

## Internal Revenue Service Provides Transition Relief to Code Section 403(b) Plans for Violations of the Once-In-Always-In Rule

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The Internal Revenue Service (IRS) recently issued guidance providing transition relief to employers who have not correctly applied the “once-in-always-in” rule (the “OIAI rule”) and, as a result, have wrongfully excluded part-time employees from participating in their Internal Revenue Code (Code) Section 403(b) plans. Under the OIAI rule, once an employee is eligible to make elective deferrals to a 403(b) plan, the employer may not exclude the employee from making elective deferrals to the plan in a later year on the basis that the employee works part-time. In response to information indicating that many employers have failed to properly administer the OIAI rule, the IRS issued Notice 2018-95 (the “Notice”) to provide transition relief with respect to certain violations of that rule. This article addresses the scope of the transition relief and discusses what a 403(b) plan sponsor must do to take advantage of it. (Although the Notice also addresses a “fresh start opportunity” after the transition relief period ends, a discussion of that provision is beyond the scope of this article.)



### Background: The Universal Availability Rule

Code Section 403(b)(12)(A)(ii) provides a “universal availability” nondiscrimination requirement applicable to all 403(b) plans. Under this requirement, or the “universal availability rule,” if any employee is permitted to make elective deferrals to an employer’s 403(b) plan, then all employees of that employer must be permitted to make elective deferrals to the plan. However, the final Treasury Regulations under Code Section 403(b), which were issued in 2007, contain limited exceptions to the universal availability rule. One such exception permits an employer to exclude

from participation any part-time employee who normally works fewer than 20 hours per week (the “part-time employee exclusion”).

Under the part-time employee exclusion, a part-time employee is treated as normally working fewer than 20 hours per week if two conditions are met. First, the employer must reasonably expect the employee to work fewer than 1,000 hours of service in the employee’s first year of employment — the “first year exclusion condition.” And second, for each plan year ending after the employee’s first year of employment, the employee must have actually worked fewer than 1,000 hours of service in the preceding 12-month period — the “preceding year exclusion condition.”

## OIAI Rule Violations and Transitional Relief

In the Notice, the IRS addressed the fact that several sponsors of 403(b) plans requested relief from violations of the OIAI rule, on the basis that they were not aware that the part-time employee exclusion was subject to the OIAI rule. Specifically, employers reported that they had applied the first year exclusion condition during a part-time employee’s first 12 months of employment and then applied the preceding year exclusion condition separately to each succeeding year, while never applying the OIAI rule to prevent a part-time employee who did not satisfy both the first year and preceding year exclusion conditions from being excluded in all subsequent years. As a result, many employers conceded to having allowed a part-time employee to participate in an earlier year, and then excluding the same individual in a later year under the part-time employee exclusion. These employers expressed that they were not aware that this was a violation of the OIAI rule. The IRS responded to this situation by issuing transition relief for violations of the OIAI rule with respect to both operation and form.

### 1. Transition relief for plan operations

The Notice provides that during the transition “relief period,” a 403(b) plan will not be treated as failing to satisfy the conditions of the part-time employee exclusion merely because the plan was not operated in compliance with the OIAI rule. For these purposes, the relief period starts with tax years beginning after December 31, 2008 (i.e., the effective date of the 403(b) final regulations), and:

- *for plans with exclusion years based on plan years*, ends for all employees on the last day of the last exclusion year that ends before December 31, 2019, or
- *for plans with exclusion years based on an employee’s anniversary year*, ends with respect to any employee on the last day of the employee’s last exclusion year that ends before December 31, 2019. (For example, if Employee A began employment on April 1, 2015, and Employee B began on July 20, 2015, the relief period for Employee A would end on March 31, 2019 and for Employee B would end on July 19, 2019.)

The IRS makes clear that the transition relief does not provide relief from other conditions of the part-time employee exclusion (e.g., a failure to properly apply the first-year or the preceding-year exclusion conditions, etc.). Accordingly, a plan sponsor relying on the transition relief will not be treated as having violated the part-time employee exclusion exception to the universal

availability rule, as a result of any operational violations of the OIAI rule that may have occurred during the relief period.

## **2. Transition relief for plan language**

The Notice also provides transition relief for plan language failures that vary depending on whether an employer has adopted an IRS pre-approved 403(b) plan document or an individually designed plan document.

**Pre-Approved Plans.** All IRS pre-approved 403(b) plan documents contain language that applies the OIAI rule retroactive to 2009, in accordance with the 403(b) final regulations. As a result, if an employer who adopted an IRS pre-approved plan document failed to follow the OIAI rule in operation, its 403(b) plan also incurred an operational failure (since its operation did not match the terms of the plan document with respect to application of the OIAI rule). However, the Notice provides that an employer who adopts an IRS pre-approved plan document will not be treated as having failed to apply the part-time employee exclusion condition correctly, solely on the basis that the pre-approved plan document's language did not match the plan's operation with respect to the OIAI rule during the relief period. Therefore, the plan will not be treated as having incurred an operational failure in this regard. Accordingly, under the Notice a plan sponsor relying on the operational relief described above is not required to amend its IRS pre-approved plan document to reflect that the plan failed to apply the OIAI rule correctly.

**Individually Designed Plans.** Under the Notice, an employer who adopted an individually designed 403(b) plan has until March 31, 2020, to amend the plan document to correct any form defects with respect to the OIAI rule. This means that if, during the transition period, the plan sponsor did not properly apply the OIAI rule, the plan must be amended to reflect the plan's actual operation in this regard. The amendment will be treated as a correction of the form defect.

Once the remedial amendment period ends, the Notice provides that both individually designed and IRS pre-approved plan documents that provide for the part-time employee exclusion must include the OIAI rule. The Notice also references several IRS "listing of required modifications" (LRMs) — specifically LRM 17 of the 2013 LRMs and LRM 17 of the 2015 LRMs — as sample language for plan sponsors to use.

## **Take-Aways**

In light of the transition relief available under the Notice, we recommend that plan sponsors evaluate their 403(b) plan operations to determine whether the OIAI rule has been properly applied to all part-time employees. And, if an operational violation of that rule has occurred in a manner eligible for the transition relief, correction should be made and documented in accordance with the terms of the Notice. If the 403(b) plan document is based on an individually designed document, correction may include timely amending the plan to reflect the form relief available under the Notice (we recommend finalizing any such amendment in 2019).

The universal availability rule is a nondiscrimination requirement for all 403(b) plans. Therefore, if a 403(b) plan sponsor is relying on the part-time employee exclusion, it is imperative that it have

in place practices and procedures to ensure that the OIAI rule is being properly followed in both form and operation.

Please contact the Trucker Huss attorney with whom you normally work if you need assistance in determining whether you have operated your 403(b) plan in compliance with the OIAI rule, and/or you have any questions about the relief provided under the Notice.

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