Janich Law Group

Employee Benefits Client Alert: March 2006

IRS FOCUSES ON YOUR PART-TIME STAFF

IRS to Challenge At Determination Letter Stage Plan Language Defining Part-Time, Seasonal or Temporary Employees By Reference to Service For Purposes of Exclusion from Participation in Qualified Retirement Plans

On February 14, 2006 the IRS issued a Quality Assurance Bulletin (QAB) which requires sponsors of qualified retirement plans that exclude part-time, seasonal or temporary workers to revisit their plan language to ensure the plan document complies with the tax rules governing the tax qualified status of the plan.

Though not binding upon the IRS, QABs address issues that plan sponsors may find to be helpful guidance when preparing for a determination letter request or replying to requests from the IRS. In the February 14, 2006 QAB, the IRS announces that its employee plans specialists will again focus on plan language dealing with excluded classes of employees who are defined by reference to the number of hours they perform service for the employer. Specifically, plan administrators will be requested to either remove or clarify plan language that could exclude part-time, seasonal or temporary workers that satisfy the plan's year of service eligibility requirement. The QAB makes clear that such plan language will be challenged upon review at the determination letter stage.

The Excluded Class and Reference to Service

Where the excluded class of employees is not defined by reference to the number of hours of service performed for the employer, the IRS has taken the position that the question of whether the particular plan exclusion constitutes a violation of the tax qualification requirements of the Internal Revenue Code is best left to plan examiners who have the opportunity to review all of the facts and circumstances of the employer's workforce. However, where the excluded class is defined by reference to 1) the number of hours of service the employee is expected to work in a given period, and 2) the definition of the excluded class of employees leaves open the possibility that such employees would

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remain ineligible to participate in the plan after satisfying the plan's year of service eligibility requirement, a revision to your plan document will be required by the employee plans specialist before a favorable determination letter will be issued to the plan.

Plan Language That May Be Subject to IRS Challenge

In several examples, the IRS illustrates under what circumstances plan language may be subject to challenge at the determination letter stage.

- If a part-time or seasonal employee is defined as "an employee who works *less* than 1,000 hours of service in a year" there would be no violation of the eligibility requirements under the Internal Revenue Code because any employee that works 1,000 hours or more during the year would no longer be defined as a part-time or seasonal employee and thus would be eligible to participate.

- If a part-time or seasonal employee is defined as "an employee who *is scheduled* to work less than 1,000 hours of service in a year" the plan provision would be challenged as imposing a service requirement because the part-time or seasonal employee who actually works 1,000 hours or more during the year would remain excluded under this definition notwithstanding the fact that such employee worked more than his "scheduled" hours of service.

- A plan will not avoid challenge by simply relabeling a part-time or seasonal worker as an "hourly employee" if such worker is defined as one "that receives an hourly wage and whose customary employment is not more than 20 hours per week" because it may exclude employees who worked more than his "customary" number of hours, i.e., at least 1,000 hours during the eligibility computation period.

- Nor will a plan avoid challenge by simply failing to define the excluded class of employees. The QAB makes clear that such a plan should be challenged to define the excluded class and the definition should be scrutinized to determine if the class of employees is being excluded based on an impermissible service requirement.

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Amend Plan Definition or Adopt Fail-Safe Language

Plans with definitions that violate the tax rules must be corrected either by amending the plan's definition of the excluded classification or, as the QAB explains, by including fail-safe language which provides: "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."

Recommended Actions

How may a plan sponsor ensure that its qualified retirement plan complies with the tax qualification requirements affecting the exclusion of part-time, seasonal or temporary workers? Our recommendations are as follows:

- Plan sponsors should reexamine the manner in which excluded classes are defined to ensure that they do not impose an impermissible service requirement.

- Plan sponsors with definitions of excluded workers that may be construed as imposing an impermissible service requirement should amend their plans to eliminate any possibility that the excluded part-time, seasonal or temporary worker would remain ineligible if, in fact, the plan's service requirements are satisfied. Words such as "scheduled" or "customary" are likely to be considered red flags to employee plans specialists and should be eliminated. Plan sponsors should consider whether such workers may be excluded on the basis of a job classification rather than service requirement.

- Plan sponsors may include the QAB's recommended fail-safe language in their plan to ensure that any defective definition of an excluded class will not result in a violation of the tax rules. Including such fail-safe language is particularly important when the plan sponsor describes the excluded class of employees in terms such as "is scheduled," "customarily," or "regularly."

- Plan sponsors should determine whether their plans have improperly excluded part-time, seasonal or temporary employees from participating in their qualified plan. If so, the plan may need to undertake one of the IRS correction methods! to make the excluded employee whole. A failure to voluntarily and completely make the necessary corrections may

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result in the imposition of severe monetary penalties upon later plan audit, if not plan disqualification.

If you have any questions on the eligibility of part-time, seasonal or temporary workers in your qualified retirement plan, require assistance in making plan corrections, or have any other questions relating to your qualified retirement plan, please contact us. For a fuller discussion of employee benefit issues affecting part-time, seasonal or temporary employees, please refer to our chapter on Contingent Workers & Employee Benefits published in the legal treatise, *ERISA Litigation*.

Important Reminder for Small Health Plans: The Deadline for Compliance With HIPAA's Security Rules Is April 20, 2006

The Security Rule triggers a host of security procedures that must be performed to ensure timely compliance with its requirements. Health plans need to be aware of their specific security obligations under the HIPAA Security rule. Sponsoring employers should be aware that the Final HIPAA Enforcement Rule issued on February 16, 2006 authorizes the Department of Health and Human Services (HHS) to impose significant civil monetary penalties for each violation of the Security Rule.

If you are a sponsor of a small health plan (one having under $5,000,000 in receipts during the prior year) and this important item has not yet been checked off your "to do" list, contact us immediately for experienced guidance in completing the steps required to ensure timely compliance with the Security Rule.

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