What's the Simplest Way to Set Up a One Year Eligibility Waiting Period for our 401(k)?

Facts

We are looking to set up a 401(k) plan for our company. Our workforce includes both hourly and salaried employees as well as full-time, part-time, and seasonal workers. For now, we really want to focus on our full-timers. It is our understanding that the maximum timeframe we can have employees wait before becoming eligible is one year. With all of the hats our in-house finance team wears (HR, payroll, billing, etc.), we are concerned that keeping track of which of our various categories of employees are eligible for the plan could be a bit much.

Question

Your most recent Question of the Week talks about simplifying eligibility provisions for plans that have a waiting period of a few months. Is there an easy way to set-up plan eligibility to handle a one-year waiting period for both hourly and salaried employees?

Answer

Absolutely, and we'll walk you right through the options to get you there. Before we do though, let's take a look at what a "one year" wait actually means. Yes, leave it to Congress and the IRS to make even something that simple more involved.

When it comes to retirement plans, a one-year eligibility period can truly be as simple as the passage of 12 months. However, the most restrictive way to define it is that an employee is credited with a year of service when he or she has completed a full 12-month period in which he or she works at least 1,000 hours of service. That translates to about 20 hours per week, which can come as a surprise, especially when a company might define full-time status as 30 hours per week for other benefit purposes.

Regardless of the tenure required for plan entry, there are really two ways to count service: elapsed time or hours of service. The elapsed time method looks at the days, months, or years that have passed since an employee was hired. Hours of service—you guessed it—looks at the actual hours an employee works during a specified period. We have a more detailed comparison of these two concepts here.

Simply stated, if you define a year of service based on elapsed time, an employee will satisfy the requirement once a year has elapsed. That means any seasonal or part-time employees could quite easily become eligible for the retirement plan after 12 months goes by, regardless of how much or little they actually work.

> **Quick look:** *Jeffrey was hired May 3, 2019. He satisfied the service requirement of one year on May 2, 2020 and would then be eligible to enter the plan. Even if Jeffrey didn't work some of the months during that period, he's still considered to have satisfied a year of service under this method.*

So, what about the hours of service method? If you consider the hours of service method, only those employees who work at least 1,000 hours in a 12-month period will satisfy the service requirement to enter the plan. In this scenario, those seasonal employees are far less likely to meet the service requirement, and any part-timers below that threshold also will not become eligible. So, using the actual hours method will make strides towards your overall eligibility goals; beautiful progress!

While using actual hours will reduce the number of part-timers who might enter the plan, it also requires some recordkeeping to track the hours each employee works. This is probably not a big deal when it comes to your hourly employees, but your team may have a few choice comments at the prospect having to track hours for salaried employees. Don't worry though, you specifically asked for something easy, and we won't let you down.

Retirement plan weeds can sometimes be onerous, but at other times, like this, those details actually allow for some pretty awesome solutions. Your plan document provides options for counting hours of service. You can count them *literally*, looking at the actual number of hours each employee works, or you can use what is referred to as the equivalency method. This allows you to assign a specified number of hours to each day, week, or month an employee works. There are regulations that set minimum thresholds, e.g. 10 hours per day or 190 hours per month, but you can always be more generous. *We've got more on the equivalency method here.*

How do we put all this to use to get you where you want to be? You can have the best of both worlds – use the actual hours method for your hourly paid employees and the equivalency method for your salaried employees. Your shorter-service seasonal and part-time employees do not become eligible, and you also avoid the chore of somehow tracking hours for salaried folks.

There is one other quick point we should mention. It's a bit further into the weeds, but it can be important. It has to do with the 12-month period you use to count hours. For the first year, that 12-month period runs from an employee's hire date to his or her first anniversary. If someone doesn't hit their 1,000 hours in that timeframe, subsequent "years" can either follow each employee's anniversary year, or they can shift to track the plan year. While using anniversary years may serve to postpone eligibility a little bit longer, it also means tracking hours over a different 12-month period for each employee. Talk about expletive-inducing! For that reason, we generally suggest using the plan year shift so that you are tracking hours over the same period for everyone.

Admittedly, this topic is a little more in the minutia than our normal discussions. But, here's the thing, with IRS-mandated plan document restatements in the works, conversations about your eligibility preferences and administrative needs are important and can really pay off. No need to commit all of this to memory though, that's why we're here. We just want you to know that there are options that can help make life easier. If you have eligibility conundrums, let us know. DWC would be happy to help problem-solve with you.