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IRS Provides Relief to 403(b) Plans from the "Once-In-Always-In" Condition for Excluding Part-Time Employees

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December 17, 2018 TO: ICI Members
Pension Committee
Pension Operations Advisory Committee SUBJECTS: Pension RE: IRS Provides Relief to 403(b) Plans from the "Once-In-Always-In" Condition for Excluding Part-Time Employees

On December 4, 2018, the Internal Revenue Service issued Notice 2018-95,[1] providing relief for 403(b) plans that have not complied with the “once-in-always-in” (OIAI) condition for excluding part-time employees from plan participation. The OIAI condition requires that once an employee is eligible to make elective deferrals into a 403(b) plan, that employee may not be excluded from making elective deferrals in any future year based on the employee’s status as a part-time employee.

Background

Under Code section 403(b)(12), 403(b) plans must comply with the “universal availability” nondiscrimination rule, which provides that if an employer allows one employee to make elective deferrals under a 403(b) plan, then the employer must allow all of its employees to make elective deferrals. One exception to this requirement is that employers may exclude employees who normally work less than 20 hours per week. In final regulations under Code section 403(b) issued in 2007, the IRS interprets what is meant by the statutory language “normally work less than 20 hours per week.”

The regulation provides that “an employee normally works fewer than 20 hours per week if and only if—

1. (1) For the 12-month period beginning on the date the employee's employment commenced, the employer reasonably expects the employee to work fewer than 1,000 hours of service (as defined in section 410(a)(3)(C)) in such period; *and*

2. (2) For *each* plan year ending after the close of the 12-month period beginning on the date the employee's employment commenced (or, if the plan so provides, each subsequent 12-month period), the employee worked fewer than 1,000 hours of service in the preceding 12-month period."
   [Emphasis added.][2]

While the "first-year" exclusion condition (to exclude an employee for the first year of employment, the employer must *reasonably expect* the employee to work fewer than 1,000 hours during the employee's first year of employment) and the "preceding-year" exclusion condition (to exclude an employee for a year after the initial year of employment, the employee must have *actually* worked fewer than 1,000 hours in the preceding 12-month period)[3] are clearly articulated in the regulation as requirements for excluding part-time employees, many employers were simply not aware that the OIAI condition also applied. The IRS first specifically articulated the OIAI condition in writing in 2015, in sample plan language issued in connection with the 403(b) pre-approved plan program.[4] When employers realized that the IRS was requiring the OIAI condition, they requested relief.

Transition Relief

In Notice 2018-95, the IRS announces that it is providing relief from the OIAI exclusion condition during a transition period.

Plan operations

During the transition period, a plan will not be treated as failing to satisfy the rules regarding exclusion of part-time employees merely because the plan did not apply the OIAI exclusion condition. The transition period begins with taxable years beginning after December 31, 2008 (the effective date of the 403(b) regulations). For plans that apply the "preceding-year" exclusion condition based on plan years, the transition period ends on the last day of the last plan year that *ends before* December 31, 2019 (the transition period ends on December 31, 2018, for plans using the calendar year as the plan year). For plans that apply the "preceding-year" exclusion condition based on work anniversaries, the transition period ends, with respect to any employee, on the date of each employee's anniversary of employment, before December 31, 2019.

Plan language

In addition to relief regarding plan operations, the notice also includes relief regarding plan language. A 403(b) pre-approved plan that has not met the OIAI condition during the transition period (1) does not need to amend its plan to reflect that the plan did not apply the condition, and (2) will not be treated as failing to follow plan terms. For individually designed plans, an employer has until March 31, 2020 to correct defects in the plan language. After the transition period, all 403(b) plans that exclude part-time employees must include the OIAI exclusion condition language in the plan document.

Fresh-start opportunity

The notice includes a “fresh-start” opportunity in conjunction with the transition relief. Once the transition period ends, a plan may apply the OIAI exclusion condition as if the provision first became effective as of January 1, 2018.

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endnotes

[1] IRS Notice 2018-95 is available at https://www.irs.gov/pub/irs-drop/n-18-95.pdf.

[2] Treas. Reg. section 1.403(b)-5(b)(4)(iii)(B).

[3] Plans can apply the “preceding-year” exclusion condition to plan years or based on each employee’s anniversary of employment.

[4] The 2015 listings of required modifications, or LRMs, included the following sentence: “Once an Employee becomes eligible to have Elective Deferrals made on his or her behalf under the Plan under this [part-time exclusion] standard, the Employee cannot be excluded from eligibility to have Elective Deferrals made on his or her behalf in any later year under this standard.”
