

Relief for 403(b) Plans Regarding the Exclusion of Part-Time Employees

PUBLISHED: December 19, 2018

The IRS recently issued transition relief for section 403(b) plans where the “once-in-always-in” (OIAI) rule under the universal availability requirement has not been correctly applied to part-time employees. See Notice 2018-95 (Dec. 4, 2018). As described below, this guidance provides broad relief.

Universal Availability Requirement

Under section 403(b)(12)(A) of the Internal Revenue Code, all employees of an employer maintaining a section 403(b) plan (with the exception of certain church employers) generally must be permitted to make elective deferrals if any employee of the employer is permitted to make elective deferrals. This has become known as the “universal availability” rule. However, certain categories of employees may be excluded from making elective deferrals despite this requirement, including part-time employees who “normally work less than 20 hours per week”.

Part-Time Exclusions

How this 20-hour rule applied was the subject of new guidance in the final 403(b) regulations generally effective for 2009. Under those new regulations, a part-time employee may be excluded from making elective deferrals under the following rules:

1. During his or her first year of employment if the employer reasonably expects the employee to work fewer than 1,000 hours during that year (the “first-year exclusion condition”).
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 (the “the preceding-year exclusion condition”).

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3. The IRS has interpreted the phrase “for each plan year” to mean that once an employee does not meet a part-time exclusion condition (worked 1,000 hours or more), and is therefore permitted to make elective deferrals, the employee may not be excluded from making elective deferrals in subsequent years because he or she returns to part-time status for any subsequent year.

Relief

It is understood that some employers failed to apply the OIAI rule consistent with this interpretation, and would exclude part-time employees who had previously worked 1,000 hours or more and become eligible for the plan if they returned to working less than 1,000 hours a year. Correction of universal availability errors under the Employee Plans Compliance Resolution System could be expensive. The IRS has now issued relief for employers who had this misunderstanding, including a “Relief Period” and “fresh-start” opportunity.

The Relief Period encompasses taxable years beginning after December 31, 2008 through the end of the last exclusion year applicable to the employee that ends before December 31, 2019 (either the last day of the plan year or each employee’s anniversary year, based on the plan’s definition of exclusion year). During the Relief Period, a plan will not be treated as failing to satisfy the conditions of the part-time exclusion merely because the plan did not follow the OIAI requirement. However, this notice does not provide relief from application of the other conditions of the part-time exclusion: (1) the first-year exclusion condition, (2) the preceding-year exclusion condition, and (3) the requirement to consistently (i.e., uniformly) administer these conditions.

For plans that apply the part-time exclusion, the OIAI exclusion condition must be included in the plan document and applied in operation. However, the Notice also provides a fresh-start opportunity under which a plan will not be treated as failing to satisfy the conditions of the part-time exclusion if: (1) the part-time exclusion condition is applied as if the OIAI exclusion condition first became effective January 1, 2018, and (2) the plan was operated during the Relief Period in compliance with the OIAI exclusion or pursuant to the relief provided under the Notice.

Plan Language

During the Relief Period, a section 403(b) pre-approved plan will not be treated as failing to satisfy the conditions of the part-time exclusion or failing to follow plan terms in light of a failure to follow the OIAI exclusion condition, and is not required to be amended to reflect that the plan failed to apply the OIAI exclusion condition. For individually designed plans, an employer has until March 31, 2020, the end of the current remedial amendment period, to amend plan language to reflect the actual application of the OIAI exclusion condition.

Next Steps

Sponsors of section 403(b) plans should evaluate whether they have been applying the OIAI rule properly, and if necessary, correct for 2019. Sponsors of pre-approved and individually designed plans may also need to amend their plans to reflect this. For more information on how to apply this relief, please contact your Groom lawyer.