IRS proposes long-term, part-time worker 401(k) eligibility rules

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In this article

A proposed IRS regulation, which employers can rely on pending a final rule, would implement the new Section 401(k) plan eligibility requirements for long-term, part-time (LTPT) workers. First added to the Internal Revenue Code (IRC) by the Setting Every Community Up for Retirement Enhancement Act of 2019 (Division O of Pub. L. No. 116-94) (SECURE 1.0), the requirements underwent further changes due to the SECURE 2.0 Act of 2022 (Div. T of Pub. L. No. 117-328). The regulation would apply to plan years starting on or after Jan. 1, 2024, which the preamble to the proposal says is generally the earliest employees will be eligible to participate in 401(k) plans under the LTPT requirements. The proposal doesn't address Section 403(b) plans that are covered by ERISA, which must comply with SECURE 2.0's LTPT eligibility requirements starting in the 2025 plan year. IRS is accepting comments on the proposal through Jan. 26, 2024, and will hold a public hearing on March 15, 2024. Originally published on Jan. 19, 2024, this updated article includes a discussion of certain plans that could see employees satisfy the LTPT eligibility rules prior to 2024, as well as recent informal IRS guidance recommending action steps for employers.

Evolution of the LTPT rules

Before SECURE 1.0, 401(k) plans had to let employees contribute after they reached age 21 and completed 1,000 hours of service in a 12-month period. Many part-time employees work less than 1,000 hours each year and could not contribute to plans that imposed these conditions. Lawmakers intended for SECURE 1.0's new eligibility requirements to make 401(k) plans more accessible to LTPT employees.

SECURE 1.0 initially said plans had to let employees contribute after completing 500 hours of service in three consecutive 12-month periods, effective for plan years starting on or after Jan. 1, 2021. Plans could exclude periods of service before 2021 for eligibility purposes (but had to count pre-2021 service for vesting). However, SECURE 2.0 reduced the consecutive 12-month periods requirement from three to two, effective for 2025 and later plan years. (SECURE 2.0 also eliminated the requirement to count periods of service before 2021 for vesting purposes, effective retroactively to the effective date of SECURE 1.0).

The proposed regulation defines the term “long-term, part-time employees” as employees who become eligible to participate in a 401(k) plan solely because of the new requirements. This article uses the term “LTPT employees” for this purpose.

When LTPT requirements start to apply. Together, SECURE 1.0 and 2.0 require plans to begin applying the new LTPT provisions as follows:

- For the 2024 plan year, 401(k) plans must let LTPT employees contribute if they are at least age 21 and complete at least 500 hours of service in three consecutive 12-month periods beginning after Dec. 31, 2020.
- For the 2025 and later plan years, 401(k) and ERISA-covered 403(b) plans must let LTPT employees contribute if they are at least age 21 and complete at least 500 hours in two consecutive 12-month periods.

The regulation contemplates that LTPT employees generally won’t be eligible to contribute under a 401(k) plan before plan years beginning on or after Jan. 1, 2024. However, as discussed later in this article, satisfying the statutory eligibility requirements might have been possible for 2023 plan years in some circumstances.

LTPT eligibility requirements

The new LTPT eligibility requirements apply to all employees except those who can be excluded from minimum coverage testing under IRC Section 410(b)(3) (e.g., collectively bargained employees and nonresident aliens with no US-source income).

New requirements apply only to employee contributions

The new eligibility requirements apply only to the cash or deferred arrangement portion of a 401(k) plan (i.e., pretax and, if offered by the plan, designated Roth contributions). Employers can continue to limit eligibility for matching and nonelective contributions to employees ages 21 and older who complete 1,000 hours of service in a 12-month period or, if those contributions are immediately 100% vested, 1,000 hours in two consecutive 12-month periods.

Catch-up contributions. The preamble to the proposal clarifies that plans can let LTPT employees make catch-up contributions, but this isn’t required. Under IRS regulations, a plan that offers catch-up contributions and is otherwise subject to the nondiscrimination requirements of IRC Section 401(a)(4) ordinarily must allow all catch-up eligible participants to make the same dollar amount of catch-up contributions. This is known as the universal availability requirement for catch-up contributions. However, as discussed later, employers can elect to exclude LTPT employees from the plan's nondiscrimination and minimum coverage tests. The preamble clarifies that if an employer makes this election, LTPT employees would be disregarded for purposes of the universal availability requirement. If the employer doesn't make this election, then the plan would have to give LTPT employees an opportunity to make catch-up contributions.

