Relief from the Once-In-Always-In Condition for Excluding Part-Time Employees from Making Elective Deferrals under a § 403(b) Plan

Notice 2018-95

Section 1. PURPOSE

This notice provides transition relief from the "once-in-always-in" (OIAI) condition for excluding part-time employees under § 1.403(b)-5(b)(4)(iii)(B) of the Treasury Regulations. Under the OIAI exclusion condition, for a § 403(b) plan that excludes part-time employees from making elective deferrals, once an employee is eligible to make elective deferrals, the employee may not be excluded from making elective deferrals in any later exclusion year (as defined in section 2.02(2) of this notice) on the basis that the employee is a part-time employee. In addition, in applying the OIAI exclusion condition for exclusion years after the transition relief ends, this notice provides a fresh-start opportunity for plans.

Section 2. BACKGROUND

.01 Universal availability requirement for elective deferrals. Section 403(b)(12)(A) of the Internal Revenue Code ("Code") provides a "universal availability" nondiscrimination requirement that must be satisfied by a § 403(b) plan that permits employees to make elective deferrals. Under the universal availability requirement, all employees of an employer maintaining a § 403(b) plan generally must be permitted to make elective deferrals if any employee of the employer is permitted to make elective deferrals.

However, the flush language of § 403(b)(12)(A) provides that certain categories of employees may be excluded from making elective deferrals despite the universal availability requirement, including part-time employees who normally work less than 20 hours per week ("part-time exclusion").

.02 Part-time exclusion

On July 23, 2007, the Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) issued final regulations under § 403(b) (T.D. 9340, 72 FR 41128) (the "§ 403(b) regulations"), which provide rules regarding the part-time exclusion. The § 403(b) regulations also provide, under § 1.403(b)-3(b)(3)(i), that a § 403(b) plan must be a written plan that satisfies the requirements of the § 403(b) regulations in both form and operation, and must include all the material terms and conditions for eligibility. The § 403(b) regulations generally are effective for taxable years beginning after December 31, 2008.

(1) First-year, preceding-year, and OIAI exclusion conditions. Section 1.403(b)-5(b)(4)(iii)(B) provides the following rules regarding the part-time exclusion:

> [A]n employee normally works fewer than 20 hours per week *if and only if*—
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> *(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*) 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.]

Thus, the provision imposes three separate conditions for an employee to be excluded from making elective deferrals under the part-time exclusion: (1) a "first-year" exclusion condition, (2) a "preceding-year" exclusion condition, and (3) the OIAI exclusion condition. Under the first-year exclusion condition, in order to exclude the employee from making elective deferrals, the employer must reasonably expect the employee to work fewer than 1,000 hours during the employee's first year of employment. Under the preceding-year exclusion condition, in order to exclude the employee from making elective deferrals in an exclusion year ending after the first year of employment, the employee must have actually worked fewer than 1,000 hours in the preceding 12-month period. Under the OIAI exclusion condition, the employee may be excluded under the part-time exclusion *if and only if,* in the employee's first year of employment, the employee meets the first-year exclusion condition, *and,* in *each* exclusion year ending after the first year of employment, the employee has met the preceding-year exclusion condition. The effect of the OIAI exclusion condition is that once an employee does not meet the part-time exclusion conditions, whether in the initial year of employment or for any exclusion year, the employee may no longer be excluded from making elective deferrals under the part-time exclusion.

(2) Definition of exclusion year. For purposes of this notice, an exclusion year is either (1) any plan year that ends after an employee's first year of employment (so that the exclusion year for each employee would be the plan year), or (2) if a plan so provides, each subsequent 12-month period ("employee anniversary year") after an

employee's first year of employment (so that employees may have different exclusion years depending on their start dates).

(3) Consistency requirement. Section 1.403(b)-5(b)(4)(i) also imposes a "consistency" requirement, under which the part-time exclusion applies only if the rules applicable under § 410(b)(4) of the Code are satisfied. Under this consistency requirement, if any employee who meets the conditions of the part-time exclusion may make elective deferrals, then no employee who meets those conditions may be excluded under the part-time exclusion.

