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IRS Issues New Guidance Regarding Part-Time Employee Exclusions

The IRS has issued a new internal bulletin dealing with plan exclusions of part-time, temporary, and seasonal employees.

Treasury Regulation Section 1.410(a)-3 notes that while a plan can impose other eligibility requirements, the maximum service requirement a plan can impose is one year of service. The regulation explains that a clause excluding part-time employees whose “customary employment is for not more than 20 hours per week” is an impermissible service requirement.

The recently issued Employee Plans Determinations Quality Assurance Bulletin (QAB) changes the way document examiners look at plan clauses that restrict employee eligibility.

The QAB instructs document examiners (or “specialists”) to “take note that the issue of whether a plan is providing a direct or indirect service requirement is not limited to part-time or seasonal employees. Any exclusion classification, whether it be part-time, seasonal, temporary, or any other classification of employees, should be closely scrutinized. Specialists should require that any such classification be clearly defined.”

However, specialists are not to challenge an exclusion classification that is defined without reference to hours of service. The QAB indicates that a plan may exclude part-time employees as long as the employer designs the provision in such a way that there is no possibility of indirectly imposing an hour of service requirement in excess of the Code Section 410(a)(1) statutory maximum.

The QAB warns that improperly drafted clauses dealing with part-time employees may be disqualifying, regardless of whether the plan has a determination letter.

- If a plan received a determination letter *after June 30, 2001*, the plan sponsor cannot rely on the letter to protect the plan regarding this issue.
- If the determination letter is dated *before July 1, 2001*, then the letter should protect the plan from retroactive disqualification.

One design option that can exclude most, if not all, part-time employees from a plan that provides immediate eligibility or an eligibility service requirement of under a year is to impose a year of service requirement for part-time employees (*i.e.*, require completion of at least 1,000 hours of service in an employment year). While this feature would have to be tested for non-discrimination, it would only be problematic if part-time employees comprise a large percentage of an employee workforce.

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