

Section III., How does the plan measure a year of service?

Part A., Definition

A plan measures a year of service either by using a counting-hours method or an elapsed time method. If the plan counts "hours of service," the administrator must keep track of service on the basis of "eligibility computation periods." The law defines a year of service as an eligibility computation period in which at least 1,000 hours of service are credited. See IRC §410(a)(3)(A)/ERISA §202(a)(3)(A). The plan may require *fewer* than 1,000 hours for a year of service, because that is being more liberal than the statutory minimum standard. However, the plan is not permitted to require more than 1,000 hours of service for a year of service. The number of hours required for a year of service, and the method of counting hours of service, will be determined by the plan document. See Chapter 1A for the definition of hours of service and the crediting methods available. Rules for measuring the eligibility computation period are discussed in Part B. of this section. Under the elapsed time method, hours of service are not counted, and there are no eligibility computation periods to measure. Instead, the plan administrator must calculate the employee's "period of service," as defined under the elapsed time rules. When the period of service equals the length of service required for eligibility, then the employee has satisfied that eligibility requirement. The elapsed time method is discussed in Part D. of this section. The majority of plans that require one or two years of service for eligibility purposes use the counting-hours method.

Parallel provisions in ERISA. Note that the eligibility rules are found not only in the tax code (IRC §410(a)) but also in ERISA (ERISA §202). Therefore, these rules are not just a matter of tax qualification for the plan, but must be satisfied by all pension plans subject to ERISA, whether or not tax qualified, unless an exemption under ERISA applies (e.g., a nonqualified unfunded deferred compensation plan that satisfies the definition of a "top hat" plan is exempt from the ERISA eligibility requirements).

1. Eligibility service requirement of less than one year. The statute and regulations only define a year of service. If the plan requires less than a year of service for eligibility periods, the plan must be written so that the manner in which that service requirement is satisfied will not delay an employee's participation in the plan beyond the statutory one year of service rule. Once an employee has satisfied the statutory one year of service rule, the employee may be excluded from the plan only by reason of an eligibility condition not related to service, such as an age requirement (e.g., age 21) or an employment classification (e.g., exclusion of hourly-paid employees). For more details on crediting service periods of less than one year, see Part E. of this section. For more details on the exclusion of employees by classification, see Part F. of Section IV of this Chapter 2. The age requirement is discussed in Section II of this Chapter 2.

2. Plan may shift to counting-hours method after having used elapsed time method. A plan that uses the counting-hours method of determining eligibility service may be amended to switch to the elapsed time method. If such an amendment is adopted, special transition rules apply. These rules are discussed in Part D. of the elapsed time definition in Chapter 1A.

3. Seasonal employees. ERISA §202(a)(3)(B) and IRC §410(a)(3)(B) provide that, in the case of any seasonal industry where the customary period of employment is less than 1,000 hours during a calendar year, the term "year of service" shall be such period as may be determined under regulations prescribed by the DOL. (Note that Reorganization No. 4 has moved this responsibility to the Treasury Department.) Although this statutory provisions grants the agencies the authority to create a special year

of service definition for seasonal workers, the regulations do not prescribe any special rules. Accordingly, until such time as special rules are adopted, the normal definition of a “year of service” (i.e., completion of at least 1,000 hours of service in an eligibility computation period) applies to seasonal workers in the same way as workers who work in continuous service.

Part B., Eligibility computation period

The DOL regulations prescribe minimum requirements for measuring the eligibility computation period when a plan uses a counting-hours method to establish a year of service. The eligibility computation period must be a period of 12 consecutive months, but, as discussed in 3.c. below, the plan may not require employment throughout the 12-month period when a counting-hours standard is used to define a year of service.

1. Initial eligibility computation period. The first eligibility computation period must begin on the employee's employment commencement date ("ECD"). See DOL Reg. §2530.202-2(a). For example, if an employee's ECD is May 18, 2014, the first eligibility computation period runs from May 18, 2014, through May 17, 2015. An employee's ECD is the first day he receives credit for one hour of service.