.03 Pre-approved plans

A § 403(b) plan may be either (1) a § 403(b) prototype plan or a § 403(b) volume submitter plan that has been approved in form by the IRS (collectively, a "§ 403(b) pre-approved plan")[1], or (2) a plan that is not a § 403(b) pre-approved plan (an "individually designed plan"). Rev. Proc. 2013-22 establishes a program for issuing opinion and advisory letters approving the form of § 403(b) pre-approved plans. Under section 9.02(1) of Rev. Proc. 2013-22, an employer that adopts a § 403(b) prototype plan may amend the plan only under certain circumstances (including by adopting sample or model amendments published by the IRS), and any other amendments will cause the employer's plan to be considered individually designed and to lose reliance on the opinion letter. Although a § 403(b) volume submitter plan may be amended by an adopting employer, section 15.01 of Rev. Proc. 2013-22 provides that the employer will

[1] See Rev. Proc. 2013-22, 2013-18 I.R.B. 985, as modified by Rev. Proc. 2014-28, 2014-16 I.R.B. 944, and clarified by Rev. Proc. 2015-22, 2015-11 I.R.B. 754, and Rev. Proc. 2017-18, 2017-5 I.R.B. 743.

not be able to rely on the advisory letter received for the § 403(b) volume submitter plan to the extent that the employer modifies the terms of the plan.

.04 Remedial Amendment Period

Section 21.02 of Rev. Proc. 2013-22 provides for a remedial amendment period during which an employer may retroactively correct defects in the form of its written § 403(b) plan either by timely adopting a § 403(b) pre-approved plan or by otherwise timely amending its written § 403(b) plan. Rev. Proc. 2017-18 sets March 31, 2020, as the last day of this remedial amendment period. Rev. Proc. 2017-18 also provides that the form of a plan will be considered to have satisfied the requirements of § 403(b) if, on or before March 31, 2020, all provisions of the plan that are necessary to satisfy § 403(b) have been adopted and made effective in form and operation from the beginning of the remedial amendment period (which is, generally, the later of January 1, 2010, or the effective date of the plan).

.05 Listing of Required Modifications

In 2013, the IRS released sample plan provisions (also referred to as “listings of required modifications” or “LRMs”) in connection with the § 403(b) pre-approved plan program (the “2013 LRMs”). LRM 17 of the 2013 LRMs provided sample adoption agreement language for excluding an employee who normally works fewer than 20 hours per week, which tracked the language of § 1.403(b)-5(b)(4)(iii)(B).

In 2015, in response to requests from commenters to clarify certain provisions, the IRS issued revised LRMs in connection with the § 403(b) pre-approved plan program

(the "2015 LRMs").[2] Revised LRM 17 of the 2015 LRMs included the following additional sentence that specifically highlights the OIAI exclusion condition in the regulations:

> 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.

.06 Request for relief with respect to the OIAI exclusion condition

Commenters have requested transition relief with respect to the OIAI exclusion condition, stating that many employers were not aware that the part-time exclusion included the OIAI exclusion condition. In particular, commenters noted that the OIAI exclusion condition was not specifically highlighted in writing until the 2015 LRMs were issued, and that, even then, the LRMs were directed at drafters of pre-approved plans and not adopting employers or sponsors of individually designed plans. As a result, commenters argued, many employers applied the first-year exclusion condition for an employee's first year and applied the preceding-year exclusion condition separately for each succeeding exclusion year, but did not apply the OIAI exclusion condition to prevent an employee who failed to meet either the first-year exclusion condition or the preceding-year exclusion condition from being excluded in all subsequent exclusion years.

[2] See https://www.irs.gov/pub/irs-tege/403b_lrm0315_redlined.pdf for the 2015 LRMs. This redlined version of the 2015 LRMs highlights changes made to the 2013 LRMs.

Section 3. RELIEF FOR § 403(b) PLANS

In response to these comments, the Treasury Department and the IRS are providing transition relief from the OIAI exclusion condition, including relief regarding plan operations for a transition period referred to as the "Relief Period," relief regarding plan language, and a fresh-start opportunity after the Relief Period ends. The Relief Period begins with taxable years beginning after December 31, 2008 (the general effective date for the § 403(b) regulations). For plans with exclusion years based on plan years, the Relief Period ends for all employees on the last day of the last exclusion year that ends before December 31, 2019. For plans with exclusion years based on employee anniversary years, the Relief Period ends, with respect to any employee, on the last day of that employee's last exclusion year that ends before December 31, 2019. For example, under this second type of plan design, if Employee A began employment on April 1, 2015, and Employee B began employment on July 20, 2015, the Relief Period for Employee A would end on March 31, 2019, while the Relief Period for Employee B would end on July 19, 2019.

