

Early Eligibility Provisions



Presenter Information

Stephen W. Forbes J.D., LL.M.

Forbes Retirement Plan Consulting

(720) 799-7039

stephen.forbes32@gmail.com



Fundamentals of the Eligibility Rules



Age and service conditions

- **Statutory Maximum Eligibility Requirements**

- A plan using a vesting schedule may not require more than **one year of service** (YOS) and **age 21** as eligibility conditions
- A plan that provides immediate 100% vesting upon participation may require **two years of service** as an eligibility condition (**not deferrals**)

- **All Service Counts**

- Plan must count all of an EE's service for eligibility purposes unless a break in service (BIS) rule applies

- Under USERRA, plan must count period of qualified military service if EE timely applies for reemployment

- Military service cannot cause a BIS

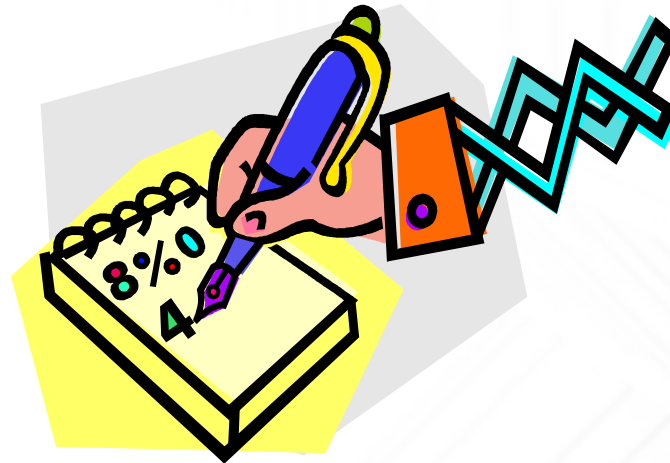
What is a “year of service”?

- A 12-consecutive month period during which an EE completes at least 1,000 hours of service (HOS)
- For eligibility purposes, first measuring period (“eligibility computation period”) begins on first day of employment and ends a year later (e.g., 7/2/23-7/1/24)
- After first measuring period, plan may shift to plan year (PY) or continue measuring by employment anniversaries
- NOT 12 consecutive months of employment
- No last day employment requirement



How do we credit hours of service?

- “Hours of service” vs. “elapsed time” method
- To determine hours of service, plan may provide for the “**actual**” method or an “**equivalency**” method (e.g., daily, weekly, monthly or semi-monthly equivalency)



Early eligibility

- Plans may permit early eligibility (i.e., eligibility provision that is less than 1 YOS or less than age 21, or both)
- Review plans terms for:
 - early eligibility conditions, and
 - consequences if not initially satisfied
- Hours requirement within short period is typically prorated based on YOS
- Typically, if no hours of service requirement, the condition is merely the passage of time
- Examples of consequences if early eligibility condition not initially satisfied:
 - Default to a regular year of service (typical), or
 - Reset (roll) eligibility period (only if condition is 6 months or less)

Simple approach

- Immediate eligibility for deferrals
- 1 YOS for match and nonelective
- Document issues - must specify:
 - Eligibility conditions
 - Entry date (may be different for match and/or nonelective)
 - If match, what compensation and deferrals count in calculating

Early Eligibility Alternatives

- Immediate Eligibility
- Months of service w/ pro-rated HOS
 - 500 HOS/6 months
 - 250 HOS/3 months
- Months w/ no HOS (mere passage of time)
 - 3 months
 - 6 months
 - 12 months



What is the required time of participation?

- Once an EE has satisfied plan's eligibility conditions, EE must enter the plan on the **earlier** of two dates:
 - **Six months** after completing plan's eligibility conditions
 - **First day** of next PY

Beware of re-employed EEs!



Immediate Eligibility

Advantages

- Attractive for new hires
- May use OEE rule for coverage and nondiscrimination
 - OEE rule; Early participation
- Commencing in 2024, top heavy issue effectively fixed
- 5500 participant count issue not as significant
- No LTPT EEs
- May apply one YOS to employer contributions
- Increases retirement savings

Disadvantages

- Increases administrative costs
 - Small accounts
 - Notices and SPDs
- More distributions
- Increases participant counts (i.e., 5500 audit)
- More participants subject to automatic enrollment
- More testing

One Year of Service

Advantages

- Lowers administrative costs
 - No short-term, part-time EEs
 - Fewer small accounts
- Reduces participant counts
 - 5500 audit
- Reduces distributions
- Reduces lost participants
- Less testing

Disadvantages

- Disincentive for new hires
- LTPT EE rules
- Less retirement savings

Months w/ HOS

Advantages

- Incentive for new hires
- Top heavy issue effectively fixed
- 5500 participant count issue not as significant
- Increases retirement savings
- Special testing rules are available
 - OEE rule; Early participation

Disadvantages

- Increases administrative costs
 - More short-term and part-time participants
 - Small accounts
- Increases participant counts (i.e., 5500 audit)
- More participants subject to automatic enrollment
- More distributions
- More lost participants
- LTPT EE rules

Months (1-12) w/ no HOS

Advantages

- Don't have to count HOS
- no LTPT EEs
- Incentive for new hires
- Top heavy issue fixed
- 5500 issue effectively fixed

Disadvantages

- Increases administrative costs
 - Short-term and part-time participants
 - Small accounts
- Increases participant counts (i.e., 5500 audit)
- More participants subject to automatic enrollment issues
- More distributions
- More lost participants

Part-Time Employee Exclusion



Can we exclude part-time EEs as a classification?



