Retirement Plan Eligibility Rules

Overview of Rules and Consequences of Failure to Apply Them Properly

Retirement plans must have a written plan document that specifies the provisions of the plan, including when employees become eligible to participate, when they can begin contributing, and when they are to begin receiving employer contributions. This document describes how eligibility is generally applied and how to correct errors in applying the plan's eligibility rules.

How is Eligibility Defined?

The eligibility provision will generally specify the following rules for joining the plan:

- **Minimum Age** – Plans can specify a minimum age for participation. The law allows employers to preclude employees from participating until they attain age 21.
- **Service Requirement** – Plans may also specify how long an employee must work before participating. The law allows employers to require up to one year of service during which an employee must work at least 1,000 hours.
- **Entry Date** – Employers are allowed to set Plan Entry dates upon which employees can start participating after meeting the other requirements. Employers often choose the first day of a month or quarter for Entry Dates.
- **Class Exclusions** – Employers can choose to exclude certain "classes" of employees from participating. If employers choose this option, special testing is required to prove that the exclusion does not discriminate in favor of highly compensated employees. Plans may not exclude employees based solely on an employee's service (i.e., part-time employees).

What are the consequences for failure to include an eligible employee?

If a plan fails to include an employee upon becoming eligible, the employer must correct the failure as follows:

- ***401(k) Salary Deferrals*** – If an employer fails to enroll an eligible employee in the salary deferral portion of a 401(k) plan, the employer must generally fund a contribution on behalf of the employee. The recommended amount is one quarter of the average amount contributed by the other participants.
- ***Employer Contributions*** – The employer must also fund any related matching contributions on the missed salary deferrals and fund any profit sharing contributions that were made to the plan.

What if an employee is allowed to participate prior to meeting the requirements?

When a participant is inadvertently allowed to participate prior to meeting the requirements, the correction differs as follows:

- ***Non-Highly Compensated Employee*** – If the employee is an NHCE, the plan has two options: (1) amend the plan to allow the employee to participate on the day the employee was inadvertently allowed into the plan or (2) distribute the ineligible deferral contributions to the employee and forfeit the ineligible employer contributions.
- ***Highly Compensated Employee*** – If the employee is an HCE, the plan should distribute any ineligible salary deferrals and forfeit any employer contributions.

In either case, a plan may choose to amend the plan's eligibility provision prospectively for all employees as long as no other employees would have missed the opportunity to become eligible.

Please contact JULY at 888.333.5859 for more information.