.01 Relief regarding plan operations for the Relief Period

(1) In general. During the Relief Period[3], a plan will not be treated as failing to satisfy the conditions of the part-time exclusion merely because the plan was not operated in compliance with the OIAI exclusion condition. However, this notice does not provide relief from the other conditions of the part-time exclusion: (1) the first-year

[3] A plan with exclusion years based on employee anniversary years that excludes two or more employees with different employee anniversary years (and, therefore, different exclusion years) will have different Relief Periods applicable to these different employees. Nonetheless, for ease of reference, this notice refers to these multiple Relief Periods under such a plan as the Relief Period.

exclusion condition (that is, for the first year of employment, an employee may not be excluded if the employee was expected to work at least 1,000 hours in the first year), and (2) the preceding-year exclusion condition (that is, for exclusion years ending after the first year, an employee may not be excluded if the employee worked at least 1,000 hours in the preceding 12-month period). It also does not provide relief from the consistency requirement.

The following example illustrates the relief provided by this section 3.01(1).

Facts. An employer establishes a § 403(b) plan on January 1, 2009, with a calendar-year plan year. The plan allows elective deferrals, provides for the part-time exclusion, and uses plan years as exclusion years for purposes of applying the preceding-year exclusion condition under the part-time exclusion. During the period from plan establishment through 2018, the first-year and preceding-year exclusion conditions were applied in operation. However, the OIAI exclusion condition was not applied in operation.

An employee started work January 1, 2012, and the employer reasonably expected the employee to work only 500 hours in the employee's first 12 months of employment. The employee actually worked the following hours for calendar years 2012 through 2017:

Year	Hours Worked
2012	1,000
2013	500
2014	500
2015	500
2016	500
2017	1,000

Because the employee was not expected to work 1,000 hours during the employee's first 12 months of employment, the first-year exclusion condition was met; accordingly,

the employee was excluded from making elective deferrals during the employee's first 12 months of employment. Because the employee worked 1,000 hours during 2012 and 2017, the preceding-year exclusion condition was not met for the employee's 2013 and 2018 exclusion years; accordingly, the employee was allowed to make elective deferrals during those years. Because the employee did not work at least 1,000 hours in each of the twelve-month periods that preceded the 2014 through 2017 exclusion years, the preceding-year exclusion condition was met for each of those exclusion years. Further, because, for the 2014 through 2017 exclusion years, the preceding-year exclusion condition was met and the OIAI exclusion condition was not applied in operation, the employee was excluded from making elective deferrals under the part-time exclusion in each of the 2014 through 2017 exclusion years (even though the employee had been eligible to make elective deferrals during 2013).

Conclusion. Disregarding the relief provided in this section 3.01, under the part-time exclusion, the employee was properly excluded from making elective deferrals in 2012 (because the employee was not expected to work 1,000 hours in 2012) and properly allowed to make elective deferrals for the 2013 exclusion year (because the employee actually worked 1,000 hours in 2012), but was improperly excluded from making elective deferrals for the 2014 through 2017 exclusion years (because, under the OIAI exclusion condition, the employee's eligibility to make elective deferrals in the 2013 exclusion year would make the employee not excludible under the part-time exclusion for any period after that exclusion year). However, pursuant to the relief provided in this section 3.01, the plan is not treated as violating the universal availability requirement even though the OIAI exclusion condition, if properly applied, would have precluded excluding the employee from making elective deferrals in the 2014 through 2017 exclusion years.[4]

(2) Interaction of first-year exclusion condition and preceding-year exclusion condition during the Relief Period. For plans that use the plan year as the exclusion year, a failure to operate in compliance with the OIAI exclusion condition during the Relief Period may raise issues regarding the application of the first-year and preceding-year exclusion conditions during the period that includes both a portion of a new employee's initial 12 months of employment and a portion of the first plan year ending after the close of the new employee's initial 12 months of employment (the "overlap

[4] The OIAI exclusion condition, if properly applied, would also have provided an independent reason, in addition to the preceding-year exclusion condition, to prevent the exclusion of the employee from making elective deferrals in the 2018 exclusion year.