1.a. Identifying the ECD/effect of weekend or holiday. Generally, the ECD is clearly determinable. An employee usually starts work on a predetermined business day, with compensation calculated from that date forward. However, there may be an issue raised when an employee is hired to start as of a date that is a weekend or holiday. For example, suppose January 1 is a Monday, but the employee is not required to report to work until January 2. Or suppose a salaried employee is hired as of January 1, but that date falls on a weekend and doesn't report to work until the first business day following January 1. Is the employee's ECD January 1 or the date the employee first actually reports to work? The answer could affect the date as of which the employee completes a year of service which, in turn, could affect the employee's entry date (i.e., date of participation), in accordance with IRC §410(a)(4) (discussed in Section IV of this Chapter 2). Ultimately, this is a matter of interpretation reserved for the plan administrator or other responsible fiduciary. Usually, the benefit of the doubt is given to the participant, and employment is treated as commencing on January 1 in this example. The terms of the employment agreement (if any), the manner in which compensation is calculated for the individual, or other relevant factors may need to be considered in identifying the appropriate ECD.

2. Measuring eligibility periods after the initial computation period. Following the first period, the eligibility computation period may be defined as the plan year or as the 12-month anniversary periods of the initial eligibility computation period. See DOL Reg. §2530.202-2(b). The plan must define which method it will use to determine eligibility computation periods. No other method is acceptable in determining whether the statutory requirements are satisfied.

2.a. Shifting to plan year. If the plan defines the subsequent periods to be the plan year, the second eligibility computation period begins with the first plan year that begins after the employment commencement date. Thus, there is an overlap between the first and second periods when the plan year definition is used, except the case where an employee's ECD is the first day of the plan year.

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Hours of service credited during the overlap count for both periods. See DOL Reg. §2530.202-2(b)(2).

2.a.1) Example - shift to plan year. Wayne's initial computation period starts August 8, 2014, and ends August 7, 2015. The plan defines subsequent computation periods as the plan year. The plan year is the calendar year. Wayne's second computation period is the plan year beginning January 1, 2015, and ending December 31, 2015. Therefore, between January 1, 2015, and August 7, 2015, the first and second computation periods overlap. Any hours of service Wayne is credited with during that overlapping period count toward satisfying a year of service for both computation periods. Following the 2015 plan year, Wayne's future computation periods are consecutive, measured on the basis of each succeeding plan year (i.e., the 2016 plan year, the 2017 plan year, and so on).

2.a.2) Plan year usually matches the vesting computation period. Many plans use the shifting method to measure the eligibility computation period because the plan also uses the plan year to determine years of service for vesting purposes (known as the vesting computation period). See Chapter 4, Section IV, for details. This way the hours counted for the plan year are used for more than one purpose.

2.b. Anniversary periods. If the plan defines the subsequent periods to be anniversary periods of the initial computation period, the second period will begin on the anniversary of the employee's ECD. See DOL Reg. §2530.202-2(b)(1). Under the anniversary method, the first and second periods will be consecutive and will never overlap.

2.b.1) **Example.** Assume in the example in 2.a.1), the plan defined subsequent computation periods as anniversary periods instead of plan years. Wayne's second computation period would begin August 8, 2015, and end August 7, 2016. There would be no overlap between his first eligibility period and his second eligibility period. The day after the first period ends, the second one starts. All subsequent eligibility computation periods start on August 8 (i.e., the anniversary date of Wayne's employment commencement date).

2.c. What if the plan year is amended? If there is an amendment to the plan year, a short plan year of less than 12 months is created. If an employee's eligibility computation period is measured with reference to the plan year, as discussed in 2.a. above, the eligibility computation period may not be the short plan year (see 2.c.2) below). Instead, the eligibility computation period must run for a full 12 months, even when there is a short plan year. The 12-month computation period beginning on the first day of a short plan year will overlap with the next computation period measured on the basis of the new plan year period.

