AMERICAN RETIREMENT ASSOCIATION

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Working for America's Retirement

November 29, 2023

Internal Revenue Service
Attn: CC:PA:01:PR (REG-104194-23)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

**SUBMITTED VIA EMAIL**

RE: Request for Relief related to Prop. Treas. Reg. 1.401(k)-5, Long-Term, Part-Time Employee Rules for Cash or Deferred Arrangements Under Section 401(k)

The American Retirement Association ("ARA") is writing in response to the Notice of Proposed Rulemaking regarding long-term, part-time employee ("LTPTE") rules for cash or deferred arrangements under section 401(k) (the "Proposed Regulation"). While ARA is thankful for the issuance of guidance on LTPTE rules, the timing of the Proposed Regulation makes administrative relief absolutely essential. Therefore, ARA respectfully requests that the Internal Revenue Service ("IRS" or the "Service") announce administrative relief as soon as possible.

ARA is the coordinating entity for its five underlying affiliate organizations representing the full spectrum of America's private retirement system, the American Society of Pension Professionals and Actuaries ("ASPPA"), the National Association of Plan Advisors ("NAPA"), the National Tax-Deferred Savings Association ("NTSA"), the American Society of Enrolled Actuaries ("ASEA"), and the Plan Sponsor Council of America ("PSCA"). ARA's members include organizations of all sizes and industries across the nation who sponsor and/or support retirement saving plans and are dedicated to expanding on the success of employer-sponsored plans. In addition, ARA has over 35,000 individual members who provide consulting and administrative services to sponsors of retirement plans. ARA's members are diverse but united in their common dedication to the success of America's private retirement system.

## Summary

IRS should issue immediate administrative relief in the form of a delay of the application and enforcement of the LTPTE rules because:

- The interpretation of the vesting rule creates irreversible administrative complexities if the plan uses the LTPTE service rule;
- Participants have entered the plan as LTPTEs in 2023 and therefore the rule has retroactive consequences that cannot be reversed; and
- Plan sponsors that would have LTPTEs entering for the first time in 2024 do not have sufficient time to respond by adjusting plan design to avoid the irreversible administrative complexities introduced by the Proposed Regulation.

It is unreasonable and unprincipled to provide fewer than 25 working days for plan sponsors to work with service providers to understand the complex implications of the Proposed Regulation and then make appropriate plan design changes. Furthermore, for some non-calendar years, it may be too late to avoid the application of the vesting rules because LTPTEs may have entered the plan in 2023. Therefore, the IRS should announce administrative relief immediately.

## Discussion

Immediate administrative transition relief from the LTPTE rules is essential. While the LTPTE rules were initially enacted in 2019, there were a host of unanswered questions that have a meaningful impact on plan design. The Proposed Regulation answers a number of those questions, but does not provide sufficient time for plan sponsors to analyze and adjust plan design in response to the guidance, which in some cases is essentially effective retroactively as illustrated below.

## 1. The Vesting Rule Has Irreversible Consequences

Code section 401(k)(15)(B)(ii) is one of the more ambiguous provisions related to LTPTEs. The statute provides that an individual participating in the plan solely as an LTPTE will vest in employer contributions for each 12-month period for which the employee has at least 500 hours of service. In addition, the statute indicates such rule will continue to apply even after the LTPTE becomes a full-time employee. For nearly four years industry practitioners have been debating what this provision would mean. It was commonly thought that vesting service under the 500-hour rule would be earned only if LTPTEs were provided employer contributions while an LTPTE. It also was commonly thought that the continuation provision would mean only that former LTPTEs would not lose years of vesting, if any, earned under the 500-hour rule upon becoming a full-time employee and thereafter would accrue vesting service under the normal 1000-hour rule. These both were reasonable interpretations of the law, which have guided advice for plan sponsors until the Proposed Regulation was issued.

The Proposed Regulation, however, takes a different tact; one which creates irreversible consequences for plan sponsors. Under the Proposed Regulation, an LTPTE will earn vesting service using the 500-hour rule, even if they do not receive any employer contributions while an LTPTE, and further that such an employee must continue to earn years of vesting service under the 500-hour rule after ceasing to be an LTPTE for any reason. This means that if anyone enters the plan as an LTPTE the plan must track special vesting for potentially the participant’s entire duration of employment with that employer, even if the plan were to be subsequently amended to allow immediate eligibility for all participants.

This interpretation adds significant administrative complexities to a plan that uses the LTPTE service requirement, which cannot be alleviated simply by redesigning the plan after an employee has entered the plan as an LTPTE. Thus, in order for plan sponsors to retain a simple plan design (which promotes correct plan administration) the sponsor will have to redesign the plan before any LTPTEs enter the plan. If the plan has a single employee enter as an LTPTE, it will have administrative complexities for the foreseeable future. Thus, it is critical for the IRS to give plan sponsors sufficient time to analyze and design their plans in order to maintain a design that promotes correct administration. As further explained below, without administrative relief, that is impossible in some cases and impractical in most cases.