period"). For example, for such a plan with a calendar-year plan year, if an employee started work on October 1, 2015, then the employee's overlap period would be from January 1, 2016, through September 30, 2016. If the employer reasonably expected the employee to work 1,000 hours from October 1, 2015, through September 30, 2016, the employee only worked 500 hours from October 1, 2015, through December 31, 2015, and the plan did not apply the OIAI exclusion condition during the Relief Period, then issues would arise as to whether the employee would be permitted to make elective deferrals during the overlap period (due to application of the first-year exclusion condition) or would be prevented from making elective deferrals during the overlap period (due to application of the preceding-year exclusion condition). During the Relief Period, despite these issues, a plan will not be treated as failing to satisfy the conditions of the part-time exclusion during an employee's overlap period, if the plan has applied the first-year and preceding-year exclusion conditions with respect to overlap periods in a reasonable and uniform manner for all employees. After the Relief Period ends, and all plans operate in compliance with the OIAI exclusion condition, these issues involving new employees and the overlap period will no longer arise because, under the OIAI exclusion condition, once an employee does not meet the part-time exclusion conditions, whether in the initial year of employment or for any exclusion year, the employee may no longer be excluded from making elective deferrals under the part-time exclusion.

.02 Relief regarding plan language

(1) Pre-approved plans. Section 403(b) pre-approved plans include language that

applies the OIAI exclusion condition retroactive to 2009 (when the § 403(b) regulations became effective). If an employer that did not apply the OIAI exclusion condition adopts a § 403(b) pre-approved plan, the plan will, in the absence of relief, have an operational failure because the plan's past operation with respect to the OIAI exclusion condition will not match the plan's terms. However, under the transition relief provided in this section 3.02(1), a § 403(b) pre-approved plan adopted by an employer will not be treated as failing to satisfy the conditions of the part-time exclusion, and the plan will not be treated as having a failure to follow plan terms, merely because the form of the pre-approved plan for the Relief Period does not match the plan's operation with regard to the OIAI exclusion condition during the Relief Period. Accordingly, if the operational relief granted in section 3.01 applies, a § 403(b) pre-approved plan is not required to be amended to reflect that the plan failed to apply the OIAI exclusion condition during the Relief Period.

(2) Individually designed plans. An employer with an individually designed plan has until March 31, 2020 (the end of the remedial amendment period provided in Rev. Proc. 2013-22), to correct form defects in the plan. Under the transition relief provided in this section 3.02(2), if the operational relief granted in section 3.01 applies, an employer may amend plan language, through March 31, 2020, to reflect that the OIAI exclusion condition was not applied for all exclusion years, and that amendment will be treated as a correction of a form defect during the remedial amendment period. Solely for purposes of the relief in this section 3.02(2), plan language that tracks the regulatory language of the part-time exclusion without explicitly highlighting the OIAI

exclusion condition (such as, for example, LRM 17 of the 2013 LRMs, which did not explicitly highlight the OIAI exclusion condition) is treated as language that reflects that the OIAI exclusion condition was not applied. An employer's eligibility for the § 403(b) remedial amendment period will not be adversely affected merely because an employer uses the relief provided under this notice (even though, under Rev. Proc. 2017-18, the remedial amendment period generally is available to correct a form defect only if all provisions of the plan that are necessary to satisfy § 403(b) have been adopted and made effective in form and operation from the beginning of the remedial amendment period).

(3) Requirements after the Relief Period ends. For periods after the Relief Period ends, both § 403(b) pre-approved plans and individually designed plans that provide for the part-time exclusion must, pursuant to § 1.403(b)-3(b)(3)(i), include the OIAI exclusion condition in plan language.[5] This OIAI exclusion condition language must be included in the plan, for periods after the Relief Period ends, by the end of the remedial amendment period.

.03 Fresh-start opportunity after the Relief Period ends

In general, for exclusion years beginning on or after January 1, 2019, a plan that provides for the part-time exclusion must apply the OIAI exclusion condition in both form and operation. However, this section 3.03 provides a fresh-start opportunity under which a plan will not be treated as failing to satisfy the conditions of the part-time

[5] For example, LRM 17 of the 2015 LRMs provides sample language highlighting the OIAI exclusion condition. LRM 17 of the 2013 LRMs also includes the OIAI exclusion condition (even though it does not explicitly highlight the condition).

exclusion for periods after the Relief Period, if the OIAI exclusion condition is applied as if the OIAI exclusion condition first became effective January 1, 2018. Thus, a plan may apply the OIAI exclusion condition by disregarding the fact that the first-year exclusion condition was not met for an employee if the employee began employment before January 1, 2018, or the fact that the preceding-year exclusion condition was not met for an employee in any exclusion year before the first exclusion year beginning on or after January 1, 2018. Notwithstanding the foregoing, even if a plan applies this fresh-start opportunity with respect to the OIAI exclusion condition, the plan must have been operated during the Relief Period in compliance with the OIAI exclusion or pursuant to the relief provided under section 3.01 of this notice. Additionally, a plan (whether a § 403(b) pre-approved plan or an individually designed plan) is not required to be amended to reflect the use of this fresh-start opportunity in applying the OIAI exclusion condition.