2.c.1) Example. A plan shifts the eligibility computation period to the plan year following an employee's initial computation period. The plan year ends June 30. Effective January 1, 2015, the employer amends the plan year to a calendar year, creating a short plan year from July 1, 2014, through December 31, 2014. Under the overlapping periods rule, one eligibility computation period runs for the full 12 months from July 1, 2014 (i.e., the first day of the plan year that was in progress when the plan year was amended) through June 30, 2015, even though the short plan year ends December 31, 2014, because of the amendment. Another eligibility

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computation period begins on January 1, 2015 (i.e., the first day of the new plan year period) and ends on December 31, 2015, coinciding with the amended plan year period. The eligibility period that begins July 1, 2014, and the eligibility period that begins January 1, 2015, overlap for six months. Thereafter, subsequent eligibility computation periods will begin on each January 1, coinciding with the new plan year period (i.e., January 1, 2016, January 1, 2017, and so on).

2.c.2) Short eligibility period not permitted. The plan may not use the short plan year as the computation period and prorate the hours of service requirement, unless the overlapping period alternative is provided to employees who cannot satisfy the proration requirement. This is because the applicable regulations do not create any exception to the 12-month period rule, nor to the 1,000-hour statutory definition. It would be incongruous for the regulations to permit the plan year measuring period to be less than 12 months, but not provide for an adjustment of the 1,000-hour standard.

2.c.2)a) Example. Suppose in the prior example that the plan provided for a short eligibility computation period running from July 1, 2014, to December 31, 2014. The plan provides that a year of service is credited for that short period if an employee completes at least 500 hours of service (i.e., one-half the normal hours requirement to reflect the six-month length of the eligibility period). Martha has an erratic work schedule. For the short period, she is credited with only 400 hours. However, from January 1, 2015, through June 30, 2015, she is credited with 620 hours. Because of the use of the short period, Martha fails to get credit for a year of service with respect to her 12-month eligibility period that starts July 1, 2014. This is a violation of the minimum standards.

Could the plan be written in a way that satisfies the statutory standards but makes use of the short plan year as well? Yes! The plan could provide for a prorated hours requirement for the short plan year period (as shown in the example), but then also provide an alternative that credits a year of service if an employee completes at least 1,000 hours of service for the 12-month period starting July 1, 2014, and ending June 30, 2015. This way, an employee who works at least 500 hours during the short plan year could have his or her eligibility requirements satisfied more quickly, without preventing someone like Martha from participating in accordance with the statutory requirements. Remember, the plan can be designed to have eligibility results that are more liberal (i.e., more favorable to some or all employees) than the statutory standards, just not less liberal than those standards.

2.d. Importance of subsequent periods. An employer or administrator may question the purpose of defining eligibility computation periods after the initial period, particularly in a plan that requires only one year of service for eligibility. There are several reasons why the second and subsequent eligibility periods may be important.

2.d.1) Employees who fail to earn year of service in first eligibility period. In a one year eligibility plan, an employee may not have enough hours of service in the initial period to qualify for participation. The plan needs to define subsequent periods to determine whether the employee becomes a participant in a later year.

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2.d.2) Effect of break in service rules. Under the break in service rules (see Section V of this Chapter 2), an employee may temporarily or permanently lose credit for previously earned years of service, depending on what happens in subsequent eligibility computation periods. Eligibility computation periods are used to measure breaks in service as well as years of service.

2.d.3) Two-year eligibility plans. If the plan requires *two* years of service for eligibility (see the discussion in Part C of Section II of this Chapter 2), an employee will need at least two eligibility computation periods before he or she can qualify for participation. For a plan that uses two-year eligibility, it is recommended to use the anniversary periods approach. If the plan shifts to the plan year, an employee usually is credited with at least 1,000 hours in both the first and second periods, which overlap, and entry into the plan is accelerated. If this is not the intended result, then the shift-to-the-plan-year method is not desirable. The following two examples compare the different results under the two methods of measuring computation periods.