- IRS can challenge such an exclusion as a “disguised service condition”
 - Any exclusion category that defines itself by service (e.g., temporary, seasonal, etc.) is potentially an issue
 - Ex.: Plan excludes part-time employees. Plan defines part-time as anyone who normally works less 30 hrs/week. Plan has effectively imposed a 1500 hr. eligibility condition. Violates eligibility rules
- Code §410(a) establishes parameters of service condition (1,000 hours)

February 14, 2006 Quality Assurance Bulletin

- Instructed agents to challenge part-time EE exclusions based on hours of service
 - No reliance on post 6/30/01 DL letters
- QAB provides guidance on how to design a part-time EE exclusion:
 1. Plan can exclude part-time as long as part-time defined as EE scheduled to work less than 1,000 HOS
 2. Must also include fail-safe language for part-time EE who actually works 1,000 HOS

Part-time EE exclusion

- Plan may exclude part-time employees (e.g., typically defined as “expected to work not more than 1000 hrs/year)
- Plan design:
 - Immediate eligibility for deferrals and match
 - Excludes part-time employees
 - Top-heavy plan
- Benefit: Part-time employees don’t participate (saves administrative costs and employer contributions)
 - If TH plan, no TH minimum for part-timers because they are not participants

LTPT Rules – Part-time EE exclusion

- Now that the LTPT rules apply, may a plan continue to exclude part-time EEs from the elective deferral portion of the plan?
 - **Yes. However, once the EE satisfies the LTPT rules, the LTPT rules would trump the exclusion and the EE would be eligible to defer (proxy for a service exclusion)**
- May a plan continue to apply the part-time EE exclusion for the employer contributions (match and nonelective)?
 - **Yes**

Coverage and Nondiscrimination Testing Rules for Early Eligibility



Otherwise Excludible Employee (OEE) Rule

- As 401(k) plans have become more popular, employees have pressured employers to liberalize the eligibility requirements
 - **Disadvantage.** permits participation by part-time and short-term employees who generally do not defer, and to whom the employer doesn't intend to provide employer contributions
 - So as not to penalize an employer for liberalizing its eligibility requirements, Congress provided the OEE rule
- The OEE rule permits an employer to divide the plan into two “deemed” plans and separately to test the plans for coverage and nondiscrimination:
 - **Upper group plan.** one plan for those employees who have satisfied the statutory eligibility requirements (one year of service/age 21), and
 - **Lower group plan.** the other plan for the employees who could not have satisfied the statutory eligibility requirements if the plan had imposed such requirements.

OEE Testing

- **Deemed plans.** In applying the coverage test to each of the “deemed” plans, the employer disregards the employees of the other plan
- **No special plan language.** Since the rule is a testing rule, the employer need not include any special language to apply the rule
- **Nondiscrimination.** The plan for the otherwise excludible employees generally consists only of NHCEs, and therefore automatically satisfies the nondiscrimination requirements
- **Separate test.** If the OEE plan includes a HCE, the employer separately would test the plan for coverage and nondiscrimination

Cross-testing: OEE plan

- Although most plans utilize the **ratio percentage test** to satisfy the coverage requirements, some plans use the **average benefit test**
- Cross-tested plans often use the average benefit test to demonstrate compliance with the general nondiscrimination test
- In applying the average benefit percentage test (the second step in the average benefit test), an employer generally must take into consideration all plans maintained by the employer.
 - However, the employer does not take into consideration benefits provided under the plan for otherwise excludible employees

Example: OEE

- Employer X maintains a 401(k) cross-tested plan
- The plan provides for immediate eligibility for the elective deferrals and one YOS/age 21 for the profit sharing contribution
- For 2023, X has:
 - 40 employees who satisfied the statutory eligibility requirements and who are eligible for both the elective deferrals and the profit sharing contributions; and
 - 10 employees who have not satisfied the eligibility requirements, and therefore are only eligible to make elective deferrals
- For coverage and nondiscrimination testing, X elects to apply the OEE rule and treats the 10 employees who have not satisfied the statutory requirements as comprising a separate plan
- X uses the average benefit test to demonstrate the profit sharing contributions comply with the general nondiscrimination test
 - X does not include the 10 otherwise excludible employees in rate group testing or in applying the average benefit percentage test

OEE rule: Safe Harbor 401(k) Cross-tested Plan

Upper Group

- Eligibility:
 - Year of service
 - Age 21
 - Passed entry date
- Result
 - Can defer
 - Gets 3% safe harbor
 - Can get top heavy, minimum gateway, profit sharing \$

Lower Group

- Allowed to defer but lacks year of service or age 21 or hasn't passed entry date
- Result:
 - Can defer
 - Not entitled to top heavy (commencing in 2024)
 - Doesn't get 3% safe harbor
 - Not eligible for minimum gateway
 - Treat them as another plan

Early eligibility

- Safe harbor 401(k) cross-tested plan (2024)
- In addition to 6 full-time EEs, ER employs 3 other EEs:
 - 2 part-time EEs (G and H), and
 - one full-time EE (I) who has not satisfied the eligibility conditions
- The plan permits all EEs to defer immediately but continues to impose 1 YOS/age 21 eligibility requirements for the safe harbor contributions
- The plan excludes part-time EEs
 - Employer doesn't have to contribute the TH minimum

Safe harbor 401(k) cross-tested plan with immediate eligibility for deferrals

	Age	Comp.	Defer	3% Safe Harbor	Other PS Alloc.	Alloc. Rate	PV Factor	EBAR
A	50	\$280,000	\$25,000	\$8,400	\$28,600	13.20%	2.338	5.65%
B	45	\$280,000	\$19,000	\$8,400	\$28,600	13.20%	1.555	8.49%
C	40	\$43,200	\$1,800	\$1,296	\$605	4.40%	1.034	4.19%
D	32	\$33,800	\$1,200	\$1,014	\$473	4.40%	0.538	8.05%
E	28	\$30,000	\$0	\$900	\$420	4.40%	0.389	11.14%
F	25	\$25,000	\$0	\$750	\$350	4.40%	0.304	14.25%
G	excluded							
H	excluded							
I	30	\$35,000	\$1,500	\$0	\$0	N/A	N/A	N/A



Otherwise Excludible Employee

- **If a safe harbor 401(k) cross-tested plan provides immediate eligibility for the deferrals and one year of service/age 21 eligibility conditions for the cross-tested and safe harbor nonelective contributions, will the plan need to provide the employees who do not satisfy the eligibility conditions (i.e., only eligible to defer) (1) a safe harbor contribution; (2) a cross-tested profit sharing allocation; (3) a top-heavy minimum contribution or (4) a minimum gateway contribution?**
 1. No.
 2. No, the participant has not satisfied the eligibility condition for the profit-sharing portion of the plan.
 3. No, commencing in 2024.
 4. No. If the plan utilizes the OEE rule, the lower group plan participants would not need cross-testing to demonstrate that lower group plan was nondiscriminatory. Thus, the lower group plan would not need to make a minimum gateway contribution for these participants with less than a year of service.

