Retirement Plan Eligibility
Workshop 25
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Recurring Issues
1. Plan uses elapsed time for eligibility; Employer wants to exclude part-time or seasonal employees who come back each year
2. Company with foreign parent; Employees transfer back and forth from HQ
3. Eligibility for re-hired employees

What’s New – SECURE ACT
Beginning in 2021, employees working 500 or more hours in 3 consecutive years must be eligible to make 401(k) deferrals (more later)
Who Can Participate?
1. Employees
2. Leased Employees?
3. NOT Independent Contractors

Who Can Participate – Employees, California

To classify workers as Independent Contractors, employer must show worker:

• Is free from company control and direction, practically and by contract;
• Performs work that is outside usual course of company's business; and,
• Is customarily engaged in an independently established trade, occupation or business of the same nature as work performed for the company

AB 5; California Labor Code section 2570.3

Who Can Participate – Employees, California

New law applies for:

• Workers comp
• Unemployment insurance
• Reimbursement of expenses
• Wage statements
• Retirement and other benefit plans? [federal law]
**Who Can Participate – Employees, California**

The new law has **LOADS of exemptions** – of course, lawyers are exempt

**Basic Eligibility Rules**

1. **Maximum requirements**
   - Age 21
   - 1 Year of Service, or 2 Years of Service with full vesting (BUT 2-year rule cannot be used for 401(k) deferrals)
   - New SECURE Act rule (see next slide)

   Plan can provide more liberal eligibility, but requirements cannot be greater

2. **Long-Term Employees – SECURE Act**
   - Effective for plan years beginning after December 31, 2020
   - Employees who work 3 consecutive 12-month periods and complete at least 500 hours in each period must be eligible to make 401(k) deferrals
   - Must meet any plan age requirement by end of last 12-month period
   - Employer nonelective or matching contributions not required (including safe harbor)
Basic Eligibility Rules

2. Long-Term Employees – SECURE Act
   E. May exclude these employees for nondiscrimination, ADP/ACP, and coverage testing
   F. No top-heavy contributions
   G. Requirements do not apply to employees covered under a collective bargaining agreement
   H. Entry date rules are the same as for other employees and eligibility computation periods are determined the same way

Basic Eligibility Rules

3. Year of Service
   A. 1,000 Hours of Service in a 12-month Eligibility Computation Period
      i. All service with Employer/Controlled Group is counted
      ii. Hour of Service – paid for performance of duties; up to 501 hours for PTO, back pay awarded or agreed to
   B. Eligibility Computation Period
      i. 12 month period beginning with date of hire
      ii. May shift to plan year after 1st year

Basic Eligibility Rules

3. Year of Service
   C. Counting Hours
      i. Actual hours worked (e.g., time card) – may not work for salaried/professionals
      ii. Equivalency
         - Day = 10 hours
         - Week = 45 hours
         - Semi-Monthly Payroll = 95 hours
         - Month = 190 hours
Basic Eligibility Rules

3. Year of Service
   C. Counting Hours
      iii. Elapsed Time – Just like it sounds
         • Beware of service spanning rule
         • Easy; no time cards or tracking hours
         • BUT: this will make it easier for part timers to become eligible

Basic Eligibility Rules

4. Entry Dates
   A. January 1 and July 1
   B. Can be more generous
   C. Follow plan terms
   D. Remember that a YOS is 1,000 hours in a 12-month computation period – employees don’t enter in the middle of a year after completing 1,000 hours.

Basic Eligibility Rules

4. Entry Dates – Auto Enrollment
   A. 30 day advance notice
   B. What does the plan say?
   C. EACA – Refund available 90 days from first deferral
   D. QACA – Auto-enrolled participants must enter plan not later than the earlier of –
      • The pay date for the 2nd payroll period beginning after notice is provided; or
      • 1st pay date that is at least 30 days after notice is provided
Excluding Classes of Employees

1. Minimum Coverage Testing
   A. Ratio Percentage Test
   B. Average Benefit Percentage Test
   C. Aggregation/Disaggregation Rules

2. Minimum Coverage Testing - Employees Taken Into Account
   A. If Plan applies minimum age and service, can exclude employees who have not met requirements
   B. If Plan is more generous than age 21 and 1 Year of Service, can separately test “otherwise excluded employees”

3. Minimum Coverage Testing – Excluded Classes
   A. Union employees
   B. Leased Employees?
   C. Nonresident aliens with no US source income
   D. Separate Lines of Business
Excluding Classes of Employees

3. Minimum Coverage Testing – Excluded Classes

What is a nonresident alien with no US source income?
Complex area – tax and immigration law

General guidance –
• Aliens (not U.S. citizens);
• Nonresidents under Code section 7701(b)(1)(B); and
• Have no U.S. source income under Code section 861(a)(3)

Excluding Classes of Employees

3. Minimum Coverage Testing – Excluded Classes

Nonresident –
• Not lawfully admitted to U.S. for permanent residence;
• Does not have “substantial presence” in the U.S.; and
• Has not made a “first year election”