Roth contributions. The preamble also clarifies that plans with a Roth contribution feature can — but aren't required to — let LTPT employees make designated Roth contributions. Roth features are usually subject to benefits, rights and features testing under IRC Section 401(a)(4). However, if an employer elects to disregard LTPT employees for nondiscrimination purposes (as discussed later), the employer can exclude LTPT employees from the plan's Roth feature. If the employer doesn't make this election, LTPT employees must be eligible to make Roth contributions on the same terms as other participants.

Entry dates

LTPT employees are subject to the same statutory entry-date requirement as other employees: An employee must be allowed to participate no later than the first day of the plan year starting after the employee satisfies the applicable age and service requirements or, if earlier, six months after that date. The proposed rule provides additional guidance on employees who separate from service before entering the plan or who are still ineligible to participate for other reasons, even after satisfying the age and service requirements.

Separation from service. If an employee satisfies the LTPT eligibility requirements but separates from service before the applicable entry date and is later rehired by the sponsor, the LTPT employee must be immediately eligible to contribute to the plan if otherwise eligible to participate (e.g., the employee is rehired into an eligible employment classification).

Ineligible employees. If an employee satisfies the LTPT age and service requirements but is still ineligible to participate in the plan (e.g., is in an ineligible employment classification), the employee must become immediately eligible to participate as an LTPT employee after satisfying the additional eligibility requirements. (See the later discussion for more details on additional eligibility requirements.)

Counting 12-month periods

The proposed regulation provides several clarifications as to how 12-month periods are counted when determining eligibility for LTPT employees.

Consecutive 12-month periods may overlap. SECURE 1.0 says 12-month periods for determining eligibility are counted the same way for LTPT employees as for all other employees: The first 12-month period starts on the employee's date of hire. Plans can then start the next 12-month period on either the first anniversary of the employee's hire date or the first day of the plan year beginning in the initial 12-month period. When plans take the latter approach, hours earned during the overlap between the first and second 12-month periods are counted for both years. The proposed regulation clarifies that the overlapping periods are considered consecutive years for the purpose of determining LTPT eligibility.

Periods before LTPT rule's effective date disregarded. Under the statute, 12-month periods beginning before 2021 are disregarded when determining an employee's eligibility under the LTPT requirements. The proposed regulation clarifies that if a sponsor chooses to count earlier periods, employees who become eligible based on those periods can't be treated as LTPT employees. This means, for example, that the plan can't apply the special LTPT nondiscrimination testing treatment (discussed later) to these employees.

No hours requirement after initial eligibility. An LTPT employee doesn't have to keep working 500 hours each year to maintain LTPT status. For example, consider an employee who achieves LTPT status in 2024 but then works fewer than 500 hours in that year. That employee must remain eligible to contribute to the plan as an LTPT employee in 2025 and future years (provided the employee satisfies other eligibility conditions — e.g., remains employed in an eligible classification).

Breaks in service. The preamble to the proposal says that if an LTPT employee terminates employment and is later rehired, the employee must be immediately eligible to participate as an LTPT employee on rehire. This appears to be true regardless of the length of the break in service. If so, then plans cannot apply to LTPT employees the "rule of parity," which allows plans to disregard a nonvested participant's prebreak eligibility service if the break lasts at least five years and is longer than the prebreak period of service.

Conversely, a footnote in the preamble says that if the former employee was eligible to participate but wasn't an LTPT employee, the employee can become an LTPT employee after rehire if the plan disregards the employee's prebreak service under the rule of parity.

Counting hours of service

Some plans base an employee's service on one of the Department of Labor's equivalency methods in lieu of counting actual hours (e.g., crediting 190 hours of service for each month in which the employee completes an hour of service). The proposed regulation would permit this approach when determining eligibility under the LTPT rules.

Other plans use the elapsed time method to measure service instead of counting actual or equivalent hours. The preamble to the proposal says that plans may generally continue to use elapsed time for eligibility purposes. However, a plan that does so won't have any LTPT employees because all employees will have a year of service at the end of the first 12-month period.

