based on actual hours of service and has an employee enter as a LTPT employee at the start of 2026 and terminate in 2028. Further assume that the employee actually works 450 hours in 2026 and 2027, and 700 hours in 2028. If the plan must use the actual hours method for determining vesting, the LTPT employee will only earn one year of vesting credit from 2026 to 2028. If, however, the plan is permitted to use the elapsed time method for determining vesting for LTPT employees, that same employee would accrue two years of vesting service during this period and the plan would not have to track hours.

In application, the elapsed time method will always satisfy the vesting rule for LTPT employees to the extent they remain employed through the end of the year. Thus, the Council's requested clarification is relevant only to determining vesting credit in the year in which a LTPT employee separates from service. We believe that our request strikes the right balance between, on the one hand, more generous vesting rules for LTPT employees in the years in which they work less than 500 hours with, on the other hand, the potential for less generous vesting rules in the years in which they separate from service. Absent our requested interpretation in the final regulations, we are concerned that the resulting administrative burdens would not be justified by the additional service crediting for LTPT employees who are not fully vested and have fewer than 1,000 but more than 500 hours of service in the year in which they terminate from service. We do not see a distinction in the special rules for LTPT employees that would compel the Treasury Department and IRS to abandon this rule of administrative convenience solely because LTPT employees receive credit based on 500 hours instead of 1,000.

RECOMMENDATIONS REGARDING AGE 21 REQUIREMENT

Under Code Section 401(k)(15)(B), with respect to employees who are eligible to participate in the plan solely by reason of the LTPT rules, the employer may elect to exclude such employees from nondiscrimination testing, minimum coverage testing

and top-heavy benefits. The employer is also not required to make nonelective or matching contributions on behalf of such employees.

In operation, the proposal uses the LTPT employee definition to determine when this relief is available and defines the term LTPT employee as an employee who is eligible to participate in the arrangement "*solely by reason*" of having met the following two requirements: (1) completing two (or three, as applicable) consecutive 12-month periods during each of which the employee is credited with at least 500 hours of service; ***and*** (2) attaining age 21 by the close of the last of such 12-month periods.[18] Thus, under the proposal, if a participant becomes eligible for a plan, but not solely by reason of attaining age 21, the participant is not treated as a LTPT employee for purposes of the relief provided through Code Section 401(k)(15)(B). On this interpretive position, the Council has three requests.

Do not require plans to adopt an age 21 requirement as a condition for LTPT employee relief

Based on the proposal's definition of LTPT employee, it appears that the proposal would require a plan to implement an age 21 requirement in order to utilize the relief under Code Section 401(k)(15)(B). If, for example, a plan does not have an age 21 requirement, it appears that no employees will become eligible to participate in the plan "solely by reason" of attaining age 21. Strangely, this means that even if an employee otherwise completes the required number of consecutive years of service with at least 500 hours and becomes eligible after attaining age 21, the employee would not be treated as a LTPT employee eligible for the relief provided by Code Section 401(k)(15)(B).

The Council believes this aspect of the proposed definition of LTPT employee is plainly inconsistent with the statutory text. It also appears that it may be unintentional. Code Section 401(k)(2)(D)(ii) provides that a plan must have an eligibility requirement under which an employee must complete either: (1) one year of service (using the 1,000-hour rule); or (2) two (or three, as applicable) consecutive 12-month periods of service during each of which the employee completes at least 500 hours of service. While plans are not required to permit employees under age 21 to participate pursuant to Code Section 401(k)(15)(A), nothing from the statute suggests that a plan must impose an age 21 requirement in order for the relief in Code Section 401(k)(15)(B) to apply, especially in the case of employees who become eligible after they attain age 21. To prevent this result, the Council recommends that any final rule be amended to clarify that a plan that does not impose an age 21 requirement is eligible for the relief under Code Section 401(k)(15)(B) as long as employees enter the plan *solely* by reason of having the requisite

[18] Prop. Treas. Reg. § 1.401(k)-5(b) (emphasis added).

number of consecutive years of 500 hours of service. That is, the "solely by reason" requirement should not apply to the age 21 requirement.