Cross-testing: including OEE plan?

- In applying the average benefit percentage test to demonstrate compliance with the general nondiscrimination test, may an employer take into consideration the benefits provided under the “plan” for otherwise excludible employees?
- Generally, the average benefit percentage test (the second step in the average benefit test) requires an employer to aggregate all qualified plans maintained by the employer. However, if the employer elects to apply the otherwise excludible employee rule, the employer may not aggregate the benefits under the portion of the plan benefiting otherwise excludible employees. **Treas. Reg. §1.410(b)-7(e)**. Of course, if the employer elects not to apply the otherwise excludible employee rule, the employer would include the portion of the plan benefiting the otherwise excludible employees.

OEE: Where to draw the line?

- An important question in applying the OEE rule for coverage and nondiscrimination testing, is what entry dates does the plan use to divide the plan into two plans
 - The plan's entry dates, which might be every day of the plan year if it has immediate eligibility for deferrals, or
 - The maximum entry dates permitted (the earlier of the first day of the plan year or 6 months after satisfying the one YOS and age 21 eligibility requirements)
 - To simplify this rule most plans simply apply semi-annual entry dates (e.g., 1/1 and 7/1)
- **IRS Chief Counsel Memorandum 201615013:** IRS agreed it was acceptable to apply the maximum age and service requirements, including the maximum waiting periods

Example

- Safe harbor 401(k) cross-tested plan
 - Immediate eligibility for deferrals
 - One YOS/age 21, semi-annual entry dates (1/1 and 7/1) for SH nonelective and cross-tested contributions
- **2023:** Any employee who would have satisfied the One YOS/age 21 and entered the plan by 7/1/23 is eligible for SH nonelective and cross-testing allocation
 - Those employees are in the **upper group** for testing
- Any employee who would not have entered the plan by 7/1/23, will not be entitled to the employer contributions (except TH) and will be in the **lower group**

Top Heavy Changes

Secure Act 2.0 §310



SECURE 2.0 §310

- To incentivize employers to provide an early eligibility provision, Congress amended the top heavy rules
- Employers no longer obligated to provide top heavy minimum to employees who enter before satisfying the statutory eligibility requirements (1 YOS/age 21)
 - Effective 2024





Top Heavy

- Employees who are eligible to participate in the plan solely because of the new part-time provision are excluded from the vesting and benefit provisions of the top heavy rules
 - Such employees also are **not** included in determining whether the plan is top heavy
- **A Safe Harbor 401(k) plan that is designed to be top heavy exempt will not lose its top heavy exempt status because a LTPT employee doesn't receive Safe Harbor 401(k) nonelective or match**

Top Heavy Election

- The regulations permit a plan to make an election to exclude the LTPT EEs from receiving top heavy minimum contributions
 - That election must apply uniformly to all LTPT EEs
 - This election is completely separate from (and in no way dependent on) the coverage and nondiscrimination testing elections
 - The election must be in the plan document
 - Unlike the coverage and nondiscrimination testing elections, the accounts of LTPTs are always included in the determination of whether the plan is top-heavy
 - The exclusion of the LTPT EEs from receiving top-heavy benefits does not change the top heavy minimum contribution

Top-Heavy and Otherwise Excludable Employee

- If plan covers otherwise excludable employees (less than 1 YOS), can treat them as a separate group for purposes of top-heavy minimum contribution in defined contribution plan
 - This means the OEEs don't need to receive the TH minimum
- However, a safe harbor 401(k) which allows OEEs to defer but not receive the SH contribution will **not** be a **safe harbor 401(k) top heavy exempt plan**

Act Section
310
Code Section
416
Qualified
DC
403(b)
No
457(b)
No
Eff. Date
Plan years after 2023

Example

- Law firm maintains a safe harbor 401k plan
 - One YOS/age 21 eligibility requirements
 - In addition to deferrals, the plan provides a basic SH match and PS contributions
 - For 2023, the law firm doesn't make a profit sharing contribution
 - The plan is top heavy exempt and the firm doesn't have to make an additional TH minimum contribution

Example: Law Firm, Inc. (2023)

Name	Position	Net Comp	Deferral	Basic SH Match	TH Minimum	Fulltime?	1 YOS?
Sam	Shareholder	\$330,000	\$30,000	\$13,200	\$0	Full	Yes
Sue	Shareholder	\$330,000	\$22,500	\$13,200	\$0	Full	Yes
Anne	Associate	\$84,000	\$6,000	\$3,360	\$0	Full	Yes
Maria	Office Manager	\$58,000	\$2,000	\$1,870	\$0	Full	Yes
Tony	Secretary	\$39,000	\$1,000	\$1,000	\$0	Full	Yes
Frank	Filing Clerk	\$24,000	\$0	\$0	\$0	Full	Yes
Tina	Secretary	\$30,000	\$0	\$0	\$0	Full	No
Carl	Law Clerk	\$13,500	\$0	\$0	\$0	800 HOS	No

- Eligibility: 1 YOS/age 21 (so Tina and Carl don't participate)
- Safe harbor 401(k) plan is top heavy exempt
- The firm doesn't need to make a TH minimum contribution for Tony and Frank

Example

- Assume the same facts as in the previous example, except the law firm amends the plan to provide immediate eligibility for deferrals (one YOS/age 21 continues to apply for the SH match) and excludes part-time employees
 - For 2023, X applies the OEE rule for coverage and nondiscrimination
 - Under the OEE rule, the upper group plan is SH and doesn't need to apply the ADP or ACP tests
 - Since the OEE doesn't apply for TH purposes, X will have to make TH minimum contributions for all eligible EEs, including those EEs with less than a year of service (Tony, Frank and Tina)

