

SECURE ACT: Long-Term Part-Time Employees (LTPTs)

Update: On November 24, 2023, the IRS issued proposed regulations regarding long-term part-time employees. In general, the proposed regulations are consistent with earlier guidance as far as the definition of long-term part-time; determining who is eligible to defer; and whether LTPT employees need to receive employer contributions and vesting should a LTPT employee ever become eligible for employer contributions. The regulations also confirm that reasonable business classifications may still be excluded from any participation and provide detail regarding non-discrimination testing.

The SECURE Act seeks to expand retirement plan coverage for U.S. workers. One of the Act's provisions changes 401(k) eligibility requirements for part-time employees. Under the soon to be 'old' law, employees that did not meet the maximum statutory requirement (age 21 AND 1,000 hours in a 12-month period) could be excluded from participating in a 401(k) Plan. However, effective with plan years beginning after December 31, 2020, the SECURE Act requires that long-term, part-time, non-union employees must be permitted to make elective 401(k) deferrals after three consecutive 12-month periods with at least 500 hours of service. SECURE 2.0 amended the requirement to only two consecutive periods beginning in 2025. This rule only applies if the employee is at least 21 years of age at the end of the consecutive 12-month periods. This rule does not apply to 457 or SIMPLE IRA plans, but beginning in 2025 under SECURE 2.0, it does apply to 403(b) plans that exclude employees expected to work fewer than 20 hours per week and student employees.

Important to note:

- Any service performed prior to January 1, 2021 is not taken into account for purposes of the new eligibility rule for participating in the elective deferral portion of the 401(k) plan. Therefore, the earliest date a long-term, part-time employee can enter the plan to make an elective deferral under the new law is January 1, 2024.
- Employees who become eligible for the elective deferral portion of the plan solely under the new rule may still be excluded for other types of contributions made to the 401(k) plan (e.g., employer matching contributions, nonelective contributions, top heavy minimum contributions) until they meet the plan's eligibility requirements for such contributions.
- This new rule does not apply to non-resident aliens with no U.S. source income or union employees.
- For purposes of nondiscrimination testing, the employer can still exclude any long-term part-time employee who becomes eligible for the deferral portion of the plan until the employee meets the plan's eligibility requirements for testing.

Special Vesting Rule:

The eligibility rules relating to employer contributions have not changed, so employers will not be required to make employer contributions for these long-term part-time employees. However, if an employer does voluntarily make employer contributions for long-term part-time employees, and such contributions are subject to a vesting schedule, a special vesting rule must be applied with respect to these employees.

Under the new special vesting rule, and for purposes of vesting of employer contributions, a long-term part-time employee must be credited with a year of service for ALL applicable 12-month periods during which the employee had at least 500 hours of service. SECURE 2.0 clarified that the first applicable year that would be required to count for vesting would be 2021. This represents a change for many plans that include a 1,000 hour requirement for their vesting schedule. This special vesting rule applies only to those long-term part-time employees who become eligible to participate in a plan solely on account of this new rule. Finally, this special vesting rule will continue to apply to a long-term, part-time employee even if such employee subsequently becomes a "full-time" employee.

Example: Assume Employee X is age 21 and completes 550 hours of service during each 12-month period from January 1, 2021 to December 31, 2023. Employee X becomes eligible to make elective deferrals under her employer's 401(k) plan in 2024 because she has completed at least 500 hours of service in each of the three consecutive 12-month periods beginning on January 1, 2021. Later in 2024, Employee X becomes a full-time employee, and she then becomes eligible for matching contributions on January 1, 2025. Employee X's years of service from 2021 forward must be taken into account for purposes of determining her vested interest in any matching contributions made on her behalf.

Accordingly, as of January 1, 2025, Employee X would be credited with 4 years of vesting service.

What Does This Mean for You?

To comply with these new rules, plans that currently require part-time employees to complete a 12-month period with at least

1,000 hours of service to be eligible to make elective deferrals should diligently track service with respect to periods beginning on or after January 1, 2021.

In addition, plans that include a vesting schedule for employer contributions should begin assessing their ability to retrieve hours data to determine vesting service for periods beginning January 1, 2021.
