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IRS Issues Proposed Regulations on Long-Term, Part-Time Employees

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Historically, qualified retirement plans have excluded part-time employees from participation. An employer's ability to do so has now been limited by the Setting Every Community Up for Retirement Enhancement Act ("SECURE Act") and the SECURE Act 2.0 ("SECURE 2.0"). Plan sponsors will now be required to allow "long-term part-time" employees to make salary deferral contributions to 401(k) plans for plan years beginning on and after January 1, 2024. In late November, 2023, the IRS issued proposed regulations which provide some long awaited guidance on these provisions of the SECURE Act and SECURE 2.0.

A "long-term part-time" employee or "LTPTE" is an employee eligible to make 401(k) contributions, if offered by his employer's plan, solely because he meets the plan's minimum age requirement and has been credited with at least 500 hours of services in each of three consecutive 12-month periods. Hours of service completed before 2021 are ignored. SECURE 2.0 reduced the number of consecutive 12-month periods required from three to two for plan years starting on or after January 1, 2025.

Example. The plan year of an employer's 401(k) plan is the calendar year, the plan's entry dates are January 1 and July 1, and the 12-month period used to determine eligibility (the "eligibility computation period") begins when the employee starts work. The plan does not have a minimum age requirement for eligibility. An employee begins work for the employer on March 1, 2021, and is credited with more than 500 hours of service during the eligibility computation period beginning on that date as well as during each of the two following consecutive eligibility computation periods (March 1, 2022 – February 28, 2023, and March 1, 2023-February 28, 2024). The employee satisfies the LTPTE eligibility requirements on February 28, 2024, and will be eligible to make 401(k) contributions to his employer's 401(k) plan commencing July 1, 2024.

An employer's plan can continue to impose a minimum age of up to 21 as a condition for eligibility as an LTPTE and can exclude years of service prior to age 18 for vesting purposes. LTPTEs do not have to considered in determining if a plan meets applicable coverage, nondiscrimination and top- heavy minimum requirements. An employee who has met the LTPTE eligibility requirements maintains that status (and continues to be eligible to make 401(k) contributions) even if he works fewer than 500 hours in a subsequent year.

Employers are not required to make any employer contributions on behalf of LTPTEs (e.g., profit-sharing contributions, matching contributions, safe harbor contributions and top-heavy contributions), but may do so. Employers may permit LTPTEs to make catch up contributions and Roth contributions but are not required to do so. If an employer does make an employer contribution on behalf of an LTPTE, all years after 2021 during which the employee completes 500 or more hours of service are counted as a year of service for vesting purposes; and if an LTPTE subsequently meets the regular eligibility requirement of his employer's plan (by working at least 1,000 hours of service during an eligibility computation period), he will continue to be credited with those prior years of service in determining his vesting in any employer contributions allocated to him under the plan.

While plan amendments incorporating these new rules can be adopted as late as the last day of the first plan year beginning on or after January 1, 2025, employers must still operate their plans in accordance with these new rules beginning with the plan year starting in 2024. In doing so, employers can rely upon the proposed regulations until final regulations are issued or other guidance is published by the IRS.

After Tax Catch-Up Contributions

SECURE 2.0 requires that catch up contributions to a 401(k) plan by participants whose compensation from their employer for the preceding year exceeds $145,000 be made on an after-tax basis as a Roth 401(k) contribution. The IRS has postponed this new rule, which would otherwise have been effective January 1, 2024, until January 1, 2026.

If you have any questions regarding these changes, please contact any of the listed attorneys.

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