Permit employees under age 21 to become eligible as LTPT employees

The proposal's definition of LTPT employee would provide that an employee who has met the requisite service requirements, but has not yet attained age 21, is not a LTPT employee for purposes of the relief provided in Code Section 401(k)(15)(B). This is because the proposed definition of LTPT employee is conditioned upon an employee becoming eligible for a plan "solely by reason" of meeting the service requirements and attaining age 21 by the close of the last of the applicable 12-month periods.

The Council requests that the IRS amend its proposal so that employees who have met the requisite service requirements but are not yet age 21 may enter the plan as LTPT employees. On this issue, we do not believe that the statute requires the IRS to exclude employees under age 21 and we are concerned that this exclusion would have negative policy implications.

From a statutory perspective, it is clear that the purpose of Code Section 401(k)(15)(A) is to permit plans to preserve the longstanding option to exclude employees under age 21.[19] The purpose is not to eliminate relief for plans that permit LTPT employees to enter the plan before age 21. In this regard, from a technical perspective, we do not believe that the IRS's definition of LTPT employee must distinguish employees who become eligible to participate solely by reason of the technical application of Code Section 401(k)(2)(D)(ii) from employees who become eligible solely by reason of satisfying the eligibility conditions that are described in Code Section 401(k)(2)(D)(ii). From a policy perspective, the proposed definition is concerning because it will encourage employers to adopt an age 21 requirement, thereby preventing younger employees from making elective deferrals, even if a plan otherwise does not impose an age 21 requirement for full-time employees. Such a result would contradict the purpose of the rules for LTPT employees — i.e., to increase plan participation among LTPT employees.

Permit LTPT employees to automatically participate upon attaining age 21

Code Section 410(a)(1)(A) provides that, as a general rule, a plan may not require, as a condition of participation, that an employee complete a period of service extending

[19] *See, e.g.*, Joint Comm. on Taxation, JCX-11-19, *Description of H.R. 1994, the "Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019"* at 30 ("The proposal requires a section 401(k) plan to permit an employee to make elective deferrals if the employee has worked at least 500 hours per year with the employer for at least three consecutive years and has met the age requirement (age 21) by the end of the three consecutive year period (for this proposal, an employee is referred to as a "long-term part-time employee" *after having completed this period of service*).") (emphasis added).

beyond the later of: (a) the date on which the employee attains age 21; or (b) the date on which the employee completes one year of service with at least 1,000 hours. Under this rule, all years of service are typically taken into account for determining eligibility, so that if an employee completes a year of service with at least 1,000 hours prior to turning age 21, they must be allowed to enter the plan once they reach age 21.

In contrast to this longstanding rule, the proposed regulations provide that an employee who has the requisite number of years of part-time service before they attain age 21 will not be treated as a LTPT employee if they become eligible to participate upon attaining age 21, unless the employee has at least 500 and less than 1,000 hours for the year in which the employee attained age 21.

Section 1.401(k)-5(b)(2)(ix) of the proposal demonstrates this surprising result. In the example, a plan excludes employees who have not yet attained age 21. An employee commences employment on June 1, 2024, and attains age 19 on October 3, 2024. During each of the 12-month periods beginning on June 1, 2024, and June 1, 2025, the employee is credited with 600 hours of service, but during the 12-month period beginning on June 1, 2026, during which the employee reaches age 21, the employee is credited with only 400 hours of service. The proposed regulations state that this employee is not a LTPT employee because the employee was only credited with 400 hours of service during the 12-month period in which the employee attained age 21. According to the example, the employee must wait until at least June 1, 2029, to become eligible as a LTPT employee, assuming the employee is credited with at least 500 (but less than 1,000) hours of service for each of the prior two 12-month periods.