2.d.3)a) Example - shift to plan year. A plan requires two years of service for eligibility purposes. The computation period shifts to the plan year after the initial period. The plan year is a calendar year and entry dates are January 1 and July 1. An employee enters the plan on the entry date which follows completion of the two-year eligibility requirement. Marta commences employment on September 1, 2014. Her initial computation period is September 1, 2014, through August 31, 2015. Her second computation period is January 1, 2015, through December 31, 2015. The first two periods overlap for eight months (January through August). As a full-time employee, Marta is credited with more than 1,000 hours of service just during the overlapping period. Hours credited in that overlapping period will apply to both computation periods. Therefore, by December 31, 2015, after only 16 months of employment, Martha already has two years of service for eligibility purposes. Her entry date under the plan is January 1, 2016.

Cross-reference tip. See Section IV of this Chapter 2 for a discussion of the entry date rules.

2.d.3)b) Example - anniversary periods. In the above example, if the plan used anniversary periods, Martha's second computation period would be September 1, 2015, through August 31, 2016. She would not enter the plan until January 1, 2017, a full year later.

2.e. Hours are not “rolled over” from one period to the next. The statutory definition of a year of service looks only at the hours credited *during* the particular 12-month eligibility computation period. Hours credited for earlier periods are not accumulated.

2.e.1) Example. Florence's ECD is August 1, 2014. She is credited with 70 hours per month. The plan shifts the eligibility computation period to the plan year (which ends every December 31). Florence's first eligibility computation period runs from August 1, 2014, through July 31, 2015. During that period, she is credited with only 840 hours, which is not enough to earn a year of service. Florence's second eligibility computation period runs from January 1, 2015, through December 31, 2015, because the computation period is shifted to the plan year. During that period, she also is credited with only 840 hours. Although by December 31, 2015, Florence's cumulative hours from August 1, 2014, through December 31, 2015, total 1,190, she

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has not earned a year of service for eligibility purposes because she did not complete at least 1,000 hours in a 12-month eligibility computation period.

2.e.2) Plan document may be written to accumulate hours. The plan described in the prior example could be written more liberally so that an employee like Florence would become a participant. For example, the plan could provide for a cumulative hours of service rule, giving an employee credit for a year of service after they have accumulated at least 1,000 hours of service, even if those hours are not completed in a single eligibility computation period. Alternatively, the plan could be written to require fewer than 1,000 hours of service in an eligibility period to earn a year of service.

3. When a year of service is credited for eligibility purposes. A year of service is credited at the end of the eligibility computation period in which it is earned. For example, if the initial computation period begins on April 10 and ends on April 9 of the following year, the employee receives credit for one year of service as of the April 9 ending date of that computation period, if he or she is credited with at least 1,000 hours of service during that 12-month period. The year of service is credited on the April 9 date, regardless of when the employee might have actually completed the 1,000th hour of service. This rule becomes important in determining the employee's entry date for participation purposes (see Section IV of this Chapter 2).

3.a. Example. Marjorie is a full-time employee and works 160 hours per month. She commences employment on May 1, 2015. During December she actually reaches 1,000 hours of service. Nonetheless, she does not receive credit for a year of service until April 30, 2016, the end of her initial computation period. If the plan provides for entry on the first day of the month following completion of the year of service, Marjorie's entry date is May 1, 2016, because her year of service is considered completed on April 30, 2016, and the plan's entry date system calls for entry on the first day of the month (May 1, in this case) following completion of the year of service.

3.b. Plan may provide for credit sooner. Remember, the rules discussed in this section are the statutory requirements, which are designed to set minimum standards to protect employees. The plan can be written more liberally, so that a year of service is credited before the end of the eligibility computation period.

3.b.1) Example. Suppose in the previous example that the plan document is written so that a year of service credited as of the end of the month in which the 1,000th hour of service is completed during the eligibility computation period. Consequently, Marjorie receives credit for a year of service on December 31, 2015. Using the plan's entry date system described in the prior example, Marjorie's entry date would be accelerated to January 1, 2016, which is the first day of the month (January 1) following the month in which the 1000th hour of service is credited. A plan should not be administered in this fashion unless the terms of the plan expressly provide for this method of crediting a year of service.

