Retirement Plans for Part-Time, Seasonal and Hourly Employees: The Song Remains the Same

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I. Retirement Plans: The Song Remains the Same

Nothing about employee benefits is uncomplicated. That's a given. However, there can be different varieties of complication, which can be of great interest to benefits practitioners. From an HR manager's perspective, though, it really doesn't matter why her head hurts. She just knows that it hurts and wishes her headache would go away.

The difference between dealing with part-time, variable-hour and seasonal employees in healthcare plans covered by the ACA, as opposed to retirement plans, is an example of two very different kinds of complication. Think of retirement plan regulation in this area as the old IBM mainframe, and the healthcare compliance requirements of the ACA as the latest smartphone. Both are complex, but one has a lot of new bells and whistles.

The analogy makes some sense if one has the luxury of time to think about it. Everyone agrees that the healthcare system in the United States before the passage of the ACA had problems. Costs had been increasing well above the rate of inflation for decades, and outcomes in terms of the health of the general population when compared with the rest of the developed world were mediocre. And its fundamental character is based on an insurance model: we want protection from potentially huge financial risks that are variable and unpredictable. The ACA was an effort to fundamentally revamp a system that consumes one-sixth of the nation's gross domestic product, so it had to take into account the current state of the system.

Retirement plans, on the other hand, have a much different character that, aside from a couple of events such as the rise of 401(k) plans and the demise of defined benefit plans, essentially have remained unchanged in their operation and purpose: providing workers a secure retirement by encouraging them and their employers to set aside money over a long career and allowing it to grow tax-deferred. Nothing too complicated about the concept, but lots of complication in the tax-related details, most of which haven't changed much over the past 50 years or so.

a. Age and Service Requirements

The standard for determining how part-time, variable-hour and seasonal employees fit in to qualified retirement plan requirements begins and ends with Section 410(a) of the Internal Revenue Code ("Code"). Section 410(a) sets forth minimum participation standards for qualified plans, including the minimum age and service requirements of Section 410(a)(1). Under Section 410(a)(1), a qualified plan may not exclude participants who have reached age 21 and performed a year of service. The general rule regarding what constitutes a "year of service" appears in Section 410(a)(3), and states that a year of service is defined as any 12-month period beginning on the date an employee first performs an hour of service during which the employee completes at least 1,000 hours of service. Section 410(a)(3)(B) specifically identifies seasonal employees as a special case that is subject to regulations promulgated by the Secretary of Labor for purposes of defining minimum participation requirements.

Speaking generally, the 1,000-hour requirement equates to about a half-time position. So the underlying policy of this requirement appears to be something like, "We want to make sure that people who work at least half-time in a year get the benefit of this great tax-advantaged retirement savings vehicle."

b. Controlled Group Rules and Classification of Employees

Section 410(b) of the Code provides for minimum coverage requirements in terms of employees eligible to participate in a qualified plan. This section permits an employer to exclude one or more classifications of employees from participation in a plan so long as those exclusions do not discriminate in favor of highly compensated employees.

It is important when considering classification and other issues to keep in mind the Code's controlled group rules. In essence, these rules provide that all employees of separate companies that have sufficient common ownership, either through a parent-subsidiary or brother-sister relationship, must be combined for purposes of determining compliance with a wide array of plan requirements, including Section 410's participation and coverage requirements noted above.

c. Navigating Nondiscrimination Rules

A problem arises when an exclusion under Section 410(b) has the effect of requiring an age or service requirement that would violate the minimum participation standards of Section 410(a). This problem is inherent in an exclusion that excludes part-time or seasonal employees, which by its nature relates to the amount of service rendered. Applicable regulations address this problem by stating that plan provisions that *have the effect* of requiring an age or service requirement with the employer maintaining the plan will be treated as if they imposed an age or service requirement.

Somewhat obscure Internal Revenue Service guidance from 2006 in the form of a Quality Assurance Bulletin ("QAB") is the latest and most comprehensive guidance regarding seasonal employees. It makes the following important points regarding part-time and seasonal employees: (1) the position of the IRS that an exclusion that has the effect of indirectly imposing a service requirement is reaffirmed; (2) whether an exclusion has the effect of indirectly imposing a service requirement depends on an examination of all the facts and circumstances; and (3) a plan containing an exclusion that has the effect of indirectly imposing a service requirement can amend the exclusion to include fail-safe language which provides that notwithstanding any exclusion classifications, any employee that completes at least 1,000 hours of service in an eligibility computation period will be an eligible employee.