Example: Law Firm, Inc. (2023)

Name	Position	Net Comp	Deferral	Basic SH Match	TH Minimum	Fulltime?	1 YOS?
Sam	Shareholder	\$330,000	\$30,000	\$13,200	\$0	Full	Yes
Sue	Shareholder	\$330,000	\$22,500	\$13,200	\$0	Full	Yes
Anne	Associate	\$84,000	\$6,000	\$3,360	\$0	Full	Yes
Maria	Office Manager	\$58,000	\$2,000	\$1,870	\$0	Full	Yes
Tony	Secretary	\$39,000	\$1,000	\$1,000	\$200	Full	Yes
Frank	Filing Clerk	\$24,000	\$0	\$0	\$720	Full	Yes
Tina	Secretary	\$29,500	\$500	\$0	\$900	Full	No
Carl	Law Clerk	\$13,500	\$0	\$0	\$0	800 HOS	No

- Safe harbor 401(k) plan is NOT top heavy exempt
- Tony, Frank and Tina must receive the TH minimum

Safe Harbor 401(k) Plan - Top-heavy exemption

- Plan avoids top-heavy minimum with “SH-only” design
- Plan must consist solely of:
 - Deferrals
 - ER nonelective that satisfies Safe Harbor 401(k) or QACA safe harbor
 - Matching contributions which are under ACP safe harbor
- Exemption is year-to-year
- Note: Split eligibility SH 401(k) plan works for SH4k rules and avoiding making the TH minimum but the plan is not top-heavy exempt
 - 1 YOS/age 21 for SH match or nonelective
 - Immediate eligibility for deferrals

Example

- Assume the same facts as in the previous example, except the plan year is 2024
 - For 2024, X applies the OEE rule for coverage and nondiscrimination
 - Under the OEE rule, the upper group plan is SH and doesn't need to apply the ADP or ACP tests
 - Commencing in 2024, Section 310 provides that the firm will not need to make a TH minimum contribution to the OEEs (Tina)
 - Unfortunately, Section 310 doesn't address the top heavy exemption for the "upper" group
 - Accordingly, the firm will need to make a TH minimum contribution for the upper group employees

Example: Law Firm, Inc. (2024)

Name	Position	Net Comp	Deferral	Basic SH Match	TH Minimum	Fulltime?	1 YOS?
Sam	Shareholder	\$330,000	\$30,000	\$13,200	\$0	Full	Yes
Sue	Shareholder	\$330,000	\$22,500	\$13,200	\$0	Full	Yes
Anne	Associate	\$84,000	\$6,000	\$3,360	\$0	Full	Yes
Maria	Office Manager	\$58,000	\$2,000	\$1,870	\$0	Full	Yes
Tony	Secretary	\$39,000	\$1,000	\$1,000	\$200	Full	Yes
Frank	Filing Clerk	\$24,000	\$0	\$0	\$720	Full	Yes
Tina	Secretary	\$29,500	\$500	\$0	\$0	Full	No
Carl	Law Clerk	\$13,500	\$0	\$0	\$0	800 HOS	No

- Eligibility: Immediate eligibility for deferrals (Tina can defer) but excludes part-time EEs (Carl can't participate); 1 YOS/age 21 for SH match (so Tina and Carl don't participate)
- SECURE §310 states that the plan doesn't need to give TH minimum to OEE (Tina), however, it doesn't preserve TH exemption (Tony and Frank)

Example

- Assume instead the plan year is 2025 and the plan imposes the following eligibility conditions:
 - 6 months and 500 hours/age 21 for elective deferrals
 - One YOS/age 21 for the SH Match
- 2025
 - Tina enters the plan under the early eligibility provision (not LTPT rule) and is eligible to defer but not yet eligible for the SH match. Because of Section 310, Tina doesn't receive the TH minimum
 - Carl is eligible to defer under the LTPT employee rules
 - Because of Tina, the plan is not top heavy exempt

Example

- Forbes Family Dentistry (FFD) maintains a 401(k) plan
 - Eligibility requirements: 1 YOS/Age 21
 - Semi-annual entry dates: 1/1 and 7/1
 - Matching and Profit Sharing contributions
 - Top heavy
- Ann, a dental assistant, has worked part-time (600-800 HOS/year) for FFD since 2018
 - Because of the plan's eligibility requirements she has never participated in the plan

Example (cont.)

- *Will Ann be eligible under the new law? If so, when?*
 - **Yes. January 1, 2024**
- *Will Ann be eligible for the match? Profit sharing contribution? Top heavy minimum?*
 - **No with respect to all three questions if employer elects to exclude LTPT EEs. Plan must specify the TH exclusion**
- *Will Ann be included in the coverage test? ADP test? ACP test? Top heavy determination?*
 - **No for coverage, ADP and ACP if employer elects. Yes for the TH determination.**
- *If the plan excluded all dental assistants, would Ann be eligible to participate in the plan?*
 - **No, unless the exclusion is a proxy for a service requirement**
- *If the plan excluded part-time employees, would Ann be eligible to participate in the plan?*
 - **Yes, once Ann satisfies the LTPT employee rule**

Example

- Corporation X maintains a 401(k) plan with one YOS/age 21 eligibility conditions and semi-annual entry dates (1/1 and 7/1)
 - Plan provides for deferrals, matching contributions and profit sharing contributions
 - In addition to its 30 full-time employees, X employs 4 part-time employees who have been with the company for several years
- **How will the new LTPT employee rule affect their participation in the 401(k) plan?**

Rehired Employees and Break-in-Service Rules



Service and eligibility guiding principle

- Hours and Years of Service always count for purposes of eligibility
 - And they don't stop counting
 - Only exception is BIS (break in service rules)
 - Very, very limited
 - Many plans have eliminated BIS rules for eligibility purposes

Classes of rehired employees and when they enter (re-enter)

Class	Entry
Already satisfied minimum age and service and entered plan	Immediately upon rehire
Already satisfied minimum age and service but terminated employment before entry date	Immediately upon rehire (or original entry date, if later)
Already satisfied minimum service but didn't enter plan because of minimum age requirement	Immediately upon rehire (or entry date following attainment of minimum age, if later)
Didn't satisfy minimum service requirement	Wait until entry date following satisfaction of eligibility requirements

- Break in service rules can affect this, depending on plan terms ⁵⁰

Case study: When does Bob enter (re-enter?)

