

Washington Pulse

December 8, 2023

IRS Issues Proposed Long-Term, Part-Time Regulations

The Internal Revenue Service (IRS) has released a [proposed regulation](#) reflecting statutory changes related to long-term, part-time (LTPT) employees made by the SECURE Act of 2019 (SECURE Act) and the SECURE 2.0 Act of 2022 (SECURE 2.0). This proposed regulation would amend Treasury Regulation (Treas. Reg.) 1.401(k)-5 to reflect the rules for LTPT employees, including specific eligibility and vesting requirements. The proposed regulation also provides guidance regarding employer contributions with respect to LTPT employees and the impact that LTPT employees will have on nondiscrimination, coverage testing, and top-heavy benefits.

Background

Historically, employers could design their 401(k) plans to prevent part-time workers from entering a plan by requiring employees to be credited with at least 1,000 hours during a plan year in order to become eligible to participate. In 2019, the SECURE Act changed the eligibility requirements so that LTPT employees who are credited with at least 500 hours in three consecutive years must be allowed to participate under a 401(k) plan's salary deferral provision; and 12-month periods beginning before January 1, 2021, are disregarded for this purpose. In 2022, SECURE 2.0 reduced the wait from three years to two, effective for plan years that begin after December 31, 2024, and expanded applicability to ERISA-covered 403(b) plans. This proposed regulation provides answers to some of the open questions regarding the administration of LTPT employees and paves the way for new plan design concepts.

The highlights of the proposed regulation are described below.

Definitions

The proposed regulation provides clarity on the criteria that need to be met in order for an employee to be considered a LTPT employee and also defines a new classification identified as *former* LTPT employees.

- **LTPT Employee.** Under this proposed regulation, a LTPT employee is defined as an employee who is eligible to participate in a plan *solely by reason of*
 - being credited with at least 500 hours of service during each of two consecutive 12-month periods (three consecutive 12-month periods for plan years beginning before 2025), and
 - attaining age 21 by the close of the last of the consecutive 12-month periods.

LTPT employees do not include employees described in Internal Revenue Code Section (IRC Sec.) 410(b)(3), including union employees and employees who are nonresident aliens with no United States source income.

If an employee becomes eligible to participate in the plan under any other service condition (or lack thereof), the employee is *not* a LTPT employee. For example, if a newly-hired employee is immediately eligible to participate in the plan for deferral purposes, she will not be considered to meet the definition of a LTPT employee. Similarly, an employee who becomes eligible to participate using the elapsed time method would not be considered a LTPT employee because the individual would not have met the service requirement solely by completing the applicable number of consecutive 12-month periods during which the employee is credited with at least 500 hours of service.

- **Former LTPT Employees.** This proposed regulation also defines a former LTPT employee. A LTPT employee will become a former LTPT employee as of the first day of the plan year beginning after the earlier of
 - the plan year in which the employee is credited with at least 1,000 hours during a 12-month period, or
 - the plan year in which the employee becomes an ineligible employee (due to an eligibility requirement other than age or service).

Eligibility and Participation Criteria

- **Determining Eligibility Service.** The proposed regulations generally leverage existing rules for determining LTPT employees, including the methods for counting hours and determining the 12-month periods during which hours must be counted.
 - **Equivalency Method.** In addition to counting actual hours, the proposed regulation will permit employers to use an otherwise permissible equivalency method to determine if an employee is credited with at least 500 hours of service during the applicable number of consecutive 12-month periods. The hours of service credited will not be affected by an employer classifying an employee as part-time. For purposes of LTPT eligibility, the IRS did not choose to reduce the number of hours that normally would be credited to an employee under the applicable equivalency method.
 - **Eligibility Computation Periods.** All computation periods beginning on or after January 1, 2021, must be considered when determining if an employee has completed the LTPT service requirements. The initial eligibility computation period begins on the employee's date of hire and ends on the anniversary date of the date of hire. Subsequent eligibility computation periods may continue as the anniversary date of hire, or may switch to the plan year depending on the terms of the plan which may result in overlapping eligibility computation periods.
- **Class Exclusions.** The proposed regulation confirms that certain classes of employees may continue to be excluded from participation in the plan, notwithstanding the LTPT requirements, so long as the class exclusions are not a proxy for imposing an age or service requirement that forces an employee to complete a period of service that extends beyond the earlier of
 - age 21 and one year of service, or
 - the applicable number of consecutive 12-month periods during each of which the employee is credited with at least 500 hours of service.
- **LTPT Entry Dates.** A LTPT employee must be permitted to enter the plan under the same entry date rules that apply to all other eligible employees. This means a LTPT employee must be permitted to enter the plan the earlier of
 - the first day of the first plan year beginning after the date the employee satisfies the eligibility requirements, or
 - six months after the date the employee satisfies the eligibility requirements.
- **Break in Service Rules.** The proposed regulation does not include any provision similar to existing eligibility break in service rules. Therefore, once an employee becomes eligible under the LTPT provisions, the completion of any 12-month period where she is credited with fewer than 500 hours does not affect her LTPT eligibility. In addition, if a LTPT employee terminates service and is rehired by the employer maintaining the plan, then the employer must take into account the previous 12-month periods during which she was credited with at least 500 hours for purposes of whether they are eligible to participate.
- **Deferral Restrictions for Non-HCEs.** In order to give effect to the statute, the proposed regulation limits the ability to impose restrictions on the right to make deferral contributions by a LTPT employee who is an eligible

non-highly compensated employee (non-HCE). The right to make deferral contributions cannot be restricted in any manner that would not be permitted for a non-HCE under a safe harbor plan. Therefore, the permissible restrictions are limited to