## 2. LTPTE Rules Are Already Effective For Some Plans

Although the Proposed Regulation suggests that the LTPTE rules are not effective until 2024, the rules are actually effective in 2023 for certain plans, as detailed below. This outcome had been speculated, but was only confirmed upon issuance of the Proposed Regulation. Thus, rules impacting LTPTEs have a retroactive effect for certain plans.

It is extremely common for 401(k) plans to switch from an anniversary year computation period to a plan year computation period for eligibility determinations. A plan that uses a plan-year switch for eligibility computation periods could have LTPTEs entering during 2023 if it is a non-calendar year plan.

> Ex: A plan uses a July 1 – June 30 plan year. Employee A is hired January 2, 2021, and works 600 hours per year. Employee A's initial eligibility computation period is Jan. 2, 2021, to Jan. 1, 2022. If the plan uses the plan-year switch, then the second computation period is Jul. 1, 2021, to Jun. 30, 2022, and the third computation period is Jul. 1, 2022, to Jun. 30, 2023. Thus, the employee meets the definition of an LTPTE on Jun. 30, 2023, and the employee must be eligible to defer on July 1, 2023.

Ideally, to avoid this 2023 entry, the plan would need to use anniversary dates for LTPTE eligibility. However, the applicable Department of Labor regulations indicate the plan may choose either to count service based on anniversary date or switch to the plan year. It does not contemplate that plans may choose to use different methods for different classes of employees. Nothing in the Proposed Regulation changes this result. Thus, assuming the plan uses the plan year switch for full-time employees, it appears to be required to use the same method for LTPTEs, in which case the plan already had LTPTE entrants before the Proposed Regulation was ever issued.

As a result, the irreversible vesting rules contained in the Proposed Regulation would already be applicable to the plan—giving the plan sponsor absolutely no time to respond to the Proposed Regulation. Regardless of whether this is technically contrary to Code section 7805(b), it would be appropriate for relief to be provided in a manner no less favorable than the relief that would be provided under Code section 7805(b).

## 3. Insufficient Time For Plan Sponsors to Respond

While the Proposed Regulation may already affect some non-calendar year plans, the vast majority of plans are calendar year plans. For these plans, LTPTEs will first be eligible for entry on January 1, 2024. This is a mere 25 working days after the Proposed Regulation was issued—and covers one of the most common periods of the year during which employees are out of the office. This amount of time is woefully inadequate for practitioners and plan sponsors to respond to the Proposed Regulation.

While the LTPTE provision has been in Code Section 401(k) for nearly four years, the Proposed Regulation takes a significantly different approach than many practitioners were expecting—particularly with regard to the Proposed Regulation's interpretation of vesting. As a result, many plan sponsors have not been designing their plans with these rules in mind. Practically, in order for plan sponsors to respond to the Proposed Regulation by January 1, service providers (primarily TPAs and recordkeepers) will have to complete all of the following steps:

- Identify clients who have service requirements impacted by the LTPTE rules;
- Develop explanations of the Proposed Regulation for those plan sponsors, likely including examples to illustrate the complex issues involved;
- Contact plan sponsors on an individual basis because the ramifications of the Proposed Regulation will differ significantly depending on the plan design and plan demographics;
- Analyze potential impacts of the Proposed Regulation for plan sponsors on an individualized basis, including potential impacts on employer contributions, top heavy exemptions, future vesting, and cost of forfeitures;
- Meet at least once more with each impacted plan sponsor to explain the actual impacts of the Proposed Regulation and communicate options and recommendations on plan design;
- Obtain the plan sponsors' elections regarding how to respond to the Proposed Regulation;
- Program each plan sponsors' plan design decision into the recordkeeping and payroll systems;

- Communicate the new plan design to eligible participants, including newly eligible employees, and obtain enrollment information; and
- Prepare and distribute any required notices, such as updated safe harbor notices.

It is impossible for plan service providers to complete all these steps for all impacted plan sponsors prior to January 1, 2024.

## Conclusion

Plan Sponsors must be given adequate time to understand the Proposed Regulation, design their plans in response to the regulation, and adjust administrative programming. It is unconscionable to apply the Proposed Regulation to plan sponsors effective January 1, 2024, when it creates irreversible (and, in some cases essentially retroactive) impacts and fails to give plan sponsors sufficient time to respond by designing their plans to simplify plan administration. The IRS should issue immediate guidance that administrative relief will be applicable for all of 2024, plan sponsors will not be penalized for failure to enroll LTPTEs, and the vesting rules of the Proposed Regulation will apply only to individuals who are participating as LTPTEs on or after January 1, 2025.

This guidance is necessary to promote sound tax administration by clarifying administration, supporting flexibility in plan design, and improving economic efficiency by reducing the complexity and burdens of the plan sponsor.

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These comments are submitted on behalf of ARA. If you have any questions regarding the matters discussed herein, please contact Kelsey N.H. Mayo, Director of Regulatory Policy, at kmayo@usaretirement.org or 704-342-5307. Thank you for your time and consideration.

Sincerely,

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