- ABC hired Bob May 1, 2021
- ABC calendar year 401(k) plan has:
 - 1 YOS/Age 21 entry requirements
 - January 1/July 1 entry dates
 - Shifting eligibility computation period
 - No eligibility break-in-service rules
- Bob always works 150 hours/month
- *When does Bob enter/re-enter plan after rehire?*

	Bob's Birthday	Bob Quits	Bob Rehired
a)	Feb. 1, 1990	Aug. 1, 2022	May 15, 2024
b)	Feb. 1, 1990	Feb. 1, 2022	May 15, 2024
c)	Feb. 1, 1990	Feb. 1, 2022	May 18, 2022
d)	Feb. 1, 1990	Aug. 1, 2021	Mar. 1, 2023
e)	Feb. 1, 2004	Aug. 1, 2022	May 15, 2023
f)	Feb. 1, 2004	Aug. 1, 2022	Dec. 15, 2025

Eligibility Rules for LTPT EEs



Example: LTPT eligibility rules

- Company X maintains separate 401(k) plans for each of its two divisions (A and B)
 - Eligibility conditions
 - Division A: one YOS/age 21
 - Division B: the applicable number (3 or 2) of 500 years
 - Both plans fail Code §401(k)(2)(D) because each plan must include an eligibility provision that satisfies the dual eligibility requirements:
 - Earlier of the period described in (a) section 401(k)(2)(D)(i), or (b) the period described in section 401(k)(2)(D)(ii) (LTPT EE rule)
 - Division A's plan violates the LTPT EE rule
 - Division B's plan violates the maximum 401(k) eligibility requirement of one YOS

Eligibility Computation Periods

- The rules for LTPT periods parallel normal eligibility rules in their application
 - The first eligibility computation period begins on the EE's date of hire and runs 12 months
 - The plan will specify whether the second eligibility computation period is the second employment year or the plan year that begins during the first eligibility computation period
 - If the latter, the first employment year and the plan year beginning during that year are treated as “consecutive years” for purposes of the two- or three-year eligibility requirement
 - Eligibility computation periods beginning before January 1, 2021, do not count in determining LTPT status

Example: Years taken into account

- Corporation X maintains a calendar year 401(k) plan
 - Eligibility: earlier of: (a) one YOS/age 21, or (b) the applicable number of 500 years
 - Semi-annual entry dates
 - No shifting eligibility computation periods
 - Ed commenced employment 9/1/20
 - 9/1/20 – 8/31/21: 600 HOS
 - 9/1/21 – 8/31/22: 600 HOS
 - 9/1/22 – 8/31/23: 600 HOS
 - 9/1/23 – 8/31/24: 600 HOS
 - Ed will not eligible to defer until 1/1/25
- LTPT EE rules do not permit any 12-month period beginning before 1/1/21 to be taken into account for purposes of determining whether an EE has completed the applicable number of consecutive 12-month periods during which the EE is credited with at least 500 HOS

Example: Eligibility computation periods

- Company X maintains a calendar year 401(k) plan
 - **Eligibility:** 1 YOS/age 21/semi-annual entry dates
 - **Eligibility computation period:** shifts to the plan year after first year (HOS completed in the overlap period count towards both computation periods)
- Mary is a part-time EE (50hrs/month)
 - Commenced employment on December 1, 2023
 - She will complete 2 consecutive years under LTPT rule on December 31, 2024 and enter the plan on January 1, 2025
- Assume the same facts except the plan measures computation periods on anniversaries of the employment commencement date
 - Mary will complete 2 consecutive years on November 30, 2025 and enter the plan on January 1, 2026

Example: Eligibility computation periods

- Company X maintains a calendar year 401(k) plan
 - Eligibility: (a) 1 YOS/age 21, or (b) the applicable number of consecutive 12-month periods during each of which the EE is credited with at least 500 HOS
 - Semi-annual entry dates
 - Eligibility computation period: shifts to the plan year after first year
- Steve is a part-time EE
 - Commenced employment on March 1, 2023
 - 3/1/23 – 2/28/24: 550 HOS
 - 2024 450 HOS
 - 2025 600 HOS
 - 2026 600 HOS
 - He will complete 2 consecutive years under LTPT rule on December 31, 2026 and enter the plan on January 1, 2027

To shift or not to shift?

- **Since the LTPT rules involve tracking more than one consecutive year period, counting eligibility on employment years means getting employment year HOS for eligibility purposes for more than the first year**
 - Vesting HOS, on the other hand, generally are credited on plan years
 - Accordingly, this will require collecting HOS for different computation periods for each potential LTPT

Question: LTPT Period

- **Can we choose employment years for LTPT EEs but plan years for regular eligibility purposes?**
- **Example:**
 - **Plan requires 1 YOS to enter for most purposes**
 - Plan shifts to plan year after first year
 - **Plan requires 3 LTPT Periods to enter as LTPT EE**
 - Plan stays with anniversary of hire date

Plan Entry

- Once the eligibility requirements are met, the LTPT EE must be permitted to begin deferrals by an entry date that meets the normal entry date requirements (i.e., the EE must be able to start deferring by the earlier of: (a) the first day of the plan year, or (b) the date six months after the EE satisfies the LTPT eligibility requirement
 - If the EE leaves the company after completing his/her eligibility requirements but before entering the plan, the EE must enter the plan immediately upon rehire
 - If a LTPT EE entered the plan and terminated employment after his/her plan entry date, the EE will also enter the plan immediately upon rehire

Question

- **Can a plan use different entry dates for LTPT EEs than are used for other Normal Requirements?**
 - Example: monthly entry for people who enter under Normal Requirements but dual entry for LTPT EEs?

