Rehired Employees –
When Are They Eligible to Participate?

Great news! That invaluable employee who terminated employment is back working with you! While that's good for your business, it's important to understand how rehired employees impact your retirement plan. Is the rehired employee considered to be a new employee as of the rehire date, or must all of the employee's prior service be taken into account? Determining when a rehired employee should begin participating can be challenging under the complex service crediting rules that apply to qualified plans.

Rehires: New or Existing Employees?

An employee's eligibility to participate upon rehire usually depends upon the employee's status *before* termination. As a general rule, you must count a rehired employee's prior service. Consequently, when determining whether the employee has met the plan's year of service (or less) eligibility requirement, you cannot treat the rehired employee as a new employee. Instead, service prior to the employee's termination must be taken into account. Following is a general guideline for determining when a rehired employee should begin participating:

Status Before Termination	Eligible Upon Rehire?
Satisfied eligibility and entered plan	Participate immediately upon rehire
Satisfied eligibility but terminated before entry date	Participate immediately upon rehire (or on original entry date, if later)
Did not satisfy eligibility	Wait to participate until the entry date after eligibility is met

Can Prior Service Be Disregarded?

Although prior service usually must be counted, a rehires pre-termination service can be disregarded under the "break-in-service" rules. A "break-in-service" (BIS) occurs when an employee works less than 501 hours during a plan year. There are two break-in-service rules that allow you to ignore prior service. If prior service is disregarded under one of these rules, the plan can treat the rehire as a new employee as of the rehire date, and the employee will have to re-satisfy eligibility. However, both rules have a limited practical application.

One-Year Holdout Rule

- Prior service is *temporarily* ignored until the rehired employee completes a year of service. Prior service is then reinstated, and prior participants enter the plan retroactively as of their rehire date.
- This rule isn't permitted for salary deferrals since they cannot be made retroactively.

Rule of Parity

- Prior service is *permanently* ignored if the rehire:
  1) previously was a participant;
  2) previously was 0% vested; *and*
  3) incurred 5 or more consecutive BIS.
- This rule is rarely applied in a 401(k) plan since salary deferrals are fully vested.

Properly applying the rehire rules can be challenging at best. Both break-in-service rules are optional provisions, and there are various approaches a plan can take to comply with the service crediting rules. Misapplication of these complex rules can result in costly corrective contributions under an IRS error correction program.

Please contact us to help you understand the rehired employee rules that apply to your plan, and to determine when a rehired employee should begin participating.

Caution – These service crediting rules also apply when calculating a rehired employee's vesting. And, if a rehired employee repays a full distribution upon reemployment, previous forfeitures may need to be restored!

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Benefits Administrators, LLC

269 West Main Street, Suite 700
Lexington, KY 40507
(859) 255-1154
www.benadms.com
lobryan@benadms.com