Excluding Classes of Employees

3. Minimum Coverage Testing – Excluded Classes

U.S. Source Income –
• Any salary, wages or other compensation for personal services rendered while in the U.S.
• Income exempt from U.S. income tax by treaty is not U.S. source income
Excluding Classes of Employees
3. Minimum Coverage Testing – Excluded Classes
   A. Plan provisions that effectively impose additional age or service requirements are impermissible
   • Plan covers employees in Division 2. Before you can work in Division 2, you must work 5 years in Division 1. Impermissible.
   • Must have driver’s license for 15 years before you can participate – disguised age requirement.
   • Plan excludes employees who are regularly scheduled to work 20 hours or less per week. Not permitted because employee could complete 1,000 hours in 12 months

Excluding Classes of Employees
3. Minimum Coverage Testing – Excluded Classes
   B. Must pass testing taking excluded employees into account

Excluding Classes of Employees
3. Minimum Coverage Testing – Excluded Classes
   C. Job Classifications
   i. Average Benefits Test
      • Classification must be reasonable
      • Nondiscriminatory
      • Hourly/Salaried classifications permitted
Excluding Classes of Employees
3. Minimum Coverage Testing – Excluded Classes
   C. Job Classifications
      ii. Definite written program
         • Communicated to employees?
         • Understandable?
         • Does Employer exercise discretion?
         • Classifications included in Employee Handbook?

Excluding Classes of Employees
3. Minimum Coverage Testing – Excluded Classes
   C. Job Classifications
      iii. Part-time employees
         • Can’t define as “part-time” – refers to hours worked/service
         • 1994 IRS Field Directive – scrutinize plan language
         • Later reversed – review in audit; no reliance on FDL
         • QAB 2006-3 – closely scrutinize classifications; plan must clearly define
         • Exclusions can be challenged in audit

Excluding Classes of Employees
3. Minimum Coverage Testing – Excluded Classes
   C. Job Classifications
      iv. Other
         • Casual employees (not related to length of service)
         • Reclassified employees – Microsoft
         • “Special Assignment Employees” – approved in IRS TAM
         • On-call employees
         • Interns
Excluding Classes of Employees

3. Minimum Coverage Testing – Excluded Classes
   C. Job Classifications
      v. SECURE Act – May not be able to exclude from making 401(k) deferrals

Re-Hired Employees

1. No Break In Service
   A. Satisfied minimum age and service and entered plan – Participate immediately on re-hire
   B. Satisfied minimum age and service; terminated before entry date – Participate immediately on re-hire (or original entry date, if later)
   C. Satisfied minimum service; did not enter plan due to age – Participate immediately on re-hire or upon reaching minimum age
   D. Did not satisfy minimum service – Entry date following satisfaction of eligibility requirements

2. Break In Service Rules
   A. Must count all Years of Service unless service can be disregarded under break in service rule
   B. Break in service rules must be written in the plan
Re-Hired Employees

2. Break In Service Rules
   C. What is a break in service?
      i. 12 month period where employee does not perform more than 500 hours of service
      ii. Must credit –
          • Paid vacation, holiday, sick, layoff, jury duty, military duty, leave, up to 501 hours
          • Unpaid maternity/paternity
          • Not Workers Comp, Unemployment Comp, or Disability Insurance

Re-Hired Employees

2. Break In Service Rules
   D. Rules for disregarding Service
      i. Two-year eligibility
      ii. One year holdout
      iii. Rule of parity

401(k) Safe Harbor Plans

1. Can Employer/Controlled Group have a Safe Harbor and a Non-Safe Harbor Plan?
   A. Don’t all employees have to be covered in 401(k) safe harbor plan?
   B. Plans must pass coverage testing
   C. No aggregation
Correcting Plan Eligibility Errors

1. Revenue Procedure 2019-19
   A. Self Correction Program
   B. Voluntary Correction Program
   C. Audit CAP

2. Correction Methods
   A. Early inclusion
      i. Employee did not complete age/service requirements or began participating before entry date
      ii. Retroactively amend plan to conform to operation – Appendix B.07(4)
         • Only the ineligible employees who were allowed to participate
         • Must satisfy other qualification requirements
         • Affected employees must be predominantly NHCEs

   B. Profit Sharing – Eligible Employees Excluded
      i. Contribution correction method
      ii. Reallocation correction method
Correcting Plan Eligibility Errors

2. Correction Methods

C. Deferrals – Eligible Employees Excluded
   i. Missed deferral – actual deferral percentage for employee’s group (HCE or NHCE)
   ii. QNEC = 50% missed deferral
   iii. 100% match
   iv. Earnings

D. Deferrals – Failure to implement deferral election
   i. Missed deferral percentage or amount
   ii. QNEC = 50% missed deferral
   iii. 100% match
   iv. Earnings
   v. If discover and correct within 3 months – No QNEC
   vi. If discover and correct within SCP correction period – 25% QNEC

E. Deferrals – Auto-enrollment failures
   i. Start deferrals and give notice within 9-1/2 months after plan year end – No QNEC required
   ii. Must contribute missed match
Questions?
Thank you for coming!

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