April 23, 2024

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Benefits Tax Counsel
Department of the Treasury
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Ms. Rachel Leiser Levy
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Ms. Kara Soderstrom
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Re: Proposed Regulations Related to Long-Term, Part-Time Employee Rules for Cash or Deferred Arrangements Under Section 401(k) [REG 104194-23]

Dear Mses. Morrison, Levy, and Soderstrom:

The American Institute of CPAs (AICPA) appreciates the efforts of the Department of the Treasury ("Treasury") and the Internal Revenue Service (IRS) to address the need for guidance related to the changes made to long-term, part-time (LTPT) employee rules as enacted in The Setting Every Community Up for Retirement Enhancement Act of 2019, signed into law on December 20, 2019 (SECURE Act), as modified by SECURE 2.0 Act of 2022 (SECURE 2.0), signed into law on December 29, 2022, as part of the Consolidated Appropriations Act of 2023.[1]

On November 27, 2023, Treasury and the IRS issued proposed regulations [REG-104194-23] related to the changes to LTPT employees made by SECURE 2.0. This letter addresses the following areas related to the proposed regulations:

I. Application Date of the Proposed Regulations and Limited Nonenforcement Period.

II. Vesting Requirements for Former Long-Term, Part-Time Employees

III. Conditions that Constitute a Proxy for Imposing an Age or Service Requirement – No Intention to Modify Application of Treasury Regulation § 1.410(a)-3(d)

Background

Section 410(a)[2] of the Internal Revenue Code (IRC) sets forth the minimum age and service requirements applicable to participate in employer-provided, tax-qualified retirement plans.

[1] P.L. 117-328.
[2] Unless otherwise indicated, hereinafter, all section references are to the Internal Revenue Code of 1986, as amended, or to the Treasury Regulations promulgated thereunder.

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Under section 410(a), a plan is generally not permitted to require a newly hired employee to complete more than one year of service to become eligible to participate in the employer's qualified retirement plan. This rule applies to employees otherwise eligible to participate under the terms of the plan. An employer is permitted to design its plan to include and exclude certain classifications of employees. However, an employee hired into an eligible classification must be allowed to participate in the plan upon completion of one year of service. Under section 410(a) and the applicable regulations, an employee is credited with one year of service if 1,000 hours of service are completed during a one-year period. Although the rules do not permit an employer to require completion of more than one year of service, an employer is permitted to allow newly hired, otherwise eligible employees to participate in the retirement plan immediately, or to impose a lesser initial service requirement.

The minimum participation requirements of section 410(a) created conditions resulting in part-time employees working for many years with the same employer never becoming eligible to participate in the employer's retirement plan. To remedy this inequity, Congress enacted the LTPT employee rules in Section 112 of the SECURE Act. Under these rules, an individual with three consecutive years of certain part time service must be allowed to participate in the salary deferral feature of an employer's plan. To be considered to have one year of part-time service, the SECURE Act required that the individual complete at least 500 hours of service. The SECURE Act further provided that part time service for initial participation was not required to be counted until 2021. Therefore, the earliest date that an individual would begin participating in the employer's retirement plan under the LTPT employee rules was January 1, 2024.

SECURE 2.0 modified the LTPT employee rules by reducing the number of required consecutive years of part-time service from three to two. Service for the two-year provision was not required to be counted until 2023. Therefore, the earliest date that an individual could begin participating in the employer's retirement plan under the rules as modified by SECURE 2.0 is January 1, 2025.

I. Application Date of the Proposed Regulations and Limited Nonenforcement Period

Overview

The LTPT employee rules did not replace the existing rules governing eligibility for plans. However, they created an alternative way for employees to begin participating in employer-provided plans. Accordingly, plan sponsors required guidance to determine whether the LTPT employee rules apply in their circumstances, and if so, how to comply with them. In response, on November 27, 2023, the IRS published proposed regulations. Since the proposed regulations were effective on January 1, 2024, plan sponsors had little time to analyze them to determine the extent to which the requirements apply to them, and to take the necessary actions to comply. Noncompliance with the rules could result in an operational plan failure, thus disqualifying the plan.

