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Insights

Covering Long-Term, Part-Time Employees Under 401(k)

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Effective for plan years beginning on or after January 1, 2024, plan sponsors of 401(k) plans must comply with new rules covering temporary, part-time, and seasonal workers. The Internal Revenue Service ("IRS") issued proposed regulations on November 27, 2023 which provided much-needed guidance on "long-term, part-time employees." The regulations are a culmination of provisions under the Setting Every Community Up for Retirement Enhancement Act of 2019 ("SECURE Act") and the SECURE 2.0 Act of 2022 ("SECURE 2.0"). In this Benefits Alert, we explain what these proposed regulations mean for 401(k) plans, which plans are impacted by the rules, and what sponsors can do to prepare for the upcoming changes to plan administration.

What type of retirement plans will be impacted by the new long-term, part-time employee guidance?
401(k) retirement plans will be impacted by the long-term, part-time employee rules only if the plan has an hours requirement under the plan's eligibility provisions. If the eligibility requirements for 401(k) deferrals have no service requirement or only have a service requirement that requires no specific number of hours to be completed, the eligibility provisions would be considered more lenient than the long-term, part-time employee provisions. In that case, the plan would not be subject to the long-term, part-time employee rules.

Who is a "long-term, part-time employee"?
The IRS proposed regulations define a long-term part-time employee as an employee who is eligible to participate in a 401(k) plan only by virtue of having: (i) completed two consecutive 12-month periods during each of which the employee is credited with at least 500 hours of service and (ii) attained age 21 by the close of the last day of the eligibility determination period.

It is important to note here that the number of years of service required for a long-term, part-time employee changed between the SECURE Act and SECURE 2.0 Act. For the first plan year beginning on or after January 1, 2024, the service determination period is the three-year period beginning January 1, 2021 and ending December 31, 2023. For plan years beginning on or after January 1, 2025, the service determination period is reduced to two consecutive years.

A long-term, part-time employee must enter the plan on either (i) the first day of the plan year following the plan year in which the employee meets the service requirement, or (ii) six months following the date the employee can be classified as a long-term, part-time employee, whichever comes first.

This means that, for a calendar year plan, employees who worked at least 500 hours in each of years 2021-2023 will be eligible to participate in an employer 401(k) plan on January 1, 2024. Employees who worked at least 500 hours in years 2023-2024 will be eligible to participate on January 1, 2025.

Who is not a long-term, part-time employee?
The long-term, part-time provisions do not apply to individuals who are non-resident aliens or union employees.

If an employee satisfies the plan's eligibility requirements to participate in the plan (for example, if the plan has immediate entry upon date of employment), the individual is not considered to be a long-term part-time employee for plan purposes.
What is special about long-term, part-time employees?

- Plan May Exclude from Employer Contributions and Top-Heavy Provisions. The plan may exclude long-term, part-time employees from employer contributions, including safe harbor match or nonelective contributions. Long-term, part-time employees may also be excluded from top-heavy minimum benefits, like top-heavy vesting and contributions.
- Service Credit is Different. A year of service for a long-term part-time employee is a 12-month period in which the individual has at least 500 hours of service. This definition applies to both eligibility and vesting service credit methods. In addition, service prior to January 1, 2021, does not have to count for eligibility or vesting purposes.
- Former Long-Term, Part-Time Employee Service Credit. If a long-term, part-time employee completes a year of service or meets the plan's eligibility requirements to participate in the plan, the employee will become a "former long-term, part-time" employee. Former long-term, part-time employees will retain the service they are credited with as a long-term, part-time employee.

What can plan sponsors do to help them prepare for and manage ongoing compliance with the new requirements?

Plan administrators can stay proactive by taking these steps:

- Communicate with External and Internal Parties. Meet with providers, advisors, and internal personnel to answer these and other questions that may help avoid future miscommunication down the road:
  - What systems do we have in place to properly track service for seasonal, part-time, and temporary workers and provide timely notice of eligibility?
  - Should long-term, part-time employees be treated exactly the same as all eligible employees? If not, what will be different? Will they be excluded from receiving safe harbor contributions?
  - What participant communication materials need to be reviewed to ensure transparency on the benefits available and relevant to a long-term, part-time employee?
- Maintain Clean and Consistent Employment Status Records. Properly tracking long-term, part-time service and employment history will be crucial to maintaining accurate records for determining eligibility and vesting under the plan. Plan administrators should become familiar with the vesting service credit rules for long-term, part-time employees and how they may differ from how the plan credits service.
- Plan for an increase in number of participants. Some plans may have a noticeable increase in the number of new participants, which may result in an increase in plan overhead expenses and potentially trigger a Form 5500 audit. While "small plan" Form 5500 filers can waive the audit requirement for filing the annual report, "large plan" filers must include an audit of the plan's financial report with their Form 5500. For these purposes, a large plan is considered to be one with over 100 participants who have a balance in the plan, or no more than 120 participants if the plan previously filed as a small plan.

- Actively Manage the Accounts of Inactive Long-Term, Part-Time Participants. As long-term, part-time participants come and go, the plan must continue meeting the timing and notice requirements outlined by the plan's policies. Administrators should ensure that the plan complies with maintaining the payouts of small balances which also helps prevent missing terminated participants and orphaned accounts.

Plan sponsors should consider the impact of these new rules on their retirement plans and workforce and consider what changes will be required and elective decisions the plan will adopt. Although the deadline to adopt most of the provisions under the SECURE and SECURE 2.0 Acts, including these proposed regulations, is December 31, 2026, it is imperative that plan sponsors understand their obligation to operate their plans as if the proposed regulations were in effect today, to the best of their ability. Documentation, whether in the form of meeting minutes, resolutions, or amendments, in the interim will ensure consistency in how the plan is operated.

If you have any questions or would like to discuss any of these provisions in more detail, please contact Lisa Durham or another member of Krieg DeVault's Employee Benefits & Executive Compensation Practice Group.

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