Given the application of the longstanding rules under Code Section 410(a)(1)(A), we are surprised by the outcome of the example recited above and understand that many practitioners were similarly surprised by this interpretation. Accordingly, the Council requests that the IRS amend its proposal on this issue so that, similar to the rules under Code Section 410(a)(1)(A), employees who automatically become eligible to participate upon reaching age 21 may be treated as LTPT employees, even if they did not have at least 500 and less than 1,000 hours in the year in which they attained 21. Additionally, the IRS should expressly clarify that plans may, but are not required to, adopt this approach to automatic LTPT employee eligibility. At the very least, to prevent unfair surprise for plans that may currently be providing this form of automatic eligibility upon age 21, the Council requests that, until final regulations become applicable, the IRS expressly clarify that it is a reasonable, good faith interpretation of the statute to treat as LTPT employees those employees who enter a plan based on the requisite number of consecutive years of part-time service and the attainment of age 21, even if such employees have less than 500 hours in the year in which they actually attained age 21.

DO NOT TREAT MINIMUM VESTING RULES "AS IF" THEY APPLY TO GOVERNMENTAL AND CHURCH PLANS

The special vesting rules applicable to LTPT employees under Code Section 401(k)(15)(B)(iii) provide that, for employees who become eligible to participate in the plan solely by reason of the LTPT rules, each 12-month period for which the employee has at least 500 hours of service is treated as a year of service for purposes of determining whether the employee has a nonforfeitable right to employer contributions. The proposal indicates that, for purposes of this rule, the minimum vesting rules of Code Section 411 will be treated "as if" they apply to governmental and church plans, taking into account the modifications for LTPT employees.[20]

As a threshold matter, the Council asks the IRS to reconsider whether governmental and nonelecting church plans should be subject to the LTPT eligibility rules at all. The preamble to the proposal states that "section 401(k)(15) does not provide any exceptions from the maximum permissible service requirement of section 401(k)(2)(D)(ii) for a qualified CODA in: (1) a governmental plan (as defined in section 414(d)), or (2) a church plan (as defined in section 414(e)) with respect to which the election provided by section 410(d) has not been made."[21] It is true that Code Section 401(k)(15) does not include an explicit exception for such plans. However, Section 401(k)(15) builds upon the minimum participation standards in Section 410(a). Under Section 401(k)(2)(D), there are two alternative eligibility rules available, i.e., one rule referencing the time period permitted under Section 410(a)(1) and the other providing for the 500-hours-of-service rule. Governmental and church plans are not subject to the rules under Section 410(a)(1) and it appears contrary to congressional intent that Congress would impose an eligibility rule on governmental and nonelecting church plans in only one of the two circumstances under Section 401(k)(2)(D). Accordingly, given that governmental and nonelecting church plans are exempt from the minimum participation standards in Section 410(a), we request that the IRS reconsider whether such plans should be exempt from the LTPT employee rules altogether.

With respect to the application of the vesting rules, as a result of the proposal's statement regarding Code Section 411 described above, although it is not completely clear what it means for Code Section 411 to be treated "as if" it applies to governmental and church plans for this purpose, it appears that the relevant regulatory language is intended to require governmental and church plans (including nonelecting church plans) to credit a year of vesting service for each year in which a LTPT employee has at least 500 hours of service, but only if such plans otherwise determine vesting based on hours or years of service. The preamble to the proposal expressly requests comments on this issue.

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[20] *See* Prop. Treas. Reg. § 1.401(k)–5(d)(1)(ii); 88 Fed. Reg. 82,796, 82,800 (Nov. 27, 2023).

[21] 88 Fed. Reg. 82,796, 82,800 (Nov. 27, 2023).

The Council is concerned about the proposal's language indicating that the rules of Code Section 411 will be treated as if they apply to governmental and church plans. This is because governmental plans and church plans that have not made an election are explicitly exempt from the Code's and ERISA's vesting requirements.[22] Accordingly, we do not understand how the IRS can treat such rules "as if" they apply, or what that would mean if it could. If the IRS can treat Code Section 411 as if it applies to governmental and church plans, can it also treat other rules as if they apply in contexts that are expressly excluded by statute? Obviously, it cannot.

