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Excluding Part-Time Employees Under the 403(b) Universal Availability Rules

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Application of the "fewer than 20 hours per week" rule to exclude part-time employees under "universal availability" rules of Internal Revenue Code (Code) Section 403(b) has become a source of confusion for employers, third-party administrators, practitioners, and other advisors, and has resulted in noncompliance. The rules for a

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403(b) plan subject to the Employee Retirement Income Security Act of 1974 (ERISA) appear to be relatively clear, and the rules for a 403(b) plan exempt from ERISA, including a plan of a public school or university, may not be all that different.

BACKGROUND ON THE UNIVERSAL AVAILABILITY RULES OF CODE SECTION 403(B)

The universal availability rules of Code Section 403(b) are a nondiscrimination requirement with respect to elective deferrals (including Roth contributions).[1] Subject to the exceptions described below, universal availability essentially requires that, if any employee[2] of an employer eligible to have employees covered under a 403(b) plan (an "eligible employer")[3] can elect to have the employer make contributions of more than $200 to a 403(b) plan pursuant to a salary reduction agreement, all employees of the employer must be able to make such election.[4] The universal availability rules do not apply to a 403(b) plan maintained by a "church" as defined by Code Section 3121(w)(3)(A) or a "qualified church-controlled organization" as defined by Code Section 3121(w)(3)(B).[5]

EMPLOYEES WHO CAN BE EXCLUDED FROM UNIVERSAL AVAILABILITY

The final 403(b) regulations, issued in 2007 and effective January 1, 2009, provide five classifications of employees who can be excluded from making elective deferrals under a 403(b) plan.[6] Employees who can be excluded from making elective deferrals under a 403(b) plan without violating the universal availability rules are:

- Employees who are eligible to make elective deferrals under another 403(b) plan of the employer or under a 457(b) eligible governmental plan of the employer.[7]

- Employees who are eligible to make elective deferrals under a 401(k) plan of the employer.[8]

- Employees who are nonresident aliens described in Code Section 410(b)(3)(C).[9]

- Employees who are students performing services described in Code Section 3121(b)(10), subject to the conditions applicable under Code Section 410(b)(4) (including Code Section 410(b)(4)(B) permitting separate testing for employees not meeting minimum age and service requirements).[10]

- Employees who normally work fewer than 20 hours per week (or such lower number of hours per week as the plan may provide), subject to the conditions applicable under Code Section 410(b)(4).

The last of the five exclusions listed above is the focus of this article. Note that the requirement to subject the exclusion of employees who normally work fewer than 20 hours per week to the conditions applicable under Code Section 410(b)(4) is statutory and not merely regulatory; that is, Code Section 403(b)(12) expressly includes such language.[11] The 403(b) regulations indicate that, because the exclusion of employees who normally work fewer than 20 hours per week is subject to the conditions applicable under Code Section 410(b)(4), if any employee who normally works fewer than 20 hours per week has the right to have elective deferrals made on his or her behalf, then no such employee may be excluded.[12]

EMPLOYER AND AFTER-TAX EMPLOYEE CONTRIBUTIONS ARE NOT SUBJECT TO UNIVERSAL AVAILABILITY

The universal availability rules do not apply to contributions other than elective deferrals, although the rules apply to Roth contributions, which are considered elective deferrals for purposes of the universal availability rules.[13] Employer matching and employer nonmatching, nonelective contributions made to a 403(b) plan are not subject to the universal availability rules of Code Section 403(b)(12), nor are after-tax (non-Roth) employee contributions. Employer matching and employer nonmatching, nonelective contributions and after-tax (non-Roth) employee contributions are instead subject to nondiscrimination and coverage requirements of Code Sections 401(a)(4), 401(m), and 410(b) in the same manner as if the 403(b) plan were described in Code Section 401(a).[14] However, those coverage and nondiscrimination requirements do not apply to a governmental 403(b) plan (within the meaning of Code Section 414(d)) maintained by a state or local government (or a political subdivision, agency, or instrumentality of a state or local government) or a 403(b) plan maintained by a "church" as defined by Code Section 3121(w)(3)(A) or a "qualified church-controlled organization" as defined by Code Section 3121(w)(3)(B).[15]