Here's an example of how subtle the differences can be between a compliant and non-compliant classification. One plan defines a part-time, seasonal or temporary employee as "an employee who works less than 1,000 of service in a year." Another plan defines the same employee as "an employee who is scheduled to work less than 1,000 hours of service in a year." The first plan is fine; the second isn't. Why? The second plan's definition could exclude an employee who, although only scheduled to work less than 1,000 hours, actually performs more than 1,000 hours of service in a year. Employers can avoid this kind of problem by including "fail-safe" language in its definition, such as:

> Notwithstanding this exclusion, in the event any Employee attains the age of 21 or greater and completes at least 1,000 Hours of Service during an Eligible Computation Period, such Employee shall be eligible to participate in the Plan.

Another complicating factor arises out of the methods of calculating service for participation, vesting and benefit accrual under ERISA and the Code. The general method establishes the one-year maximum eligibility waiting period of time (or two years with immediate vesting), combining it with the requirement that an employee must be credited with a year of service if the employee provides at least 1,000 hours of service during the first 12 months of employment.

Applicable regulations provide for an alternative method of calculating service called the "elapsed time" method of calculating service. The "elapsed time" method allows the use of a period of time without counting the number of hours worked. In essence, this method is designed to lessen the administrative burden on an employer by eliminating to the need to keep track of actual hours worked during for purposes of determining whether the employee meets the one-year participation requirement.

This eliminates, of course, the ability to exclude an employee who has met the prescribed period of elapsed time without actually working for 1,000 hours. In addition, the "elapsed time" method introduces the concept of "spanning" that in essence requires the counting of periods of severance from service between periods of employment when such periods of severance last a year or less.

Most retirement plans today are "off the shelf" products called prototype or volume submitter plans. They consist of two components. First, there is the "basic plan document" which contains most of the terms of the plan, which typically runs to 100 pages or more of fine print that employers, as a practical matter, never read. Second, there is the adoption agreement. This document allows an employer to customize select terms of the plan. It typically runs at least 30 pages.

Employers that do not take the time to review (or engage someone to review for them) both the basic plan document and the adoption agreement can run into unintended surprises with respect to part-time or seasonal employees. For example, either the basic plan document or the adoption agreement may provide for the "elapsed time" method of counting hours. If so, then the 1,000-hour requirement becomes irrelevant, since an employer only counts months of service. The "spanning" concept that is part of the elapsed time method can result in an especially nasty surprise under the right circumstances.

Suppose, for example, an employer has a reasonable expectation that one or more seasonal employees won't meet the 1,000-hour requirement because of their limited service in any given year. If spanning applies, however, past periods of service can be combined with current periods as if there were no break in service, resulting in a requirement that such employees be permitted to participate in the plan.

II. Other Benefits Considerations: A Potpourri of Potholes

a. Compliance with Other Federal Laws

While not necessarily having an impact on benefits, other federal laws have an impact on part-time, seasonal and temporary employees. For example, such employees are treated the same as full-time employees under the Fair Labor Standards Act concerning minimum wage, overtime pay, recordkeeping and child labor. They are also covered under OSHA's safety and health policies concerning work-related injuries, illnesses and occupational fatalities.

b. Compliance with State Laws

While benefits issues related to part-time, seasonal and temporary employees primarily implicate federal law under the Code and ERISA, employers also must be aware hat the law of the states in which they reside may also be relevant. For example, every state has some form of worker's compensation law that deals with how on-the-job injuries are processed and compensated. Others may have retirement and welfare plan requirements that are more stringent than what federal law requires. An examination of these state laws is beyond the scope of this paper, but it is important that employers consider them and ensure that they take them into account in developing and operating any benefit plans.

c. Dealing with Temp Agencies and Other Service Providers

Temporary employees can present their own unique set of issues, many of which are beyond the scope of this paper. Some potential problems, however, are worth mentioning.

A company typically will hire temporary employees from a temporary staffing agency. Usually these workers are employed by the agency, and they are "leased" to the company. Temporary employees eventually can be hired by the company directly, depending on the company's contractual relationship with the temporary staffing agency. In any such situation that presents the possibility of a shift from one employer to the other, companies need to make sure they understand who the "employer" is at all times along with any assumptions of contractual or legal obligations, including those related to benefits.

A related situation arises when an employer enters into a relationship with a "professional employer organization," or PEO. These organizations offer to undertake many employee-related functions from an employer, including payroll, benefits, and other human resource services.

The biggest risk for employers from a benefits compliance perspective is that by off-loading benefit plans to a PEO, an employer may assume that it is off-loading fiduciary responsibility and other compliance requirements with respect to the plans as well. This may not always be the case. The Department of Labor has become concerned over the past several years about such purportedly consolidated arrangements whereby a PEO administers a single plan in which multiple, unrelated employers participate. Recent guidance has made clear that each participating employer retains fiduciary responsibility for the operation of the plan, and is responsible for filing its own annual 5500 information return to the Department of Labor. In a large, PEO-sponsored plan, this may mean dozens of 5500s rather than a single one filed by the PEO.