Eligibility conditions not based on age or service

The proposed regulation clarifies that plans can still apply eligibility conditions unrelated to age or service (e.g., working in an eligible employment classification). This means LTPT employees who satisfy the age and service conditions won't become eligible to participate until they satisfy any other permissible eligibility conditions.

Proxies for age and service not allowed. The proposal warns that eligibility requirements that have the effect of imposing additional age or service conditions are not allowed (a similar prohibition exists in

Treas. Reg. Section 1.410(a)-(3)(e)(1)). For example, if one of an employer's divisions employs only individuals who work at least 1,000 hours per year, a plan that's available only to that division's employees would impose an impermissible service condition.

Plans with exclusionary language for part-time employees. Some plan documents provide that part-time employees are ineligible to participate but will become eligible if they are at least age 21 and complete at least 1,000 hours in a 12-month period. The proposed regulation makes clear that sponsors can retain this language in their documents but must modify it to provide that part-time employees can also become eligible by satisfying the LTPT eligibility requirements.

Vesting rules

The SECURE acts and the proposed regulation include special vesting rules for LTPT employees, even though plans can continue to exclude LTPT employees from the types of contributions (i.e., matching and nonelective) that can be subject to a vesting schedule. Certain aspects of these vesting rules can produce more generous outcomes for LTPT employees than the rules that apply to other employees. This is particularly true for LTPT employees who eventually end up working 1,000 hours in a year (see Former LTPT employees below).

Year of vesting service. Both the statute and the regulation say a plan must credit LTPT employees with a year of vesting service for each 12-month period during which the employee works at least 500 hours. Under the existing vesting rules, other employees must be credited with a year of service for each 12-month period during which they work at least 1,000 hours.

Breaks in service. The proposed regulation provides that an LTPT employee is considered to have a break in service in any 12-month period during which the employee doesn't work at least 500 hours. This provision also is slightly more favorable to LTPT employees than the rule for other employees, who are considered to have a break in service in any 12-month period during which they don't work at least 500 hours.

Counting 12-month periods. Although the statutory language is unclear, the proposed regulation clarifies that plans can designate any 12-month period for vesting purposes and don't have to use the same 12-month periods for vesting and eligibility.

Periods before Jan. 1, 2021. Plans can disregard an LTPT employee's service before Jan. 1, 2021, when determining the employee's vested interest in matching and nonelective contributions. Before issuing the proposed regulation, IRS said in Notice 2020-68 that SECURE 1.0 required taking into account all periods of service with the employer — including periods beginning before 2021 — when determining an LTPT employee's vested interest. SECURE 2.0 subsequently amended SECURE 1.0 to disregard 12-month periods beginning before 2021 for both vesting and eligibility purposes, rendering that portion of Notice 2020-68 obsolete. However, the preamble to the proposed regulation clarifies that a plan can give credit for pre-2021 service for vesting purposes and still treat the employee as an LTPT employee. This differs from the treatment for pre-2021 eligibility service (as noted earlier).

Nondiscrimination issues

The statute provides that employers can elect to exclude LTPT employees for the following nondiscrimination purposes:

- Nondiscriminatory contributions or benefits testing under IRC Section 401(a)(4)
- Actual deferral percentage (ADP) testing under IRC Section 401(k)(3) and actual contribution percentage (ACP) testing under Section 401(m)(2)
- ADP and ACP safe harbor contributions under IRC Sections 401(k)(12) and (13) and 401(m)(11) and (12) (these are the regular safe harbor provisions and the qualified automatic contribution arrangement (QACA) safe harbors)
- Minimum coverage testing under IRC Section 410(b)

If an employer elects to exclude LTPT employees from any of the plan's nondiscrimination tests, the election must apply for all of the above tests and to all LTPT employees eligible to participate in the plan.