One situation in which the universal availability rules may come into play is with respect to a 403(b) plan that is intended to satisfy one of the actual contribution percentage (ACP) test "safe harbor" designs of Code Sections 401(m)(11) or 401(m)(12). One of the requirements of the ACP safe harbor designs is that the matching or nonelective employer contributions intended to satisfy the requirements of the ACP safe harbor must be provided to all nonhighly compensated employees eligible to make elective deferrals to the 403(b) plan.[16] Unless the employer intends to provide those the matching or nonelective employer contributions to all employees required to be eligible to make elective deferrals under the universal availability rules, the employer may need to maintain a second plan for those employees to whom the employer does not wish to provide those the matching or nonelective employer contributions. By allowing those employees to make elective deferrals to the second plan, the exception to the universal availability rules for employees who participate in one of the other plans permitted by the exception can be satisfied.[17]

WHO IS AN EMPLOYEE THAT NORMALLY WORKS FEWER THAN 20 HOURS PER WEEK?

For purposes of excluding an employee from the universal availability requirement to be eligible for 403(b) elective deferrals, the regulations define the class of employees who normally work fewer than 20 hours per week. The 403(b) regulations provide the following definition:

> an employee normally works fewer than 20 hours per week if and only if—
>
> (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.
>
> (See, however, Section 202(a)(1) of the Employee Retirement Income Security Act of 1974 (ERISA) (88 Stat. 829) Public Law 93–406, and regulations under Section 410(a) of the

> Internal Revenue Code applicable with respect to plans that are subject to Title I of ERISA.)[18]

For those 403(b) plans subject to ERISA, the parenthetical in the above quote from the 403(b) regulations makes it rather clear that the rules under Code Section 410(a) and the parallel provisions of ERISA Section 202(a)(1) and related regulations apply in the same manner as would apply to a tax-qualified plan under Code Section 401(a).[19] Under those rules, once an employee has at least 1,000 hours of service in the applicable 12-month measurement period, the employee can no longer be excluded and must be allowed to participate in making elective deferrals no later than the earlier of (1) the first day of the first plan year beginning after the date the employee satisfied the 1,000 hours of service requirement or (2) the date 6 months after the date the employee satisfied the 1,000 hours of service requirement.[20] Unlike the rule in the above quote from the 403(b) regulations, there is not simply a "look back" to the prior 12-month period to determine whether the employee begins participating at the start of the current 12-month period. Further, for 403(b) plans subject to ERISA, the rules under Code Section 410(a) and the parallel provisions of ERISA Section 202(a)(1) and related regulations require that the employee continue to be able to participate in elective deferrals for subsequent 12-month periods while employed by the employer.[21]

In addition, the rules under Code Section 410(a) and the parallel provisions of ERISA Section 202(a)(1) and related regulations would permit a plan to exclude even a full-time employee until such employee completed 1,000 hours of service (or completed a permitted alternative measure of a year of service) during the applicable 12-month measurement period. However, the "fewer than 20 hours per week" rule of 403(b) universal availability would not permit a full-time employee to initially be excluded from making elective deferrals, because a full-time employee would not reasonably be expected to work fewer than 1,000 hours of service during the employee's first 12 months of employment and would not normally work fewer than 20 hours per week. An employer sponsoring a 403(b) plan subject to ERISA should be aware of this distinction in applying the first-prong of the two-prong test of an employee who normally works fewer than 20 hours per week. It seems unlikely that the typical employer would want to exclude full-time employees from making elective deferrals unless they satisfied one of the other exclusions of the five exclusions permitted under universal availability rules, particularly since the employer could exclude those employees from receiving a matching contribution until they completed 1,000 hours of service (or a permitted alternative measure of a year of service) during the applicable 12-month measurement period.[22]

