

## Long Term Part Time Employees – What you need to know

On December 20, 2019, President Trump signed into law the, Setting Each Community Up for Retirement Enhancement Act (“SECURE”). SECURE makes some of the most significant changes in retirement plan legislation in over a decade.

The following is important information found in Division O, Section 112 of SECURE. The section is entitled *Qualified Cash or Deferred Arrangements Must Allow Long-Term Employees Working More Than 500 but Less Than 1,000 Hours Per Year To Participate*.

IRS Notice 2020-68 provides additional guidance for Section 112 provisions, and although more guidance is expected, it is important to consider now how these new rules may affect your plan.

Section 112 pertains specifically to expanded eligibility and vesting rules for 401(k) plans.

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### Summary

SECURE introduces a new classification of participant called the Long-term, Part-time participant (“LTPT”). An LTPT is any employee who earns at least 500 hours of service in 3 *consecutive* years and has attained age 21. Once an employee has satisfied these requirements they must be permitted to enter the plan on the next plan entry date, and they must be permitted to begin making salary deferral contributions even if the plan’s eligibility requirements would otherwise have prevented their participation. Under the LTPT rules the LTPT’s participation can be limited to just the salary deferral portion of the plan, meaning they ARE NOT required to receive any employer contributions. Further, LTPT participants do not need to be considered for coverage or non-discrimination testing.

The intent of Section 112 is to increase deferral opportunities for more employees without adding a significant administrative burden to plan sponsors. In fact, plans that do not require any hours of service requirement for eligibility may see little to no impact to their plan under these rules.

However, as with most things, good intentions often come with unanticipated consequences, and Section 112 is no exception. For example, LTPT participants are treated differently for vesting calculation, and as of right now, even though LTPT participants are not included in the plan’s coverage test, they ARE included in the 5500 participant count which determines if a plan is required to perform an annual 5500 audit.

Below I will provide more detail on how these rules are currently expected to work. Please note as discussed in the following section, 2024 is the first year that most employees could be considered to be an LTPT, and it is hoped that before then the IRS will issue more guidance on these rules to help decrease some of the unintended administrative issues.

**Although most plan sponsors will put the LTPT rules into effect for 2024, it is important for plan sponsors to immediately review their payroll systems to make certain that employee hours of service are readily determinable at least on a plan year basis. The reasoning for this precaution will become more evident in the following sections.**

TROMBINO PENSION ADMINISTRATORS, INC.

45946 Corte Carmello, Temecula, California 92592

951-302-9267 fax 951-302-2011

TPA@TrombinoPension.com

There is a lot of information provided here, so if nothing else, please be certain to read through the *Unintended Complexity* section at the end and then go back and read the details as time permits.

## **DETERMINING WHO IS AN LTPT**

An employee must be treated as an LTPT when they have earned 500 hours of service in 3 consecutive 12 month periods, if they have not already satisfied the plan's eligibility requirements. The 12 month measuring period is the same measuring period that is used for determining a year of service under the plan's eligibility rules.

**For this purpose, service earned before January 1, 2021 can be excluded.** Although I'm anticipating that most plan sponsors will put off the LTPT rules until 2024, there is nothing in the law that says an employer could not enact these rules sooner and allow employees who are not eligible (for example the plan requires 1000 hours of service and the employee has never earned 1000 hours) to participate if they have already satisfied the 3 consecutive years with 500 hours requirement.

The following example assumes the plan sponsor will exclude years of service prior to January 1, 2021 for LTPT eligibility purposes.

EXAMPLE: Company X's plan requires an employee to earn 1000 hours in a 12 month period and attain age 21 to be eligible to participate. The employee becomes a participant on the first day of the month that coincides with or next follows the date the entry requirements are satisfied.

Employee A, age 25, has worked for the plan sponsor since 2018 and always works 600 hours in a year. Under the terms of the plan, Employee A has never satisfied the entry requirements and therefore has never been able to participate in the plan.

Employee A also earns 600 hours of service in 2021, 2022, and 2023, thus satisfying the requirement of 3 consecutive years of service with at least 500 hours of service in the year. Although Employee A continues to not meet the plan's "regular" participation requirements, Employee A must be treated as an LTPT as of January 1, 2024 and must be given the opportunity to at minimum, make a salary deferral election and begin deferring into the plan.

Please remember that if the employee meets the plan's eligibility requirements before meeting the LTPT eligibility requirements, they must be treated as a participant under normal terms of the plan. In other words, whichever eligibility requirements the employee meets first determines their entry and status in the plan.

## **ADMINISTERING THE PLAN WITH LTPT PARTICIPANTS**

Under the current guidance, once the LTPT eligibility requirements are satisfied, the LTPT participant must be allowed to enroll in the plan and make an election to defer their compensation into the plan.

The plan would not be required to provide any employer contributions. For example, if the plan provides for matching contributions, the deferrals of the LTPT participant would not need to be matched. If the plan provided for a non-elective contribution, the LTPT would not need to receive a non-elective contribution. This includes safe harbor contributions if the plan is a safe harbor 401(k) plan, and top heavy minimum contributions.

Further, the LTPT would not need to be included in the plan year's coverage test or non-discrimination testing.

Often, however, Section 112 of SECURE uses wording such as "An employer may elect to...". This presumes that the plan sponsor may allow LTPT participants to receive employer contributions and may include LTPT participants in compliance testing. What is not clear, particularly with respect to compliance testing, is if the inclusion or exclusion of LTPT participants could be elected each plan year.

