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Part-timers Improperly Excluded from Your 403(b) Plan? There's Still Time to Correct That!

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Authors
Joanne Jacobson, JD, LLM
Julia Zuckerman, JD

Employers that have excluded part-time employees from making deferrals under a 403(b) plan after initial participation in violation of the "once in always in" rule now have the chance to correct both the plan document and operations without penalty.

Background

With certain exceptions, the Internal Revenue Code requires all employees of an employer that sponsors a 403(b) plan to be eligible to make elective deferrals — commonly referred to as "universal eligibility." One exception is for part-time employees who normally work less than 20 hours a week (i.e., 1,000 hours in 12 months) — subject to certain conditions and if provided for under the terms of the plan. Specifically, for a part-time employee to be ineligible to make deferrals, (1) the employer must reasonably expect the employee to work less than 1,000 hours in the first year of employment and (2) for each subsequent "exclusion" year (plan year or date of hire anniversary year, depending on plan terms), the employee must have worked less than 1,000 hours in the previous year. Once an employee fails to meet either condition, the employee must be permitted to participate going forward. This concept is known as the "once in always in" rule.

> **For example:** Employee A was hired on January 1, 2016 on a part-time basis and was not expected to work 1,000 hours; she was not eligible to make deferrals in 2016 as the plan document allowed for exclusion of part-time employees who are expected to or work less than 20 hours a week. However, Employee A ended up working more than 1,000 hours in 2016. In 2017 — her first "exclusion" year — she only worked 500 hours but was eligible to make deferrals based on her 2016 hours. Employee A only works 500 hours each in 2018 and 2019 but must be permitted to make deferrals in those years.

In 2015, the IRS issued a revised List of Required Modifications for sample language under a 403(b) pre-approved ("prototype") plan that clarifies this rule. The guidance confirmed that once a part-time employee falls outside one of the two conditions and becomes eligible to make elective deferrals, the

employee may no longer be excluded from the plan even if the employee works less than 1,000 hours in a subsequent year.

Confused employers get a reprieve

Many employers were unaware of the "once in always in" rule and excluded employees who moved from full-time to part-time status. In response, the IRS issued Notice 2018-95 to provide relief from this rule for both plan operations and plan language during a transition period ("Relief Period"). Under this guidance, an employer will not be treated as failing to satisfy the conditions of the part-time exclusion during the Relief Period for a failure to include a part-time employee who had previously participated.

> **Note:** Both document and operational errors, if not corrected or otherwise eligible for relief during the transition period, are qualification errors that can, in the extreme, result in plan disqualification with potential adverse tax effects for plan participants.

The Relief Period runs from taxable years beginning after December 31, 2008 through the last day of the exclusion year that ends before December 31, 2019. This means that for most calendar year plans, the Relief Period ended on December 31, 2018. However, the Notice provides a "fresh start" for years beginning on or after January 1, 2019 that allows plan sponsors to treat the "once in always in" rule as initially effective January 1, 2018 so that prior years that an employee satisfied the eligibility condition are ignored in determining eligibility for 2019 and beyond.

> **For example:** Same example as above, except that Employee A was excluded from making deferrals in 2018 because the "once in always in" rule was not applied. The relief allows the exclusion to stand. For 2019 and future years, the "fresh start" allows the employer to ignore the hours worked in 2016 and continue to exclude Employee A from the plan until Employee A completes 1,000 hours in a prior 12-month period (2018 or later). Employee A works 1,000 hours in 2019 and is permitted to start deferrals again in 2020.

The Notice also gives employers until March 31, 2020 to amend individually-designed 403(b) plans to reflect that the "once in always in" rule was not applied for the exclusion years during the Relief Period (assuming the plan document had stated the part-time exclusion correctly) and to add it effective for future deferrals. Prototypes were only approved with the correct language. IRS is providing relief without requiring them to amend for faulty years to match operations.

In closing

Employers that were not aware that employees once eligible to participate in a 403(b) plan must always be eligible, regardless of their current status as part-time employees, now have the chance to fix their plan and operations without penalty and without retroactive contributions. The fix applies generally to operations beginning with 2019 and to plan amendments made by March 31, 2020.

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