PRIOR 12-MONTH LOOK BACK RULE OF CODE SECTION 403(B)

A number of practitioners and other plan advisors have taken the position that the 12-month look back rule for determining whether an employee normally works fewer than 20 hours per week (*i.e.*, paragraph (2) of the regulation quoted above) is applied such that an employee expected to work fewer than 20 hours per week switches between being eligible and ineligible to make elective deferrals from year to year, depending on whether the employee had 1,000 hours of service in the immediately preceding year. Although the regulatory language could perhaps be clearer, it appears that position is not the proper reading of the regulatory language, based on informal guidance from the Internal Revenue Service (IRS) and a plain reading of the regulation.[23]

The following example should aid in making this discussion clearer:

Example

Sandy is hired by an eligible employer on July 1, 2009 and is reasonably expected to work fewer than 1,000 hours during the 12-month period commencing July 1, 2009. Sandy's employer excludes an employee from making elective deferrals to a 403(b) plan that is not subject to ERISA, provided the employee normally works fewer than 20 hours per week as described by the above quote from the 403(b) regulations (excluding the parenthetical reference for plans subject to ERISA). The 403(b) plan has a calendar plan year and the plan does not provide for a 12-month look back period based on anniversaries of an employee's employment commencement date. The first plan year ending after the close of the 12-month period beginning on the date the employee's employment commenced is 2010.

Sandy works less than 1,000 hours in 2009, 2010, and 2012, but works more than 1,000 hours in 2011.

In the example, Sandy satisfies the first prong of the two-prong test to be excluded from participating in elective deferrals under the 403(b) plan, because "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." The second prong of the test requires that, “For each plan year ending after the close of the 12-month period beginning on the date the employee’s employment commenced … the employee worked fewer than 1,000 hours of service in the preceding 12-month period.”[24]

Sandy can be excluded for the 2009 plan year, because the employer reasonably expected Sandy would work fewer than 1,000 hours from July 1, 2009 through June 30, 2010. Sandy can be excluded for the 2010 and 2011 plan years, because Sandy worked fewer than 1,000 hours in the preceding 12-month period (*i.e.*, the preceding plan year) for each plan year ending after the close of the 12-month period beginning on the date the Sandy’s employment commenced (*i.e.*, for each plan year ending after June 30, 2010). However, because Sandy worked more than 1,000 hours in 2011, Sandy cannot be excluded from participating in elective deferrals to the 403(b) plan for the 2012 plan year.

So what happens for 2013? As noted above, some advisors would say that, because Sandy worked fewer than 1,000 hours in 2012 and is expected to work fewer than 20 hours per week in 2013, Sandy can once again be excluded from participating in elective deferrals to the 403(b) plan for 2013. Many of those advisors would say Sandy must be excluded for 2013 to avoid running afoul of the “conditions applicable under Code Section 410(b)(4)” that must be applied to the exclusion of employees who normally work fewer than 20 hours per week (described previously). However, the second prong of the test does not look only at what happened in the immediately preceding 12-month period, but rather the second prong of the test requires that Sandy have worked fewer than 1,000 hours of service in the preceding 12-month period *for each plan year* ending after the close of the 12-month period beginning on the date the Sandy’s employment commenced (*i.e.*, *for each plan year* ending after June 30, 2010). The latter interpretation is consistent with informal guidance and the Department of the Treasury’s and IRS’s general perspective on excluding part-time employees from plan participation only if they never have 1,000 hours of service in an applicable 12-month measurement period.