Plan document requirements. The statute requires an employer to make an election to exclude LTPT employees from these nondiscrimination tests. The proposed regulation would set different election requirements for safe harbor contributions and nondiscrimination tests:

- For safe harbor contributions, the plan document would need to state expressly the employer's election to exclude LTPT employees from receiving those contributions. The employer would need to amend the plan before the start of the first plan year in which the election would take effect, and the election would have to remain in effect for the entire plan year.
- For nondiscrimination, ADP/ACP and coverage testing, the preamble to the proposed regulation says the employer would need to add enabling language to its plan document authorizing the election to exclude LTPT employees from the tests. However, the election wouldn't need to be expressly stated in the document. The regulation doesn't say whether plans must apply this election consistently from year to year.

Otherwise excludable employees. The preamble to the proposed regulation confirms that if a plan doesn't exclude LTPT employees from its nondiscrimination tests, the employees can still be treated as otherwise excludable employees. Otherwise excludable testing generally allows plans with more generous eligibility conditions than the IRC's maximum allowable conditions to separately test employees who have and haven't met the maximum conditions.

Top-heavy plans. The statute includes two special rules regarding the effect of LTPT employees on a plan's top-heavy test:

- Unlike the other nondiscrimination tests mentioned above, an employer can't exclude LTPT employees when determining whether a plan is top heavy. However, if a plan is top heavy, the employer can elect not to provide the top-heavy minimum benefit to nonkey employees who are

LTPT employees. The proposed regulation clarifies that the plan document would need to state this election, and it would be separate from the other nondiscrimination testing elections discussed above.

- Under the pre-SECURE top-heavy rules, a 401(k) plan isn't considered top heavy if it satisfies the ADP and ACP safe harbors and offers no other matching or nonelective contributions. SECURE 2.0 amended the top-heavy rules so an employer's election to exclude LTPT employees from receiving safe harbor contributions won't, by itself, cause a safe harbor plan to lose its top-heavy exemption. The proposed regulation further provides that safe harbor plans offering nonsafe harbor matching or nonelective contributions to LTPT employees may also retain the top-heavy exemption.

SIMPLE 401(k) plans. The proposed regulation clarifies that an employer can't elect to exclude LTPT employees from the match or nonelective contribution requirements for savings incentive match plan for employees of small employers (SIMPLE) plans.

Former LTPT employees

The proposed regulation includes rules for "former long term, part-time employees" — defined as employees who first become eligible to participate as LTPT employees but then cease to be LTPT employees because either:

- The employee works 1,000 hours in a 12-month period.
- The employee ceases to satisfy eligibility conditions unrelated to age and service (e.g., transfers to ineligible status).

An LTPT employee becomes a former LTPT employee at the start of the next plan year after the year in which the employee satisfies either of the above conditions.

Return to LTPT employee status. A former LTPT employee who ceased to satisfy the plan's eligibility conditions unrelated to age and service will return to LTPT employee status as of the first day of the plan year in which the employee once again becomes eligible. However, a former LTPT employee can't return to LTPT employee status after working 1,000 hours in a 12-month period.

Nondiscrimination. If an employer makes an election to exclude LTPT employees from nondiscrimination testing (as discussed earlier), the election would cease to apply to employees once they become former LTPT employees. This applies regardless of how an LTPT employee becomes a former LTPT employee.

Vesting. The proposal provides that former LTPT employees are always subject to the special vesting rules for LTPT employees discussed earlier, even after working 1,000 hours in a 12-month period. This means, for example, that a plan must credit former LTPT employees with a year of vesting service for 12-month periods during which the employee works at least 500 hours. This is true even if the employee is now working full-time and even if other full-time employees who didn't join the plan as LTPT employees need to work at least 1,000 hours to receive a year of vesting service. The following example shows how this provision can lead to disparate results for LTPT and other employees.

