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 1 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., nonqualified unfunded deferred compensation plan that satisfies the definition of a "top hat" plan).**

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. The age requirement is discussed in Section II of this chapter.

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 1.

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.

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, 2004, the first eligibility computation period runs from May 18, 2004, through May 17, 2005. 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). 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. Hours of service credited during the overlap count for both periods. See DOL Reg. §2530.202-2(b)(2).

2.a.1) **Example**. Wayne's initial computation period starts August 8, 2004, and ends August 7, 2005. 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, 2005, and ending December 31, 2005. Therefore, between January 1, 2005, and August 7,