### **Becoming a "regular" participant**

The ongoing service of the LTPT must continue to be monitored to ensure that if the LTPT participant does satisfy the plan's "regular" eligibility requirements that they are treated as a non-LTPT participant going forward.

Going back to Employee A in the prior section's example, assume Employee A earns 1000 hours of service in 2024. Beginning on January 1, 2025 Employee A must be treated as a "regular" participant for all plan purposes with one very important exception that will be discussed later. If the plan provides for matching contributions with each payroll for example, starting January 1, 2025 Employee A must start receiving matching contributions. Further, even if Employee A's hours are reduced to less than 1000 in a future year, Employee A must continue to be treated as a "regular" participant.

### **VESTING REQUIREMENTS**

Earlier I stated that the intention of the LTPT rules is to allow for greater participation without undue burden on plan sponsors. Vesting is one area where that goal appears to fall short, at least as it is interpreted by the IRS in their recently released Notice 2020-68.

To start, many plans require an employee to earn 1000 hours of service in the plan year to earn a year of vesting service. Under the LTPT rules, an employee who becomes an LTPT participant is required to earn only 500 hours of service for a year of vesting service.

Further, as determined in Notice 2020-68, even if the LTPT participant earns sufficient service to be treated as a "regular" participant (similar to the example earlier when Employee A earned 1000 hours of eligibility service), the now "regular" participant continues to earn vesting service by only earning 500 hours of service.

Lastly, in Notice 2020-68 the IRS states that, in general, ALL plan years are considered when calculating vesting service for LTPT participants. Contrast that guidance with the eligibility rules that allows a plan sponsor to exclude service prior to January 1, 2021.

If the plan provides that LTPT participants are limited to making salary deferrals only, that is they do not receive employer contributions, then vesting service would not be an issue.

However, let's go back to our example with Employee A in Company X's plan. You may recall that Employee A earned 600 hours of service in 2018, 2019, 2020, 2021, 2022, 2023, and earned 1000 hours of service in 2024. Assuming the plan requires 1000 hours of service in a plan year to earn a year of vesting service, normally Employee A would have 1 year of vesting service when Employee A started receiving matching contribution is 2025. However, under the LTPT rules, and the guidance in Notice 2020-68, Employee A actually has 7 years of vesting service which would make Employee A 100% vested under any permissible vesting schedule.

The IRS has asked for comments on some of the guidance issued in Notice 2020-68, and measuring vesting service is one of the areas for which comments were requested. Hopefully by 2024 there may be some relief from at least this aspect of the LTPT rules.

## UNINTENDED COMPLEXITY

For plans that do not require an employee to earn a certain number of hours of service as part of the eligibility requirements the LTPT rules should not have an impact on the administration of the plan. For example, if a plan requires a participant to wait three months before they are eligible to participate, and strictly measures the period of time without regard to the number of hours worked in the three month period, every employee should have the opportunity to become eligible under the plan's eligibility requirements before they would have met the LTPT requirements. In effect there may never be an LTPT participant in this type of plan.

For plans that do require a certain number of hours of service, or perhaps require a certain number of *consecutive* months of service for eligibility, the plan sponsor is going to have to monitor hours of service earned very carefully to make sure that no one that meets either the plan's eligibility requirements or the LTPT eligibility requirements is inadvertently not given the opportunity to participate.

Specifically, here are some areas of particular concern:

- **5500 Counts:** Under current guidance, LTPTs will be counted as a participant for 5500 count purposes. This could have *significant consequences* for plans that for example, use the longest permissible waiting period (generally One Year of Service), to keep the number of eligible participants below the number that would require a 5500 plan audit. (Generally speaking, if a plan has 100 or more combined eligible participants and terminated participants with account balances remaining in the plan, the plan requires an audit.) Audits can be *very expensive*. The inclusion of LTPT participants in this count could cause many plans that in the past did not require an audit to cross the participant count threshold.  
[Plan sponsors should review their current employee demographics and determine if this may be an issue.](#)
- **Counting Hours:** Plan Sponsors should begin looking at their payroll tracking systems and determine if they have the capability of tracking hours sufficiently to meet the LTPT rules, especially when it comes to determining prior years of service for vesting purposes. Things could get complicated when an LTPT participant earns sufficient service to be eligible under the plan's normal eligibility requirements but is still required to only earn 500 hours of service for vesting when a participant that was never an LTPT participant is required to earn 1000 hours of service.
- **Keeping track of LTPT participants:** The first two points above I think present issues to consider, if not immediately, at least sooner than later. The issue of how to keep track of LTPT participants will be one to have resolved before the first LTPT participant becomes eligible. Here the concern would be in making certain that the LTPT participant is treated appropriately under the plan. For example, assume the plan will limit LTPT participation to just salary deferrals. How will the LTPT participant be distinguished in the payroll system from regular participants who may be receiving matching contributions. I can foresee issues where the LTPT participant is not properly identified and the payroll provider calculates a match which gets

deposited into the plan. This can get further complicated if the error is not discovered before the participant takes a distribution.

#### **CLOSING**

For plans that do not have an hour requirement for plan eligibility the good news is these rules may never effect plan administration. For all other plans, the good news is the first LTPT participant is not required to be eligible until January 1, 2024, so there is some time to start thinking through the requirements and formulating the proper processes and procedures that will enable a seamless integration of these new rules. And there is always hope that further guidance will reduce some of the administrative burden so that the intended purpose of allowing more participants to save for retirement is not overshadowed by undue complexity.

If you have questions, or would like to discuss the implementation of the LTPT rules, please do not hesitate to contact our office.