Hours of Service (HOS)

- The plan may use equivalency rules for determining the hours requirement for LTPT EE status
 - Daily – 10 HOS
 - Weekly – 45 HOS
 - Semi-monthly – 95 hours
 - Monthly – 190 HOS



Example: Equivalency

- Corporation X maintains a calendar year 401(k) plan
 - **Eligibility:** earlier of: (a) one YOS/age 21, or (b) the applicable number of 500 Years
 - Semi-annual entry dates
 - No shifting eligibility computation periods
 - Plan uses daily equivalency (10 hours/day) to measure HOS
 - Ben and Ann (part-time EEs) – commenced employment on 5/1/23
 - **2023.** Ben works 55 days (550 HOS) and Ann works 58 days (580 HOS)
 - **2024.** Ben works 45 days (450 HOS) and Ann works 55 days (550 HOS)
 - Ann is eligible to defer on 7/1/25; Ben is not yet eligible to defer

Elapsed Time

- The plan cannot use elapsed time for the two or three year LTPT eligibility requirement, because the EE is deemed to have a year of service after one year of elapsed time, would enter the plan under the normal eligibility rules, and would not be a LTPT EE
 - A 1-year period of service is the maximum period that a 401(k) plan may require any EE complete in order to participate
 - The IRS didn't create an elapsed time version of the LTPT EE rule

Example: Elapsed Time

- Corporation X maintains a calendar year 401(k) plan (with discretionary match and profit sharing)
 - The plan requires that an EE complete a 1 year period of service (elapsed time) and attain age 21 to be eligible to defer and receive employer matching and profit sharing contributions
- If a part-time EE becomes eligible under the plan's elapsed time provision, will he/she be a LTPT EE?
 - **No. To be considered a LTPT EE, the EE must be eligible to defer solely because of the LTPT rules**
- May a plan using elapsed time avoid applying the LTPT rules?
 - **No. In other words, the plan will still need to determine whether any EE who doesn't satisfy the plan's elapsed time eligibility provision would be eligible under the LTPT rules**

Example: Elapsed Time

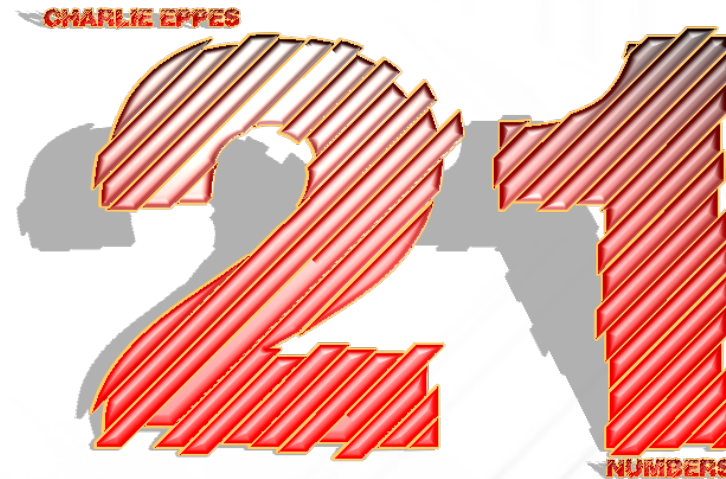
- May a plan with elapsed time require a part-time EE complete 2 consecutive periods of service to be eligible to defer?
 - Plan fails because, under the elapsed time method of crediting service, a 1-year period of service is the maximum period that a 401(k) plan may require any EE complete in order to participate
 - The IRS didn't create an elapsed time version of the LTPT EE rule



- Is it possible for an EE in a plan with elapsed time to not be eligible under elapsed time but be eligible under the LTPT rules? **Yes.**
 - **Ex. X maintains a calendar yr. 401k plan**
 - requires one year period of service (elapsed time) to be eligible to defer
 - **Mary, a seasonal EE, commences employment 4/1/23 and completes 600 HOS**
 - Terminates 8/1/23
 - **Rehired 11/1/24; completes 600 HOS by 3/31/25**
 - **Not eligible under elapsed time but eligible under LTPT rules**

Age 21 Requirement

- The LTPT rules require an EE to attain age 21 before the end of the last year of the eligibility requirements (second or third year)
 - The age 21 requirement presents an administrative challenge if the EE fails to complete 500 HOS in the year in which he/she attains age 21
- The age 21 requirement will be difficult for an employer with younger EEs



Example: Age 21

- Corporation X maintains a calendar year 401(k) plan
 - Eligibility: earlier of: (a) one YOS/age 21, or (b) the applicable number of consecutive 12-month periods during each of which the EE is credited with at least 500 HOS
 - Semi-annual entry dates
 - No shifting eligibility computation periods
 - Mary (age 19; 6/5/04) commenced employment 4/1/23
 - 4/1/23 – 3/31/24: 600 HOS
 - 4/1/24 – 3/31/25: 600 HOS
 - 4/1/25 – 3/31/26: 400 HOS
- Mary would normally enter the plan on 7/1/25, but she is not yet 21
- Mary turns age 21 6/5/25 but completes only 400 hours in that year
- Because she has not completed at least 500 hours in the year in which she turns age 21, she does not enter the plan
- She must wait until she has two consecutive years in which she is credited with at least 500 HOS and is at least age 21 in the second of those years
- 4/1/24 – 3/31/25 is not one of those years, the earliest she would enter is 7/1/28, after completing at least 500 hours in two consecutive years

LTPT EE Definition

- To be an LTPT EE, the only reason why the participant is eligible to defer must be the application of the LTPT rules
 - If the EE becomes eligible for any other reason, he/she is not a LTPT EE
 - If the plan has eligibility requirements that are more lenient than those of the LTPT rules (e.g., where HOS are not an issue or where the otherwise LTPT will enter faster than required under the law), the EEs are never LTPTs
 - The effect of not being a LTPT EE is that the LTPT vesting rules will not apply

LTPT EE Definition

- Once an EE has entered the plan under eligibility requirements other than the LTPT rules (normal requirements), the plan doesn't redetermine LTPT status
 - Ex. An EE who works more than 1,000 hours in his/her first employment year and meets the plan's one YOS eligibility requirement, will not be transformed into an LTPT EE if, in later years, he/she works between 500 and 999 HOS in two consecutive years

Example: Immediate Eligibility

Avoiding the LTPT EE Rules?