The relevant statutory exclusions in the Code and ERISA for these types of plans reflect deliberate decisions from Congress to exempt these plans from the minimum vesting rules for various policy and legal reasons, including constitutional concerns about the federal government's ability to regulate churches and state and local governments. Given these statutory exclusions, we do not believe that the IRS has the authority to treat Code Section 411 "as if" it applies to governmental and church plans.[23] For all of these reasons, the Council requests that the IRS delete the language indicating that Code Section 411 will be treated as if it applies to governmental and church plans.

PROVIDE GUIDANCE ON THE APPLICATION OF THE LTPT RULES TO 403(B) PLANS

SECURE 2.0 extends the new rules for LTPT employees to ERISA-covered 403(b) plans by way of amendments to the Code and ERISA. The proposal does not, however, amend the 403(b) regulations, leaving some key points of clarity that are needed for 403(b) plans to be able to apply the LTPT rules. Accordingly, the Council recommends that the IRS propose regulations addressing how the LTPT rules apply to 403(b) plans. Public input will be critical to that effort and the IRS should not attempt to finalize guidance on 403(b) plans without first issuing a proposal.

Confirm LTPT employees are exempt from ACP safe harbors

Under Code Section 403(b)(12)(D)(i)(II), employers may elect to exclude LTPT employees from the application of the actual contribution percentage ("ACP") test in Code Section 401(m)(2). Neither the statute nor the proposed regulations expressly provide that employers may also elect to exclude LTPT employees from the application of the corresponding safe harbors in Code sections 401(m)(11) and (m)(12). The Council

[22] *See* Code § 411(e)(1)(A) and (B); ERISA § 4(b)(1) and (2).

[23] For example, the IRS does not have the authority to treat the Code's minimum vesting rules as if they apply to governmental plans any more than it has the authority to treat the nondiscrimination rules of Code § 401(a)(4) as if they apply to such plans. *See* Code § 401(a)(5)(G).

requests that the IRS confirm that because employers may elect to exclude LTPT employees from the application of the ACP test, employers that rely on the ACP safe harbors may also exclude LTPT employees from receiving employer contributions under the safe harbors. If an employer can already exclude LTPT employees from the ACP test, it logically follows that the employer would have no need to satisfy the safe harbors to the ACP test.[24]

Confirm the application of the universal availability rule's exceptions

The Council requests two clarifications with respect to the universal availability rule in Code Section 403(b)(12)(A). The universal availability rule provides that all employees of the organization maintaining a 403(b) plan must be eligible to make elective deferrals if any employee has the right to make elective deferrals. Two exceptions exist that are relevant to the new rules for LTPT employees: (i) employees who normally work less than 20 hours per week; and (ii) student employees performing services described in Code Section 3121(b)(10), such as students who work at the university where they are enrolled.

First, with respect to the exception for employees working less than 20 hours per week, we request confirmation on how the exception interacts with the LTPT eligibility requirement of two (or three, as applicable) consecutive 12-month periods of service during each of which the employee completes at least 500 hours of service. The Council believes that the LTPT eligibility rules apply in addition to the universal availability rule. That is, an ERISA-covered 403(b) plan would not be permitted to exclude from the plan an employee who normally works less than 20 hours per week if the employee otherwise meets the requisite service requirements by accruing at least 500 hours of service in each of two (or three) consecutive years. We request that the IRS clarify that such employees would not be excluded from the LTPT rules.