> *Example*. Company M sponsors a 401(k) plan with a matching contribution. Employees ages 21 and older are eligible to contribute to the plan after completing 1,000 hours of service in a 12-month period or satisfying the LTPT eligibility rules, whichever occurs first. Employees ages 21 and older are eligible for the matching contribution after completing 1,000 hours in a 12-month period, but LTPT employees aren't eligible for the match. The plan applies a six-year graded vesting schedule to matching contributions and gives a year of vesting service to LTPT employees who work at least 500 hours during the year and to other employees who work at least 1,000 hours during the year.
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> Ann and Lisa are both hired by Company M into part-time positions on Jan. 1, 2024, and both work 600 hours during 2024. On March 1, 2025, Ann moves to a full-time position and works more than 1,000 hours during 2025, crossing that mark in July. She becomes eligible to contribute to Company M's 401(k) plan and receive the match starting Jan. 1, 2026. Lisa remains a part-time employee in 2025 and works 600 hours during the year. Lisa also becomes eligible to contribute to the plan on Jan. 1, 2026, but isn't eligible for the match because she's an LTPT employee.
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> In 2027, Ann remains a full-time employee, and Lisa moves to a full-time position on June 1. Lisa works more than 1,000 hours during the year and becomes eligible for the plan's matching contribution on Jan. 1, 2028. Ann and Lisa both work more than 1,000 hours in 2028.
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> On Jan. 1, 2029, Lisa has five years of vesting service — one year each for 2024, 2025, 2026, 2027 and 2028 — and is 80% vested in her matching contributions. Because Lisa initially became eligible as an LTPT employee, she receives a year of vesting service for each year in which she works at least 500 hours. However, Ann has only four years of vesting service — one year each for 2025, 2026, 2027 and 2028 — and is 60% vested in her matching contributions, even though she has been eligible for the match two years longer than Lisa. This is because Ann was never an LTPT employee and therefore receives a year of vesting service only for years in which she works at least 1,000 hours.
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> In 2029, Ann and Lisa both return to part-time status and work 600 hours during the year. Lisa receives a year of vesting service in 2029 because she is a former LTPT employee. Ann does not receive a year of vesting service because she is not a former LTPT employee and must work 1,000 hours in a year to receive a year of vesting service. As a result, on Jan. 1, 2030, Lisa has six years of vesting service and is 100% vested in her matching contributions, but Ann still only has four years of vesting service and is 60% vested in her matching contributions.

Breaks in service. Former LTPT employees get the same benefit of the more generous break-in-service rules as other LTPT employees. In the example above, if Ann and Lisa both worked 500 hours during 2029, Lisa would not have a break in service (and would receive a year of vesting service), but Ann would have a break in service (and wouldn't receive a year of vesting service).

Possible satisfaction of LTPT rules before 2024

The preamble to the proposed regulation says that the effect of disregarding 12-month periods for eligibility purposes (as discussed earlier) beginning before Jan. 1, 2021, is that employees generally will not become eligible to contribute to a 401(k) plan under the LTPT rules until plan years beginning on or after Jan. 1, 2024. However, under IRS's interpretation that overlapping periods are considered consecutive years for LTPT eligibility (see Consecutive 12-month periods may overlap), some employees could have satisfied the requirements in 2023. Employers with employees in this situation may want to consult with legal counsel.

Noncalendar year plan years. Plans with noncalendar year plan years could have some employees that satisfied LTPT eligibility requirements in 2023. Consider the following example:

> *Example*. Company M hires Dorian into a part-time position on Feb. 1, 2021. Company M sponsors a 401(k) plan that allow employees ages 21 and older to participate after completing either 1,000 hours of service in a 12-month period or 500 hours in three consecutive 12-month periods, whichever occurs first. The plan provides that an employee's first 12-month period starts on the hire date, and the second 12-month period starts on the first day of the plan year that begins during the first 12-month period. The plan has a June 1 – May 31 plan year.
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> Dorian works 600 hours from his hire date through Jan. 31, 2022; 600 hours from June 1, 2021, through May 31, 2022; and 600 hours from June 1, 2022, through May 31, 2023. Under the plan's terms, because the overlapping periods are considered consecutive years, Dorian becomes eligible to contribute as an LTPT employee on June 1, 2023, which is the first day of the plan year after he satisfies the LTPT eligibility requirements.

The interaction of the consecutive year requirement and the requirement to disregard 12-month periods beginning before Jan. 1, 2021, could lead to some seemingly illogical results. Consider the following example:

> *Example*. Company M hires Oscar on Dec. 1, 2020, two months before hiring Dorian. Oscar works 600 hours from Dec. 1, 2020, through Nov. 30, 2021. However, because this period is disregarded for purposes of determining Oscar's eligibility to participate as an LTPT employee, Oscar's first 12-month period begins on June 1, 2021, the first day of the first plan year starting after Jan. 1, 2021. Oscar works 600 hours each year from June 1, 2021 – May 31, 2022, June 1, 2022 – May 31, 2023, and June 1, 2023 – May 31, 2024. Oscar becomes eligible to contribute to the plan as an LTPT employee on June 1, 2024 — a full year after Dorian, even though Oscar was hired two months earlier.

