

Why 401(k) Plan Sponsors Need to Start Tracking Part-Time Employees' Hours

The passage of the SECURE Act 2.0 brought about a number of changes to employer-sponsored retirement plans. One particular change that started this year, will allow long-term, part-time employees to make 401(k) deferral contributions. While the change does not come into effect for a couple of years, employers that apply an eligibility service requirement to determine whether employees can contribute to a 401(k) plan must have begun tracking hours of service for part-time employees beginning January 1, 2021.

With the change in the SECURE Act, employers will have a choice to keep the current participation requirements or expand the requirements to allow the participant of part-time employees in the deferral process.

Currently, eligibility for participation in most 401(k) plans is limited to employees who are at least 21 years of age, have completed one year of service and worked at least 1,000 hours within that year. There are instances where a plan sponsor may change the age and/or hours of service requirement, or even forgo any conditions. With the change in the SECURE Act, passed in 2020, employers have a choice to keep the current participation requirements or expand the requirements to allow the participation of part-time employees in the deferral process.

Eligibility Rules Change

The SECURE Act amended the Internal Revenue Code to prohibit 401(k) plans from excluding long-term, part-time employees who complete at least 500 hours of service for three consecutive 12-month periods and are at least 21 years of age at the end of said 36-month period. The SECURE Act 2.0 amends the 36-month wait period to 24 months after 2024.

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If a part-time employee meets these new conditions, they are eligible to make elective deferral contributions to their employer's 401(k) plan. It's important to note that the plan can still exclude them from receiving employer contributions until they have met the typical 1,000 hours of service eligibility requirement. The plan may also omit the part-time employees from minimum coverage and nondiscrimination testing, contributions made to satisfy actual deferral percentage (ADP) and actual contribution percentage (ACP) safe harbor plan designs, and the top-heavy rules.

If a plan sponsor provides employer contributions to the part-time employees, each 12-month period where the part-time employee has attained at least 500 hours of service will be treated as one year of service for purposes of the plan's vesting schedule. All years of service with the employer, except when a participant is under the age of 18, must be taken into account for purposes of calculating the part-time employee's vesting schedule.

To be prepared for the changes outlined above, plan sponsors may want to review their current plan documents to understand how the changes may effect them. Sponsors should also consider whether any plan design changes are required to comply with the new rule. This also creates an opportunity to review whether the plan sponsor is happy with their current plan or may want to look at some alternatives. Perhaps the most important step is for a plan sponsor to explore options to implement a system to track employees' hours of service. Taking steps now to track hours of service for the next two years can help minimize any issues that may arise come January 1, 2025.

The SECURE Act 2.0 will also create a database that can be searched to help people locate their retirement plan contributions that they may have lost track of over the years. The Department of Labor (DOL) will be in charge of the database, which according to the DOL should be operational before the end of 2024.

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