Second, with respect to the exception for student employees, we request clarification on how the exception interacts with the proposal permitting plans to establish eligibility conditions that are not related to age or service. The proposal provides that the LTPT rules do not preclude a plan from establishing an eligibility condition that must be satisfied in order for an employee to participate in the arrangement, provided that the condition is not a proxy for imposing an age or service requirement.[25] As an example,

[24] A discussion draft containing technical corrections to SECURE 2.0 was released on December 6, 2023, by the chairs and ranking members of the U.S. House of Representatives Committee on Education and the Workforce, the House Committee on Ways and Means, the Senate Finance Committee and the Senate Committee on Health, Education, Labor and Pensions. Section 2(i) of the discussion draft would explicitly provide our requested clarification. Pending enactment of the provisions of the discussion draft, however, the IRS should confirm that it agrees with our requested interpretation.

[25] Prop. Treas. Reg. § 1.401(k)–5(c)(3).

the proposal notes that a requirement that an employee be employed within a specified job classification would not violate this rule. In the Council's view, an ERISA-covered 403(b) plan that excludes student employees does not impose an age or service requirement that violates the LTPT eligibility rules because a "student" classification is not a proxy for an age or service requirement. We request that the IRS confirm this interpretation.

Clarify the treatment of LTPT employees who become full-time employees

The Council requests clarification on whether employees in ERISA-covered 403(b) plans become former LTPT employees once they have completed a year of service with at least 1,000 hours. The Code provides that, generally, when part-time employees in 401(k) plans become full-time employees, the relief provided to employers under Code Section 401(k)(15)(B) no longer applies.[26] However, with respect to ERISA-covered 403(b) plans, the Code and ERISA are silent on whether a similar rule applies. We ask that the final regulations address this uncertainty by clarifying that once an employee becomes eligible to participate in an ERISA-covered 403(b) plan as a LTPT employee, they are always eligible for the relief available to LTPT employees.

PROVIDE RELIEF FOR BREAKS IN SERVICE FOR NONVESTED LTPT EMPLOYEES

The preamble to the proposal provides that if a former employee who was eligible to participate as a LTPT employee is re-hired by an employer maintaining the plan, then the 12-month periods during which the employee previously was credited with at least 500 hours of service with an employer maintaining the plan must be taken into account for purposes of determining whether the re-hired employee is eligible to participate as a LTPT employee. The preamble also provides that the proposal does not include any provisions similar to the break-in-service rules under Code Section 410(a)(5) for purposes of determining LTPT employee eligibility. Thus, absent any break-in-service rules, it appears that employees who are initially eligible as LTPT employees, leave the employer and are then re-hired — even many years later — would be immediately eligible to participate as a LTPT employee, even in the case of nonvested participants.

The Council requests that the IRS provide relief such that the break-in-service rules in Code Section 410(a)(5)(D) would apply to the LTPT rules of Code Section 401(k)(2)(D)(ii). Under Code Section 410(a)(5)(D)'s rule of parity, years of service before any period of consecutive one-year breaks in service may be ignored for determining the eligibility of nonvested participants if the number of consecutive one-year breaks in service equals or exceeds the greater of: (a) five years; or (b) the aggregate number of years of service before the break.

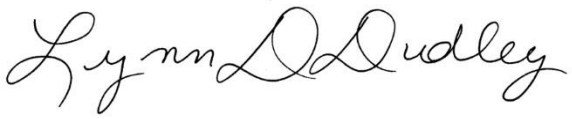
[26] Code § 401(k)(15)(B)(iv).

Following the rule of parity in Code Section 410(a)(5)(D), the Council requests that if an employee who made no elective deferrals and received no vested employer contributions separates from service and is later re-hired, the plan is permitted to apply rules similar to those under Code Section 410(a)(5)(D). These rules would provide a reasonable limitation on the proposal's current lack of any break-in-service rules. Without such a limitation, we are concerned that plan sponsors could experience administrative difficulties in tracking service-related information for former nonvested, part-time employees that are re-hired potentially many years after they initially separated from service.

* * * * *

Thank you for considering the Council's requests and recommendations on the proposed regulations addressing LTPT employees. If you have any questions or if we can be of further assistance, please contact me at 202-289-6700 or ldudley@abcstaff.org.

Sincerely,



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