

Long-Term Part-Time Employee Update

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After the parties and sparkle of the holiday, it's time to hit the ground running in 2024. First on the agenda: making sure clients are aware that the long-term part-time employee (LTPTE) rules have officially taken effect. Beginning January 1, 2024, part-time employees who have worked at least 500 hours for three consecutive 12-month periods must be eligible to participate in at least the deferral feature of most 401(k) plans. On November 24, 2023 — a meager 25 working days before the effective date of the LTPTE rules — the Treasury and IRS released a proposed regulation implementing the LTPTE rules under SECURE 1.0 and SECURE 2.0. We've repurposed our December article on LTPTEs to include updates from the proposed guidance in italics below. Be on the lookout in February for a companion piece on how to correct LTPTE enrollment errors.

Applicability

The rule generally applies to 401(k) plans as of January 1, 2024 (and to ERISA 403(b) plans as of January 1, 2025). The rule does not apply to other defined contribution plans, like 457 plans or SIMPLE IRA plans. It also does not apply to collectively bargained plans or plans not subject to Code Section 410 requirements (such as governmental plans). *The proposed regulation applies to plan years beginning on or after January 1, 2024, and employers may rely on it until other guidance is issued.*

The Gist of It

401(k) plans can no longer have a service condition that prevents an employee from making salary deferrals if he or she has worked at least 500 hours for three consecutive years. Employees who do not meet the normal 1,000-hour year of service, but who do meet this new minimum service requirement, are called long-term part-time employees (LTPTEs). Any non-service conditions — such as excluding hourly employees, salaried employees, or highly-compensated employees — appear to still be permitted so long as they are not functioning as disguised service conditions. Exclusions of “part-time employees” and “seasonal employees” generally are service conditions and therefore are subject to the new rules. *The proposed regulation confirms that these 12-month*



periods that are counted for LTPTE service begin on the hire date and may later shift to the plan year. The special rules applicable to LTPTE, as described in the proposed regulation, apply only to employees who are “solely” in the plan because of the LTPTE rules.

Who Is Impacted

Plans that do not have an hours-based service condition, such as plans that permit employees to defer immediately, or after 90 days, or that use the elapsed time method (rather than hours) to count service are not impacted by the rule. Plans that impose an hours-based service condition for any group of employees (which generally includes plans that exclude “part-time employees” and “seasonal employees”) will be impacted by the rule. *The proposed regulation confirms that job class exclusions remain permissible in 401(k) plans, so long as they do not act as a proxies for impermissible age or service requirements.*

Two Options

Plan sponsors who are impacted by the new rule generally have two options.

First: Plan sponsors can keep their plan's existing service conditions, with the caveat that anyone who meets

the LTPTE definition will be allowed to make deferrals to the plan. On one hand, this limits the number of part-time workers who are eligible for the plan (which might reduce administration cost) and ensures nondiscrimination testing and top heavy minimum contributions are not impacted. On the other hand, though, this imposes an additional duty on the plan sponsor to carefully track hours of any employee that might become a LTPTE. Additionally, the implications of LTPTE status (such as how and when accelerated vesting of employer contributions must apply) are still very unclear, which could lead unintended results. These complexities in accounting and tracking employees may increase the likelihood for operational issues.

Second: Plan sponsors can modify the plan's existing service condition to ensure all employees are eligible to make salary deferrals before they meet the LTPTE definition. On one hand, this simplifies administration and avoids the LTPTE rules all together, and simplicity generally reduces the likelihood of plan errors. On the other hand, though, such a change may impact nondiscrimination testing for non-safe harbor plans, may increase company contributions for safe harbor plans, and may increase the number of plan accounts in both cases (which, in turn, may increase audit and administration costs).

Impact on Vesting and Testing

The proposed regulation confirms that a LTPTE will earn vesting service for years in which he or she performs 500 hours of service — even if the employee didn't receive employer contributions before earning 1,000 hours of service. Additionally, a LTPTE who earns 1,000 hours of service (or is otherwise eligible for reasons other than as a LTPTE) will continued to accrue vesting service using the 500-hour rule. LTPTEs who are covered by the new rules: (1) may be disregarded for Section 410(b) coverage testing, (2) may be disaggregated for purposes of ADP and ACP testing, and (3) are not required to receive minimum top-heavy contributions (though they are included in calculating the top-heavy ratio).

Now is the time to join with your TPA partner and ensure clients understand the guidance and, if impacted, have begun enrolling LTPTEs.

Reminders

- **January 31, 2024:** Usual deadline for providing plan participant data to plan vendors for testing. Now is a great time to make sure your clients have all data ready.
- **January 31, 2024:** Deadline for distributing Form 1099-R to plan participants who received distributions in the prior year.
- **February 28, 2024:** Deadline for filing hard copies of Form 1099-R with the IRS (if not submitted electronically).