

401(k) Plans: Can Interns be Excluded?

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PRACTICES Employee Benefits and Executive Compensation

As summertime rolls around and employers prepare for a fresh crop of interns, the question may arise whether those interns can be excluded from participating in the 401(k) plan. The answer is generally yes, but different conditions must be satisfied depending on whether the intern job classification results in an indirect service requirement.

An employer may exclude certain job titles from participating in its 401(k) plan. For example, a 401(k) plan could be written to exclude all employees whose job title is “forklift operator” or “claims adjuster.” Such a categorical exclusion, without conditions, is permissible *if the exclusion is not service-based* (i.e., the categorical exclusion is based on job function or some other common denominator not tied to service). If the categorical exclusion is tied to service, such as with exclusions of seasonal or temporary employees, then the exclusion will generally not be permissible unless specific “fail-safe” language (explained below) is also included. This is because the IRS treats any exclusion tied to service as a “minimum service requirement,” and qualified plans are prohibited from excluding any employee who has completed a year of service.

If an exclusion could be considered a “minimum service requirement,” the plan must include fail-safe language that provides, at a minimum that, notwithstanding the exclusion:

- Any employee in the excluded class who completes at least 1,000 hours of service in an eligibility computation period will be eligible to participate; and
- Any employee in the excluded class who completes 500 hours during each of three consecutive 12-month periods will be eligible to make deferral contributions.

The fail-safe language prevents a plan from impermissibly excluding an employee who has completed a year of service.

Whether a categorical exclusion of “interns” would be considered a service-based exclusion will depend on how interns are defined as a job category by the employer. For example, if the employer defines “interns” as employees who are expected to work a certain number of months or no more than a certain number of hours per week, then the IRS will consider an exclusion of interns to be a service-based exclusion (requiring the minimum fail-safe language). Even if the employer does not define the “intern” position in terms of service, the IRS may still consider the categorical exclusion of interns to be a disguised service-based exclusion if, in the context of the employer’s job classifications, there is not a denominator (such as a job function or location) that defines interns beyond service. If an employer is unsure whether the IRS would consider its intern classification to be service-based, the safest alternative is to include the fail-safe language.

Whether or not interns are excluded may also impact other areas of compliance for a plan, such as nondiscrimination and minimum coverage testing.

Employers should discuss with their legal counsel whether their definition of “interns” could be considered a service-based exclusion.