CONDITIONS APPLICABLE UNDER CODE SECTION 410(B)(4)

Many advisors have been concerned about how to avoid running afoul of the “conditions applicable under Code Section 410(b)(4)” that must be applied to the exclusion of employees who normally work fewer than 20 hours per week. In the case of a 403(b) plan subject to ERISA, some of those advisors have said that it is not possible to exclude employees who normally work fewer than 20 hours per week, because the rules that apply to a 403(b) plan subject to ERISA (*i.e.*, the rules under Code Section 410(a) and the parallel provisions of ERISA Section 202(a)(1) and related regulations) require that the employee continue to be able to participate in elective deferrals for subsequent 12-month periods while employed by the employer.[25] Essentially, their concern has been that ERISA requires the employee who subsequently works less than 1,000 hours to remain a participant in a 403(b) plan subject to ERISA ("once in, always in"), but the 403(b) regulations require the employee who subsequently works less than 1,000 hours to be excluded because the exclusion is subject to the conditions applicable under Code Section 410(b)(4) ("if anyone who works fewer than 20 hours per week is not excluded, no one who works fewer than 20 hours per week can be excluded"). Their conclusion is that an ERISA 403(b) plan must permit employees who normally work fewer than 20 hours per week to participate in elective deferrals, because once any one of those employees works 1,000 hours in a year, the conditions applicable under Code Section 410(b)(4) will be violated unless all those employees can participate.

The conclusion of the prior paragraph appears to be based on an improper reading of the 403(b) regulations. The key is in the definition of an employee who normally works fewer than 20 hours per week. An employee normally works fewer than 20 hours per week *if and only if*: (1) the employer reasonably expects the employee to work fewer than 1,000 hours of service for the 12-month period beginning on the date the employee's employment commenced *and* (2) the employee worked fewer than 1,000 hours of service in the preceding 12-month period *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 prior sentence defines a classification of employee. Once an employee works at least 1,000 hours of service in a preceding 12-month period, that employee no longer belongs to the class of employees considered to normally work fewer than 20 hours per week. Under this interpretation of the definition, there is not an insurmountable inconsistency between the application of ERISA and the Code for purposes of determining when an employee has met the minimum service requirement to participate in 403(b) elective deferrals.

The question of the possible inconsistency between the ERISA and Code rules was raised with IRS and Department of the Treasury (Treasury) representatives at the May 2009 Meeting of the American Bar Association Section of Taxation. The question and answer were summarized in a report based on the notes and recollections of representatives from the Joint Committee on Employee Benefits as Q&A-17. While the responses of IRS and Treasury representatives at such meetings reflect the unofficial, individual views of the representative as of the time of the meeting and do not necessarily represent official policy, and cannot be relied upon by any taxpayer, such responses can provide insight into the intent of official guidance. According to the response summary in the report, a 403(b) plan subject to ERISA must independently satisfy the requirements of the 403(b) regulations and ERISA. However, quoting from the report's summary of the response:

> For purposes of ERISA, there can be a 1,000 hour of service requirement in the initial eligibility computation period for those who are reasonably expected to be below the 20-hour per week level. In such situations, the employee would be eligible at the end of the 12-month period if the employee satisfied the 1,000 hours of service requirement. If the employee does not satisfy the 1,000 hours of service requirement, the employer must keep testing using the normal ERISA rules for the future, which is the same rule as in the Section 403(b) regulations.

The response summary also noted that the IRS intended to accommodate this situation in the draft 403(b) prototype plan language provided along with Announcement 2009-34 in the list of required modifications (LRM) item 13.[26] Included at the beginning of the draft 403(b) prototype plan language is a note to sponsors of Section 403(b) prototype plans stating that, "Since the IRS does not have jurisdiction over Title I [of ERISA], this package does not contain sample Title I plan provisions." LRM item 13 provides the following definition: "An Employee normally works fewer than 20 hours per week if, 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 under Section 410(a)(3)(C) of the Internal Revenue Code) and, for each Plan Year ending after the close of that 12-month period, the Employee has worked fewer than 1,000 hours of service."