The proposed regulations define the term "long-term, part-time employee" as an employee who is eligible to participate in the plan **solely** by reason of having completed two consecutive 12-

month periods during each of which the employee is credited with at least 500 hours of service, and has attained the age specified in section 410(a)(1)(A)(i) (i.e., age 21) by the close of the last of the two consecutive twelve month periods during which the employee has completed at least 500 hours of service.[3] The various examples in the proposed regulation illustrate that if an individual becomes eligible other than by completing 500 hours of service in each of two consecutive years, that individual is not considered a LTPT employee under the proposed regulations.[4] In addition, under the proposed regulations, an individual's status as a LTPT employee, and the requirements related to such status is permanent for plan years beginning on or after January 1, 2024.

Recommendation

The AICPA recommends that Treasury and the IRS issue final regulations providing relief related to the implementation of the application date of the proposed regulations, including providing a non-enforcement period until the changes to the requirements for LTPT employees made by SECURE 2.0 are effective on January 1, 2025, or if later, the date that the proposed regulations become final.

Analysis

The SECURE Act, as amended by SECURE 2.0, made significant changes to the plan eligibility criteria that plan sponsors have become accustomed to administering with their payroll and recordkeeper service providers. Plan sponsors, employers, and recordkeepers required the issuance of guidance from Treasury and the IRS to implement the new rules, including aligning any mandates with their corporate mission. Additionally, plan sponsors must work closely with their recordkeepers to implement the changes to employee eligibility and determine additional services they may need to ensure proper administration protocols are adopted. Employers awaited guidance to assist with planning the amendment of plan terms and related participant communication and to analyze corporate budgets to determine how to incorporate employer contributions. Recordkeepers also required guidance before determining whether they would provide relevant services including implementing policies and protocols for this complex mandate, which includes internal processes that are not completed by service providers. These significant changes coupled with the intricacies of the interaction of plan sponsors, employers, and recordkeepers required time to implement once guidance was received.

Failure to comply with the requirements would lead to a plan qualification failure. Plan qualification failures can be corrected under the Employee Plans Compliance Resolution System (EPCRS), thereby avoiding plan disqualification. However, correction under the EPCRS for relief from failure to timely implement the proposed regulations saddles employers with the time and expense for correction at a time when they are incorporating a major plan change.

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[3] Proposed Reg. § 1.401(k)-5(b)(1)(i).

[4] Proposed Reg. 1.401(k)-5(b)(2). See Example 1 (plan allows employees to make a cash or deferred election as soon as administrative practical after the employee's employment commencement date); Example 2 (employees are eligible to begin participating after completing one twelve month period in which the employee has worked at least 500 hours of service); and Example 4 (plan requires an employee to complete a one year period of service under the elapsed time method in order to be eligible to make a cash or deferred election).

In addition to the compliance burdens, the proposed regulations also provide plan sponsors with opportunities to re-evaluate plan designs to avoid complying with the LTPT employee requirements. Under the proposed regulations, once an individual becomes an LTPT employee, the status is permanent, meaning that the employer is forever required to apply the rules to the employee. As a result of the new rules, an employer may prefer to avoid an additional layer of administrative complexity, and apply different, and potentially more generous participation requirements to newly hired employees. The proposed regulations, as currently drafted, could lock employers with certain plan designs into a requirement to permanently monitor compliance with the parallel set of requirements that apply to individuals who qualify as LTPT employees under the proposed regulations. A one-year non-enforcement period will allow employers the opportunity to evaluate their plans and determine how to best address LTPT employees.