If the plan in this example counted Dec. 1, 2020, through Nov. 30, 2021, as Oscar's first 12-month period for eligibility purposes, Oscar would enter the plan on the same date as Dorian — but wouldn't be considered an LTPT employee under the proposed regulation.

Plans with more generous entry dates. Some plans allow employees to participate immediately or shortly after satisfying the applicable eligibility requirements. In the first example above, if Company M's

401(k) plan allowed employees to participate on the first of the month after satisfying the eligibility requirements, Dorian would have become eligible to contribute on June 1, 2023, regardless of the plan's plan year.

IRS-recommended action steps

In a recent issue of IRS's *Employee Plans News*, IRS recommends employers take the following steps to ensure compliance with the LTPT requirements:

- Review census data for all employees who are ineligible for the 401(k) plan because they haven't completed a year of service
- Identify whether any of these employees are age 21 and have completed more than 500 hours of service in three consecutive 12-month periods since 2021
- Ensure each employee who has satisfied the LTPT requirements is able to make salary deferrals to the plan (although employees who haven't satisfied any additional permissible eligibility requirements unrelated to age or service can still be excluded)

The newsletter says "[f]or a 401(k) plan that uses the calendar year as its plan year, this change could require enrollment of long-term part-time employees as of January 1, 2024." However, as noted in the prior section, some plans may have employees who satisfied the LTPT requirements before 2024.

Plan amendments

Employers will need to amend their plan documents to reflect the new eligibility requirements for part-time workers and, to the extent applicable, for how the plan will treat LTPT employees for nondiscrimination testing purposes (as discussed earlier). IRS Notice 2024-2 — issued after the proposed regulation — extends the deadline for these amendments and all other required and discretionary amendments for SECURE 1.0 and 2.0 to Dec. 31, 2026 (later dates may apply for governmental and certain collectively bargained plans).

403(b) plans

SECURE 2.0 made salary deferral features under ERISA-covered 403(b) plans subject to the eligibility rules for LTPT employees, effective for plan years starting on or after Jan. 1, 2025. This means 403(b) plans will need to start letting LTPT employees contribute starting in the 2025 plan year if they are at least age 21 and work at least 500 hours in two consecutive 12-month periods (but disregarding years of service beginning before Jan. 1, 2023). Although the proposed regulation doesn't address 403(b) plans, sponsors may reasonably be able to look to the 401(k) regulations for guidance, to the extent applicable, when the LTPT eligibility requirements for 403(b) plans take effect.

However, 403(b) plan sponsors may still need guidance on issues specific to those plans. For example, sponsors will need guidance on how the LTPT rules affect the universal availability requirement for 403(b) plan deferrals, which generally requires that all of the employer's employees must be eligible to contribute if any employee is eligible. Certain exceptions apply, including for employees who normally work fewer than 20 hours per week and certain students. But those two exceptions cease to apply when any employee in either group becomes eligible to contribute. Does this mean, for example, that the exception for employees who work fewer than 20 hours per week will no longer apply if one such employee becomes eligible under the LTPT eligibility rules?

Related resources

Non-Mercer resources

- Notice 2024-2 (IRS, Dec. 20, 2023)
- Proposed regulation (Federal Register, Nov. 27, 2023)
- Div. T of Pub. L. No. 117-328, the SECURE 2.0 Act of 2022 (Congress, Dec. 29, 2022)
- Division O of Pub. L. No. 116-94, the SECURE Act (Congress, Dec. 20, 2019)

Mercer Law & Policy resources

- After empty 2023 RA List, IRS delays amendment deadlines for new laws (Dec. 21, 2023)
- User's guide to SECURE 2.0 (regularly updated)
- Viewing SECURE 2.0 through a 403(b) lens (May 22, 2023)
- Alert: SECURE 2.0 retirement reforms set to become law (Dec. 20, 2022)
- IRS issues FAQs on SECURE and Bipartisan Miners acts (Sept. 22, 2020)
- SECURE Act set to become law (Dec. 19, 2019)

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