More recently, the question of whether an employee who works at least 1,000 hours one year and less than 1,000 hours in a subsequent year once again becomes excludable under the universal availability rules of Code Section 403(b)(12), without regard to ERISA, was asked specifically at the May 2012 Meeting of the American Bar Association Section of Taxation. Again, the responses of IRS and Treasury representatives at such meetings reflect the unofficial, individual views of the representative as of the time of the meeting and do not necessarily represent official policy, and cannot be relied upon by any taxpayer, but such responses can provide insight into the intent of official guidance. The question and answer were summarized in a report based on the notes and recollections of representatives from the Joint Committee on Employee Benefits as Q&A-17. The question asked was whether, once an employee works 1,000 hours of service during a plan year, will the employee thereafter never be excludable for purposes of the universal availability rule, even if the employee moves from full-time to part-time employment? The answer proposed by the questioner was, yes, there is no exception in the regulations for employees who work 1,000 hours in one year and fewer than 1,000 in the next. According to the summary report, the government representative agreed that there is no exception in the regulations for employees who work 1,000 hours in one year and fewer than 1,000 in the next.

ALTERNATIVES TO TRACKING HOURS OF SERVICE

The question of whether an alternative rule explicitly applicable for determining a "year of service" as defined under Code Section 403(b)(4) based on a measure of work other than hours of service, such as the number of courses taught during an annual work period, could be applied to measure whether an employee normally works fewer than 20 hours per week was recently raised at the May 2012 Meeting of the American Bar Association Section of Taxation. The question was based on an example from the 403(b) regulations intended for determining a "year of service" as defined under Code Section 403(b)(4), which is used for purposes of the 15-years of service special catch-up contribution permitted for employees of certain "qualified organizations" and determining "includible compensation" for purposes of the limitation on annual additions under Code Section 415.[27] The example involves determining a "year of service" as defined under Code Section 403(b)(4) for those purposes in which an adjunct faculty member teaches one course for three hours per week for one semester and regular, full-time faculty members teach nine hours per week for two semesters. The example concludes that the adjunct faculty member is considered to have completed one-sixth of a year of service during the academic year.[28] The question was whether an alternative rule to measure service for determining a "year of service" as defined under Code Section 403(b)(4) could be used to determine whether an employee normally works fewer than 20 hours per week for purposes of the universal availability exclusion.

The question and answer were summarized in a report based on the notes and recollections of representatives from the Joint Committee on Employee Benefits as Q&A-18. Again, the responses of IRS and Treasury representatives at such meetings reflect the unofficial, individual views of the representative as of the time of the meeting and do not necessarily represent official policy, and cannot be relied upon by any taxpayer, but such responses can provide insight into the intent of official guidance. According to the summary report, the government representative noted that a plan cannot import a definition from one section of the regulations to another when the regulations explicitly state the purpose for which a definition applies. The government representative indicated that, because the regulations explicitly state such alternative based on a measure of work other than hours of service applied for purposes of determining a "year of service" as defined under Code Section 403(b)(4), such alternative could not be used to determine whether an employee normally works fewer than 20 hours per week for purposes of the universal availability exclusion.

According to the September 24, 2012, BNA Daily Tax Report, the IRS is aware that some employers use alternative methods to determine whether an employee normally works fewer than 20 hours per week. BNA references remarks made by an IRS representative during an American Law Institute Continuing Legal Education course on September 21. According to BNA, the representative stated that the IRS will consider them on a case by case basis and such employers will have to defend such alternative methods on audit.[29]

ALTERNATIVES AVAILABLE FOR PLANS SUBJECT TO ERISA

As noted at the start of this article, the parenthetical in the definition of an employee who normally works fewer than 20 hours per week indicates that the rules under Code Section 410(a) and the parallel provisions of ERISA Section 202(a)(1) and related regulations apply to those 403(b) plans subject to ERISA. Those rules provide for methods for measuring a year of service for purposes of satisfying the minimum service requirement to participate in a plan under Code Section 410(a) and ERISA Section 202(a)(1) that are alternatives to tracking hours of service during the applicable 12-month measurement period to determine whether an employee worked at least 1,000 hours during such period. Alternative methods for measuring service include using hours of service equivalencies for periods of employment (specified by the regulations) or elapsed time for periods of employment.[30] Note, however, that the alternatives generally are more generous than actually tracking hours. For instance, the elapsed time method generally measures service as a period of employment from an employee's first hour of service until the employee has a severance from service and, with certain exceptions, aggregates multiple periods of employment to determine a year of service for purposes of eligibility to participate in a plan. The hours of service equivalencies method allows a plan to assign hours of service based on a specified period during which an employee has at least one hour of service. For example, under the hours of service equivalencies method, a plan could credit an employee with 10 hours of service for each day an employee has at least one hour of service, 45 hours of service for each week an employee has at least one hour of service, or 190 hours for each month an employee has at least one hour of service.[31]