- Company X maintains a calendar year 401(k) plan (with discretionary match and profit sharing) with 1 YOS/age 21 eligibility provision
- X amends the plan effective 1/1/24 to provide for immediate eligibility for elective deferrals
 - Will the plan have any LTPT employees? **No.**
 - Will the plan need to apply the LTPT employee vesting rules? **No.**
 - Can X decide to apply immediate eligibility on 1/1/24 and amend the plan by the end of the 2025 plan year? **Yes.**
- ***Note.*** In order for an EE to be considered a LTPT EE, satisfying the LTPT rules has to be the only reason why the participant is eligible. If the EE is eligible for any other reason, he/she is not a LTPT EE.

Example: 12 months/500 HOS

Avoiding the LTPT EE Rules?

- Company X maintains a calendar year 401(k) plan (with discretionary match and profit sharing) with 1 YOS/age 21 eligibility provision
- X amends the plan to require that an EE complete 500 HOS within a 12-month period of service to be eligible to make elective deferrals
 - Will the plan have LTPT EEs? No.
 - Will the plan need to apply the LTPT EE vesting rules? No.
- *Would an eligibility provision of 500 HOS/6 months avoid the LTPT EE rules? No.*
- *Illustration:* Ann works 300 HOS (or, any amount less than 500 HOS) in each of 4 consecutive six month measuring periods, she will not enter the plan under the plan's eligibility provision. However, under LTPT rule she would be eligible to enter the plan.

Example 500 HOS in 6 Months

Will this provision avoid the LTPT rules?

- Normal Requirements: 500 HOS in 6 months; monthly entry
- Example 1:
 - Emily hired 1/1/2024; 100 HOS/month
 - Enters plan 7/1/2024; never an LTPT EE
- Example 2:
 - Andrea hired 1/1/2024; 50 HOS/month
 - Never satisfies Normal Requirements
 - LTPT EE 12/31/2025; eligible to defer 1/1/2026

Example: Effective date

- Company X maintains a calendar year 401(k) plan (with discretionary match and profit sharing) with 1 YOS/age 21 eligibility provision
- Effective 1/1/24, the plan's eligibility provision to provide that an EE is eligible to defer on the earlier of: (a) one YOS/age 21, or (b) two consecutive 500 Years
 - Will the plan have LTPT EEs in 2024?
 - For the plan year beginning January 1, 2024, none of the EEs who is eligible to make deferrals are LTPT EEs because none of the EEs is eligible to participate solely by reason of having completed three consecutive 12-month periods during each of which the EE is credited with at least 500 HOS
 - 2025?
 - Yes, if the EE enters under the two consecutive 500 years
 - Will the plan have to apply the LTPT vesting rules to EEs who become eligible by completing two consecutive 12-month periods during which they are credited with at least 500 HOS in 2024? No. 2025? Yes.

Which Eligibility Provisions avoid the application of the LTPT Rules?

- Immediate eligibility for deferrals
- 1 - 12 months of service with no HOS (mere passage of time)
- 500 or fewer HOS in 12 months

Can we design a 401(k) plan to avoid the application of the LTPT employee rules?



Avoiding the LTPT employee rule by plan design?

- In determining whether an employer can design an eligibility provision to avoid the application of the LTPT employee rules, the practitioner needs to examine the provision carefully
 - If there is any possibility that an employee can complete 500 HOS in three (2025: two) consecutive eligibility computation periods and not be eligible to make elective deferrals, the design does NOT avoid the LTPT employee rules
 - *Note: Very few eligibility designs will be able to avoid the LTPT employee rules*

Avoiding the LTPT employee rule by plan design?

- Corporation X maintains a 401(k) plan (with discretionary match and profit sharing) with 1 YOS/age 21 eligibility provision
- X amends the eligibility provision to 6 months/500 HOS to avoid application of the LTPT employee rule
 - Does it work? **No. Why not?**
 - For any EE that doesn't satisfy the 6 months/500 HOS requirement, most plans will then revert to the 1 YOS rule (1,000 HOS)
 - This will trigger the application of the LTPT employee rule
 - Vesting: 500 HOS for LTPT employees

Avoiding the LTPT employee rule by plan design?

- Assume the same fact except the plan continues to apply the 6 months/500 hos for EEs who don't satisfy the eligibility requirement initially
 - Continually “rolls” the 6 months/500 HOS eligibility condition
- Will this avoid the application of the LTPT employee rules? **No. Why not?**
 - Let's illustrate with an example:
 - Ann works 300 HOS (or, any amount less than 500 HOS) in each of 4 consecutive six month measuring periods, she will not enter the plan under the plan's eligibility provision. However, under LTPT rule she would be eligible to enter the plan.
 - Vesting: 500 HOS for LTPT employees

Avoiding the LTPT employee rule by plan design?

- Corporation X amends SH 401(k) match plan (top heavy exempt) with a 1 YOS eligibility provision to 6 months/500 hos for elective deferrals (SH match continues to apply 1 YOS) to avoid the application of the LTPT employee rule
 - Relies on SECURE 2.0 §310 to retain top heavy exempt status (i.e., commencing in 2024, no longer need to provide TH minimum to otherwise excludible EEs)
- Does the amendment allow the plan to avoid the application of the LTPT employee rule? Is the plan top heavy exempt? **No and No. Why not?**
 - **LTPT employee rule.** For the same reasons explained in the previous slides
 - **Top heavy exempt status** – Under Section 310, a plan will not need to provide TH minimums to the otherwise excludible employees. However, Section 310 doesn't permit a SH plan with dual eligibility to retain TH exempt status
 - EEs with more than one YOS who don't receive at least a 3% employer contribution, will need to receive an addition contribution to bring them to the TH minimum
 - **Vesting.** 500 HOS for LTPT employee

Avoiding the LTPT employee rule by plan design?