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3.c. Continuous employment not required. The fact that a year of service is not credited until the end of the eligibility computation period does not mean the employee must be employed continuously during that computation period in order to receive credit for the year. In fact, the employee does not even have to be employed on the last day of the computation period to receive credit for the year of service.

3.c.1) Example - layoff for portion of eligibility period. Assume Janelle's ECD is June 4, 2014. Her initial eligibility computation period ends June 3, 2015. Janelle works until November 10, 2014, and is laid off. On February 2, 2015, she is rehired. Although Janelle is not employed continuously from June 4, 2014, through June 3, 2015, her initial eligibility computation period is still measured on that basis. If during her periods of employment during that initial computation period she receives credit for at least 1,000 hours of service, the plan must credit her with a year of service as of June 3, 2015. It is not acceptable to start a new eligibility computation period on February 2, 2015, when Janelle returns, because such approach would fail to give her credit for a year of service on a timely basis (i.e., as of June 3, 2015).

3.c.2) Example - seasonal employees. Corporation X hires seasonal employees. The employees usually work from March through June and from September through December. Steven, a seasonal employee, has an ECD of March 8, 2014. Steven works 550 hours of service through June 28, 2014. Steven recommences employment for the next seasonal period on September 10, 2014, and works through December 20, 2014. During the second period, he receives credit for 480 hours of service. Steven does not recommence employment until March 16, 2015. Steven's initial eligibility computation period runs from March 8, 2014, through March 7, 2015. During that period, Steven completed 1,030 hours of service. The plan must credit Steven with one year of service as of March 7, 2015, even though he is not actually employed on that date.

***Cross-reference tip.* Also see the discussion in Part A.3. of this Section III regarding statutory authorization to create special rules for seasonal workers.**

3.c.3) Elapsed time alternative. See the discussion in Part D of this section for rules relating to the elapsed time alternative. Under elapsed time, periods of service are accumulated to determine whether a service requirement is satisfied, rather than counting hours of service during computation periods. However, a rule known as the "service spanning rule" will require certain periods of absence to be treated as periods of service under the elapsed time method, which may result in greater service credits than is indicated by the individual's actual work schedule, particularly in the case of seasonal employees.

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3.c.4) Use of “consecutive” language in plan may cause confusion. It is common to see the plan define the eligibility computation period to be a “12-consecutive-month” period, and then define the year of service as 1,000 or more hours in such period. The use of the phrase “12-consecutive-month” is usually required by IRS reviewers looking at the plan language before issuing an approval letter (e.g., determination letter). The reason for the consecutive designation is to clarify that the statutory year of service definition requires the employee to complete all 1,000 hours within twelve months that are consecutive. In other words, if an eligibility computation period starts April 1, then it ends the following March 31, because there are 12 consecutive months which make up that period. The use of the word “consecutive” does not mean that the employee must be employed continuously during the 12-month period. As long as the employee completes at least 1,000 hours in the designated computation period, a year of service must be credited, even if the employee was not employed for a portion of that period.

3.c.4)a) Example. Neil’s employment commencement date is May 1, 2015. He only works certain months of the year. He earns 100 hours in each of the following months: May 2015, June 2015, July 2015, November 2015, December 2015, January 2016, February 2016, May 2016, June 2016, July 2016. Although Neil’s hours at the end of July 2016 total 1,000, and he completed those hours in only 10 different months, this is not a statutory year of service, because those months were not part of a 12-consecutive-month eligibility computation period. Neil’s initial eligibility computation period runs from May 1, 2015, to April 30, 2016. During that period, his hours only total 700. Therefore, Neil does not have credit for a year of service (unless the plan is written more liberally to allow hours to accumulate until he earns 1,000 hours, as discussed in 2.e. above). On the other hand, if Neil worked 150 hours in May 2015, June 2015, July 2015, November 2015, December 2015, January 2016, and February 2016, he would have more than 1,000 hours in his initial eligibility computation period, and would be credited with a year of service as of April 30, 2016, even though he did not work for 12 consecutive months.