One could interpret the unofficial comments described earlier in this article in at least one of two ways. The IRS and/or Treasury could mean that, in order to satisfy both the 403(b) universal availability requirements and the ERISA requirements, a 403(b) plan subject to ERISA must track hours of service to determine whether an employee has ever had at least 1,000 hours in a 12-month measurement period. While that could permit use of the hours of service equivalencies for periods of employment described above, it might not permit use of the elapsed time method to measure participation service. Or the IRS and/or Treasury could mean that all methods to measure a year of service for purposes of Code Section 410(a) are available to a 403(b) plan subject to ERISA. Clarification on this point from the IRS and Treasury would be useful to many 403(b) plan sponsors.

ALTERNATIVES AVAILABLE FOR PLANS NOT SUBJECT TO ERISA

Not all 403(b) plans are subject to ERISA. A 403(b) plan that is either a "governmental plan" under ERISA Section 3(32) or a non-electing "church plan" under ERISA Section 3(33) is not subject to Title I of ERISA, because governmental plans" and "church plans" generally are excluded from coverage under Title I of ERISA.[32] In addition, Department of Labor (DOL) regulations provide an exception from coverage under Title I of ERISA for a 403(b) plan that is not "established or maintained by an employer" because: (1) participation of employees is completely voluntary, (2) all rights under the annuity contract or custodial account are enforceable solely by the employee or beneficiary of such employee, or by an authorized representative of such employee or beneficiary, (3) the involvement of the employer is limited to certain specified activities,[33] and (4) the employer receives no direct or indirect consideration or compensation in cash or otherwise other than reasonable reimbursement to cover expenses properly and actually incurred in performing the employer's duties pursuant to the salary reduction agreements.[34]

The fact that the definition of an employee who normally works fewer than 20 hours per week includes an express reference to hours of service as defined under Code Section 410(a)(3)(C) raises the question of whether alternative methods of measuring service are available to 403(b) plans not subject to ERISA. Code Section 410(a)(3)(C) states that, "the term 'hour of service' means a time of service determined under regulations prescribed by the Secretary of Labor." The 403(b) regulations do not indicate which such regulations are applicable. DOL Regulations Section 2530.200b-2 deals specifically with defining an "hour of service" but DOL Regulations Section 2530.200b-3 further defines how to determine an "hour of service" and includes the hour equivalency rules. Arguably, the reference to hours of service as defined under Code Section 410(a)(3)(C) in the universal availability rule of the 403(b) regulations could sweep in the various equivalency rules under DOL Regulations Section 2530.200b-3. It is not so clear whether the elapsed time service measurement rules of Treasury Regulations Section 1.410(a)-7 (which prior to the ERISA reorganization plan was DOL Regulations Section 2530.200b-9) would be pulled in. The elapsed time rules would be more generous to an employee who works for at least 12 months, but works few hours in those months, as the employee would have a year of service at the end of the 12 months. The hour equivalency rules tend to be more generous to an employee who works less than 12 months, but works enough days, weeks, months, etc. to be credited with the equivalent of 1,000 hours during the period worked. As the 1,000 hour requirement of universal availability was created by regulations, and the alternative methods permitted by the rules under Code Section 410(a) and the parallel provisions of ERISA Section 202(a)(1) and related regulations are generally more generous than tracking actual hours, it would seem Treasury could amend or interpret the 403(b) regulations to permit those alternative methods whether a 403(b) plan is subject to ERISA or not. Whether that happens remains to be seen. Of course, allowing more generous rules may not be of much interest to employers seeking to keep part-time employees from participating in elective deferrals to the 403(b) plan.[35]

