

SECURE ACT Update: Coverage and Plan Participation for Long-Term Part-Time Employees

Signed into law on December 20, 2019 as part of the Further Consolidated Appropriations Act, 2020, The Setting Every Community Up For Retirement Enhancement Act of 2019 (the "SECURE Act"), made sweeping changes to retirement plan rules. As part of our series of continuing updates on different aspects of the SECURE Act that may impact (or provide opportunities for) employers that sponsor retirement plans (with our earlier alerts in this series available [here](#), and [here](#)), this alert provides an overview of changes to rules related to the eligibility of long-term part-time employees to contribute to employer-sponsored 401(k) plans.

Part-Time Employee Participation in Non-Collectively Bargained 401(k) Plans

Under current rules, 401(k) Plans can condition eligibility to make pre-tax (and, where made available under a Plan, Roth)¹ contributions on completing a year of service during which 1,000 hours of service have been credited. Of course, eligibility can begin sooner, and many plans permit employees to make pre-tax or Roth contributions without having been credited with such a year of service (or a year of service based on elapsed time concepts that do not require a particular number of hours to have been completed). Some plans use a bifurcated approach – requiring a year of service (typically with 1,000 hours) for some employees, while allowing other employees to participate sooner, which is also permitted so long as applicable nondiscrimination rules are not violated. A plan can also require that employees have attained age 21 before they are eligible to participate (for any types of contributions).

Under Section 410(a) of the Internal Revenue Code of 1986, as amended (the "Code"), part-time employees cannot be excluded from a 401(k) plan as a class – because the Code's rules permitting a service requirement (of up to one year of service with 1,000 hours for 401(k) pre-tax and Roth contributions) provide for the maximum service requirement that can be required. Excluding part-timers is not permitted because a part-timer may have worked 1,000 hours in a measuring year and have satisfied the maximum permissible service requirement for pre-tax or Roth contribution eligibility. Similarly, the IRS has indicated that excluding employees based on other classifications that really relate to part-time status is not permissible – because if it is an exclusion based on how much an employee works, the year of service rule (not permitting a requirement to work more than 1,000 hours in a measuring year) generally is the only service-time-based exclusion that can be used.

For non-collectively bargained plans, the SECURE Act modifies the maximum service requirement that can be imposed by a 401(k) plan with regard to employee pre-tax (and, where applicable, Roth) contributions. Under the SECURE Act provision, a part-time employee will be required to be treated as having met a plan's service requirements for pre-tax (and, where applicable, Roth contributions) if the employee was credited with at least 500 hours of service in each of the previous three consecutive 12-month eligibility periods. Therefore, long-term part-time employees who never completed a year of service with 1,000 hours would be required to be able to make pre-tax (and, if applicable, Roth) contributions if they met that three-year/500 hour requirement, unless they were legitimately excluded from participation on another basis, unrelated to the number of hours of service they are credited with or the length of their

¹ Although not explicit in the SECURE Act, and guidance from the IRS has not yet been issued, we interpret these new requirements to apply in the context of eligibility to make designated Roth contributions generally in the same manner as they apply in the context of eligibility to make employee pre-tax contributions.

service.² It is still permissible, however, to require that an employee has attained age 21 before participation can begin.

While this provision is first effective in plan years commencing in 2021, it is noted that 12-month periods beginning prior to January 1, 2021 do not need to be considered when applying the three-year/500 hour rules for eligibility purposes – and that therefore, in practice, a plan could operate whereby eligibility for pre-tax or Roth contributions by long-term part-time employees (who had not been credited with 1,000 hours of service in a measuring year) does not actually start until 2024 (or for some employees, 2025).

401(k) plans are not required to permit employees who have worked fewer than two years with 1,000 hours of service (but with earlier participation required if vesting is not immediate, or for some safe harbor plan designs) to be eligible for employer contributions or to make non-Roth after-tax contributions, and those rules are not changed by the SECURE Act. But for vesting purposes, for part-time employees who have worked three consecutive years with 500 hours of service being credited in each of those years, those years will count toward vesting requirements, even if the plan would otherwise normally require 1,000 hours of service to be counted for vesting purposes. The IRS in September 2020 issued guidance indicating that for vesting purposes, even years commencing prior to 2021 during which a part-time employee completed 500 hours of service will need to be considered for vesting purposes (and therefore, where applicable, records regarding pre-2021 hours of service will also need to be considered). Under otherwise applicable vesting rules, only years of service prior to an employee's attaining age 18 (not age 21) can be excluded from consideration (if the plan so provides) for vesting purposes – that age limitation has not changed under the SECURE Act.

The employees who only participate in the plan because they met the three-year/500 hour requirement (where they would not otherwise have been eligible to make pre-tax or Roth contributions), could, but need not, be considered when applying various nondiscrimination tests that apply to 401(k) plans, including the nondiscrimination tests under Code Section 401(a)(4), as well as the Average Deferral Percentage (ADP) tests (that consider levels of pre-tax and Roth contributions) and the Average Contribution Percentage (ACP) tests (that consider levels of employer matching and employee after-tax contributions). Accordingly, nondiscrimination tests will not be failed on account of their exclusion from employer contributions (nonelective or matching) or from the ability to make non-Roth after-tax contributions. Those same employees can also be excluded from eligibility for employer (matching or non-elective) safe harbor employer contributions without the plan losing its 401(k) safe harbor status. They can also be excluded from top-heavy benefit and vesting requirements.

Plan Amendment Deadlines

The SECURE Act provides a remedial period and deadline by which plans must adopt plan amendments to reflect changes made or permitted by the Act. While plan operations must change starting on the effective date of each relevant provision, conforming plan amendments (retroactive to the first day as of which the new rules apply) will not be required to be adopted any earlier than the last day of the first plan year beginning on or after January 1, 2022 (or the last day of the first plan year beginning on or after January 1, 2024 for certain collectively bargained and governmental plans). However, we note that it is not completely clear whether the 2022 amendment deadline would apply to a plan for which participation by long-term part-time employees would not start before January 1, 2024.

² Note that this new rule for 401(k) plans is different from the universal availability rule that applies with regard to employee pre-tax and Roth contributions to 403(b) plans. Under the 403(b) universal availability rule, which was not modified by the SECURE Act, a 403(b) plan can still generally require that an employee who normally works fewer than 20 hours per week (generally – an employee who is not expected to work 1,000 hours or more in the first 12 months of employment), to complete a measuring year of service having been credited with 1,000 hours of service before being required to be eligible to make pre-tax (and, where applicable, Roth) contributions, but most other non-service-related eligibility exclusions are not permitted to apply. 401(k) plans have more flexibility with regard to non-service-related eligibility rules, and generally can exclude groups of employees based on criteria not related to hours or length of service, so long as applicable coverage and nondiscrimination requirements are met.

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