The following examples illustrate the fresh-start opportunity provided in this section 3.03:

Example 1 (disregarding a prior failure to meet first-year exclusion condition). Facts. An employer established a § 403(b) plan on January 1, 2009, with a calendar-year plan year. The plan allows elective deferrals, provides for the part-time exclusion, and uses plan years as exclusion years for purposes of applying the preceding-year exclusion condition under the part-time exclusion. An employee started work on January 1, 2017, and the employer reasonably expected the employee to work 1,000 hours during the employee's first 12 months of employment. The employee actually worked 500 hours during the 2017 calendar year and 500 hours during the 2018 calendar year. The employee was allowed to make elective deferrals during the employee's first year of employment (the 2017 calendar year), and the employee is excluded from making elective deferrals during the 2018 exclusion year under the part-time exclusion. The employee is also excluded from making elective deferrals during the 2019 exclusion year under the part-time exclusion.

Conclusion. Without using the fresh-start opportunity provided in this section 3.03, the employee could not be excluded from making elective deferrals for the 2019 exclusion year because, under the OIAI exclusion condition, the employee could not be excluded for any subsequent exclusion year after the first-year exclusion condition was not met. That is, because the employer reasonably expected the employee to work at least 1,000 hours in the first year of employment, the employee could not be excluded from making elective deferrals in the first year of employment or in any subsequent exclusion year. However, pursuant to the fresh-start opportunity in this section 3.03, because the employee began employment before January 1, 2018, the employer may, in applying the OIAI exclusion condition, disregard the fact that the first-year exclusion condition was not met. Accordingly, excluding the employee from making elective deferrals during the 2019 exclusion year will not be treated as a failure to satisfy the conditions of the part-time exclusion.

Example 2 (disregarding a prior failure to meet preceding-year exclusion condition). Facts. An employer established a § 403(b) plan on January 1, 2009, with a calendar-year plan year. The plan allows elective deferrals, provides for the part-time exclusion, and uses plan years as exclusion years for purposes of applying the preceding-year exclusion condition under the part-time exclusion. An employee started work on January 1, 2016, and the employer reasonably expected the employee to work only 500 hours in the employee's first 12 months of employment. The employee actually worked 1,000 hours in the 2016 calendar year, but worked only 500 hours in the 2017 calendar year and 500 hours in the 2018 calendar year. The employee was excluded from making elective deferrals during the employee's first year of employment (the 2016 calendar year) under the part-time exclusion, but was allowed to make elective deferrals during the 2017 exclusion year. The employee is excluded from making elective deferrals during the 2018 exclusion year and the 2019 exclusion year under the part-time exclusion.

Conclusion. Without using the fresh-start opportunity provided in this section 3.03, the employee could not be excluded from making elective deferrals for the 2019 exclusion year, because, under the OIAI exclusion condition, the employee could not be excluded for any subsequent exclusion year after the preceding-year exclusion condition was not met for the 2017 exclusion year. That is, once the employee works at least 1,000 hours in the applicable 12-month period preceding an exclusion year, the employee could not be excluded from making elective deferrals in that exclusion year or in any subsequent exclusion year. However, pursuant to the fresh-start opportunity in this section 3.03, because the exclusion year for which the preceding-year exclusion condition was not met was an exclusion year before the first exclusion year beginning on or after January 1, 2018, the employer may disregard the fact that the preceding-year exclusion condition was not met for that exclusion year. Accordingly, excluding the employee from making elective deferrals during the 2019 exclusion year will not be treated as a failure to satisfy the conditions of the part-time exclusion.

Section 4. DRAFTING INFORMATION

The principal author of this notice is Patrick T. Gutierrez of the Office of Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this notice, contact Patrick T. Gutierrez at (202) 317-4148 (not a toll-free number).