- restrictions on election periods,
- the amount of deferral contributions,
- the types of compensation that may be deferred, and
- limitations under the IRC (e.g., 402(g) and 415 annual additions limits).

Vesting Service Regulations

The proposed regulation would require employers to credit LTPT *and* former LTPT employees with one year of vesting service for each year that an individual is credited with at least 500 hours during a 12-month vesting computation period. Therefore, former LTPT employees will continue to be credited with vesting service under the LTPT vesting provisions, necessitating separate tracking of such participants for vesting purposes.

Employer Contributions for LTPT Employees

The proposed regulation stipulates that—except in the case of a SIMPLE 401(k) plan—employers are not required to provide nonelective and matching contributions to LTPT employees. This applies even if the employer makes contributions on behalf of other eligible employees. An employer that wishes to forego making matching or nonelective contributions on behalf of LTPT employees in a safe harbor plan must make an election—described below—to exclude LTPT employees for purposes of determining whether the plan satisfies the nondiscrimination and minimum coverage requirements.

Impact on Nondiscrimination and Coverage Testing

The proposed regulation permits an employer to exclude LTPT employees from several compliance tests including the nondiscrimination requirements under IRC Sec. 401(a)(4), the actual deferral percentage (ADP) and actual contribution percentage (ACP) tests, ADP and ACP safe harbor provisions, and the 410(b) minimum coverage test. If the employer does not elect to exclude LTPT employees, those employees generally will be otherwise excludable employees for purposes of IRC Sec. 410(b)(4)(B).

- **Former LTPT Employees.** Unlike LTPT employees, the proposed regulation does not permit former LTPT employees to be excluded from testing or be considered otherwise excludable because these employees have satisfied the minimum age and service requirements of IRC Sec. 410(a)(1).
- **All-Inclusive Testing Election.** An employer's election to exclude LTPT employees from nondiscrimination and coverage testing must apply to *every* nondiscrimination and coverage testing provision (as applicable). This election must also apply to *all* LTPT employees who are eligible to participate in the plan.
- **Testing Election Documentation.** If a plan is an ADP or ACP safe harbor plan, the employer's election must be included in the plan document and satisfy the safe harbor plan year requirements. If a plan is a non-safe harbor plan, the employer's election does not have to be included in the plan document, but the plan's terms must provide language that enables the employer to make an election to exclude LTPT employees from the nondiscrimination and minimum coverage requirements.
- **SIMPLE 401(k) Plan.** An employer may not exclude LTPT employees for purposes of determining whether the plan satisfies the SIMPLE 401(k) requirements of IRC Sec. 401(k)(11) and (m)(10).

Impact on Top-Heavy Benefits

The proposed regulation permits an employer to exclude LTPT employees from the application of the vesting and minimum benefit requirements of the top-heavy test. For such an election to apply, the plan's terms must provide that LTPT employees are excluded from the vesting and benefit requirements of IRC Sec. 416(b) and (c). The election would not apply for the purpose of determining whether a plan is a top-heavy plan and would not apply to former LTPT employees.

With respect to safe harbor plans, a plan will not fail to be excluded from the definition of a top-heavy plan if the employer makes an election to exclude LTPT employees from the nondiscrimination and coverage tests and they do

not make safe harbor contributions on behalf of LTPT employees (or they make nonelective or matching contributions in an amount that does not satisfy the requirements for safe harbor contributions).

Employer elections regarding the nondiscrimination and coverage testing, and the top-heavy benefits are considered separate elections.

Next Steps

Employers may rely on the proposed regulations prior to the date final regulations are published. If applicable, employers should consider the pros and cons of amending their plan's eligibility requirements to avoid the application of the LTPT employee rules. For example, employers should consider how other variables—including the possibility of increased employer contributions and the loss of testing exemptions will affect their operation. To assist employers that choose to change their eligibility requirements, the proposed regulations provide that employers may change their eligibility requirements in operation and generally need not formally amend their plans for such changes until the end of the 2025 plan year, when other amendments for SECURE 2.0 are required.

The IRS is accepting written or electronic comments on the proposed LTPT regulations until January 26, 2024. A public hearing is scheduled for March 15, 2024.

Ascensus will continue to follow any new guidance as it is released. Visit ascensus.com for the latest developments.