- Company X maintains a 401(k) Plan with matching and profit sharing contributions
 - Eligibility. One YOS/age 21
 - Plan excludes Union and Seasonal employees
- Would the LTPT employee rule apply only to the Seasonal employees?
 - **No.** The LTPT employee rule would apply to Seasonal employees and any other employee (nonseasonal) who satisfies the LTPT employee requirements

Avoiding the LTPT employee rule by plan design?

- Corporation X maintains a 401(k) plan (with discretionary match and profit sharing) with 1 YOS/age 21 eligibility provision
- X amends the eligibility provision to **12 months with no hours of service** (i.e., mere passage of time) to avoid application of the LTPT employee rule
 - Does it work? **Yes. Why?**
 - A “LTPT” employee would always enter under the plan’s eligibility provision before he/she would enter under the LTPT employee rule
 - This will not trigger the application of the LTPT employee rule
 - Vesting. 1000 HOS

Avoiding the LTPT employee rule by plan design?

- Can you avoid the LTPT employee rule by amending your eligibility requirements for elective deferrals to **immediate eligibility**?
 - **Yes. However, the plan should weigh the costs in adopting such an amendment against the LTPT employee rule**
- Could the plan avoid the LTPT employee rules if it amended its elective deferral eligibility provision to immediate eligibility but excluded part-time employees
 - **No. The LTPT employee rule trumps the part-time employee rule**
 - **The plan can continue to include the part-time employee exclusion. The exclusion would apply until the LTPT employee rule applies. Furthermore, the part-time employee exclusion could apply to the employer contributions**

Avoiding the LTPT employee rule by plan design?

- Private University has a 403(b) plan with a matching contribution
 - Eligibility. One YOS/age 21
 - Exclusions. student employees and employees who normally works less than 20 HOS/week
- Although Universal Availability applies to deferrals, the exclusion will trigger the application of the LTPT employee rule
 - Vesting: 500 HOS for LTPT employees
- What if the plan didn't apply the exclusion to deferrals (applied to matching contributions only)?
 - LTPT employee rule would not apply

Elapsed Time



Elapsed time method

- The elapsed time method may be used in lieu of the hours counting method for determining eligibility, vesting, and benefit accrual
 - The elapsed time method may be used for all three purposes, or a plan can use elapsed time method for one or two purposes and the hours counting method for the other(s)
 - Under the elapsed time method, one year equals one year
 - One year minus a week does not equal one year

Elapsed Time Method

- In contrast to the actual or equivalency methods, the elapsed time method determines service taken into account by reference to a “**period of service**” rather than by reference to hours credited toward a “year of service.”
 - A period of service begins on the employee’s employment (or reemployment) commencement date, and ends on the employee’s date of severance from service
 - If a plan uses the elapsed time method, “one year period of severance” replaces “one year break in service” for purposes of applying the break in service rules. The regulations require the plan to take into account certain periods of severance.
 - The plan may use the elapsed time method in applying the vesting and benefit accrual rules
 - **Service crediting provisions.** A plan may credit different classes of employees under different methods of crediting hours of service. The plan’s service crediting provision must not discriminate in favor of highly compensated employees, based on all relevant facts and circumstances.

Service Spanning Rules

- For purposes of eligibility and vesting, an employee who has severed from service by reason of a quit, discharge, or retirement but is rehired within **12 months** will get credit for the entire time between the severance date and the rehire date
- However, if the employee was absent for any other reason and then quits, the employee must be rehired within **12 months** after the absence began to get credit, even though that is less than **12 months** after the date of severance. This is to prevent having to give credit for more than **12 months** of service after an employee is absent or severs from service.
- For purposes of benefit accrual, periods of severance need not be taken into account

Elapsed Time

- The plan cannot use elapsed time for the two or three year LTPT eligibility requirement, because the EE is deemed to have a year of service after one year of elapsed time, would enter the plan under the normal eligibility rules, and would not be a LTPT EE
 - A 1-year period of service is the maximum period that a 401(k) plan may require any EE complete in order to participate
 - The IRS didn't create an elapsed time version of the LTPT EE rule

Example: Elapsed Time

- Corporation X maintains a calendar year 401(k) plan
 - The plan requires an EE complete a 1 year period of service (elapsed time) and attain age 21 to be eligible
- If a part-time EE becomes eligible under the plan's elapsed time provision, will he/she be a LTPT EE?
 - **No. To be considered a LTPT EE, the EE must be eligible to defer solely because of the LTPT rules**
- May a plan using elapsed time avoid applying the LTPT rules?
 - **No. In other words, the plan will still need to determine whether any EE who doesn't satisfy the plan's elapsed time eligibility provision would be eligible under the LTPT rules**
- **Note. The IRS LRM states:** *"If a plan uses the elapsed time method for eligibility service crediting, the long-time part-time rules do not apply."*

Example: Elapsed Time



- May a plan with elapsed time require a part-time EE complete 2 consecutive periods of service to be eligible to defer?
 - **Plan fails because, under the elapsed time method of crediting service, a 1-year period of service is the maximum period that a 401(k) plan may require any EE complete in order to participate**
 - **The IRS didn't create an elapsed time version of the LTPT EE rule**
- Is it possible for an EE in a plan with elapsed time to not be eligible under elapsed time but be eligible under the LTPT rules? **Yes.**
 - **Ex. X maintains a calendar yr. 401k plan**
 - **requires one year period of service (elapsed time) to be eligible to defer**
 - **Mary, a seasonal EE, commences employment 4/1/23 and completes 600 HOS**
 - **Terminates 8/1/23**
 - **Rehired 11/1/24; completes 600 HOS by 3/31/25**
 - **Not eligible under elapsed time but eligible under LTPT rules**

THANK YOU

The text 'THANK YOU' is written in a bold, dark blue, sans-serif font. Below the text is a thick, light blue wavy line that starts under the 'T', goes down, then up and over the 'A', 'N', 'K', and 'Y', then down and over the 'O', and finally curls up at the end.