II. Vesting Requirements for Former Long-Term, Part-Time Employees

Overview

The proposed regulations create a vesting schedule for a LTPT employee that is different from the vesting schedule applicable to plan participants who become eligible under the traditional eligibility requirements. Under the proposed regulations, once an individual qualifies as a LTPT employee the vesting schedule would be permanently applicable to that participant. As such, a plan with a LTPT employee who later satisfies the eligibility requirements under the non-LTPT employee eligibility rules (referred to as a "former" LTPT employee) would continue to be required to be credited with a year of service for vesting purposes upon completing 500 hours in a plan year while other plan participants who never qualified as LTPT employees must work at least 1,000 hours during a year in order to be credited for a year of service.

Recommendation

The AICPA recommends that Treasury and the IRS issue final regulations stating that an individual is no longer a LTPT employee once they are credited with 1,000 hours of service in any subsequent plan year.

Analysis

Many plan sponsors utilize a vesting schedule to reward employees who are employed with the same employer on a long-term basis. In these cases, employees are rewarded for their efforts towards the employer's success which allows the employer to make profit sharing and matching contributions for those eligible employees.

The proposed regulations grant any employee who, at any time qualified as an LTPT, an easier path toward becoming vested than an employee who never qualified as an LTPT employee, but who also worked long-term for the same employer. The employee who qualified as an LTPT employee would not be required to be credited with more than 500 hours of service in a year to gain a year of service for vesting purposes, but a similarly situated employee who never qualified as an LTPT employee would still be required to complete 1,000 hours of service for this same amount of vesting credit. Additionally, an employer that encouraged full time and

long-term employment through employer profit sharing contributions could feel compelled to limit employer contributions to traditional entry participants, to keep their retention strategy message consistent.

An employer is not required to allow LTPT employees to participate in employer contributions and can avoid the dichotomy in worker vesting created by the proposed regulations by choosing to not offer employer contributions to LTPT employees, which is contrary to the foundational goal of the SECURE Act and SECURE 2.0., to increase access to retirement income to all American workers. By issuing final regulations which provide that an individual is no longer considered a LTPT employee once the individual is credited with 1,000 hours of service in any subsequent plan year, the plan could apply the same vesting schedule to similarly situated employees.

III. Conditions that Constitute a Proxy for Imposing an Age or Service Requirement – No Intention to Modify Application of Treasury Regulation § 1.410(a)-3(d)

Overview

The minimum participation rules of section 410(a) allow an employer to require a newly hired employee, who is eligible to participate in the employer's retirement plan, to be part of a covered class of employees. However, Treas. Reg. § 1.410(a)-3(d) permits an employer to design its plan to exclude certain categories of employees from participating provided that the employer's decision regarding excluded categories of employees does not result in a disguised age and service requirement not permitted by section 410(a) but does satisfy certain nondiscrimination testing. The proposed regulations incorporate this concept to determine the eligibility of LTPT employees.

Recommendation

The AICPA recommends that Treasury and the IRS provide final regulations which clarify that the reference to employee exclusion categories is not intended to modify the application of Treas. Reg. § 1.410(a)-3(d) as it relates to the proposed regulations.

Analysis

Proposed Reg. § 410(k)-(5)(c)(3) refers to an employer's ability to exclude certain classifications of employees as a parenthetical to the relevance of a proxy for an age or service criteria that would be prohibited under the proposed regulations. While the examples in the proposed regulations use "part time" employees as the definition for exclusion, clarification that the regulations which guide plan design under Treas. Reg. § 1.410(a)-3(d) are not intended to be modified is requested.

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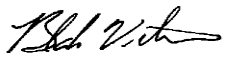
We appreciate your consideration of these comments and welcome the opportunity to discuss them further. If you have any questions, please contact Tom Pevarnik, Chair, AICPA Employee Benefits Taxation Technical Resource Panel, at (202) 879-5314, or tpevarnik@deloitte.com; Kristin Esposito, AICPA Director – Tax Policy & Advocacy, at (202) 434-9241, or kristin.esposito@aicpa-cima.com; or me, at (830) 372-9692, or bvickers@alamo-group.com.

Sincerely,



Blake Vickers, CPA, CGMA
Chair, AICPA Tax Executive Committee

cc: Ms. Laura Warshawsky, Deputy Associate Chief Counsel, Internal Revenue Service