CONCLUSION

The "fewer than 20 hours per week" rule to exclude part-time employees under the "universal availability" rules of Code Section 403(b) has created confusion among employers, third-party administrators, practitioners, and other advisors, resulting in unnecessary noncompliance. It would be both helpful and valuable for Treasury and the IRS to clarify which, if any, of the plan eligibility service measurement rules and alternatives under Code Section 410(a) (and, through Treasury's interpretive authority over ERISA Section 202(a), under ERISA Section 202(a)(1)) carry over to the 403(b) universal availability exclusion of employees who normally work fewer than 20 hours per week. Such clarification would be valuable for employers with 403(b) plans not subject to ERISA, as well as employers with 403(b) plans subject to ERISA, if 403(b) plans subject to ERISA are to independently satisfy both ERISA and Code Section 403(b) requirements.

The 1,000 hour rule of the "fewer than 20 hours per week" exclusion was a regulatory creation, so it is not clear why Treasury and the IRS could not expand this regulatory rule to include all measures of eligibility service permitted under Code Section 410(a) and the corresponding regulations. The ability to use hour equivalencies and elapsed time would allow an employer to exclude certain temporary or intermittent employees excludable under those measures, if the employer so chooses, without having to track actual hours for those employees. Making the eligibility service measurement rules consistent under Code Section 410(a) for 403(b) plans, whether subject to ERISA or not, and 401(a) tax-qualified plans would reduce confusion and unnecessary "traps for the unwary," as well as bring consistency to those employers who have 401(a) plans, whether defined contribution or defined benefit, as well as 403(b) plans.

NOTES

1. *See* Code § 403(b)(12)(A)(ii) and Treas. Reg. § 1.403(b)-5(b)(1).
2. An "employee" is a common-law employee performing services for the eligible employer and does not include a former employee or independent contractor. *See* Treas. Reg. § 1.403(b)-2(b)(9).
3. An "eligible employer" is either: (1) a state (or a political subdivision of the state, or any agency or instrumentality of the state), but only with respect to an employee of the state performing services for a public school; (2) a Code § 501(c)(3) tax-exempt organization with respect to any employee of such organization; (3) an employer of a minister described in Code § 414(e)(5)(A), but only with respect to the minister; or (4) a minister described in Code § 414(e)(5)(A), but only with respect to a retirement income account established for the minister. *See* Treas. Reg. §§ 1.403(b)-2(b)(8) and 1.403(b)-2(b)(20).
4. Universal availability applies separately with respect to each Code § 501(c)(3) organization if the 403(b) plan covers the employees of more than one such organization and applies separately to each state or local governmental entity not part of a common payroll if the 403(b) plan covers the employees of more than one such entity. *See* Treas. Reg. § 1.403(b)-5(b)(3)(i).
5. *See* Code § 403(b)(12)(B). Note that a plan maintained by a "church" as defined by Code § 3121(w)(3)(A) or a "qualified church-controlled organization" as defined by Code § 3121(w)(3)(B) is a narrower category than a "church plan" as defined by Code § 414(e).
6. *See* Treas. Reg. § 1.403(b)-5(b)(4). These five exclusions also appear in Code § 403(b)(12)(A). The final 403(b) regulations no longer permit the exclusion of the following classifications of employees for purposes of the universal availability rule that had previously been permitted

under IRS Notice 89–23: (1) employees who are covered by a collective bargaining agreement; (2) employees who make a onetime election to participate in a governmental plan described in Code § 414(d), instead of a 403(b) plan; (3) professors who are providing services on a temporary basis to another public school for up to one year and for whom 403(b) contributions are being made at a rate no greater than the rate each such professor would receive under the 403(b) plan of the original public school; and (4) employees who are affiliated with a religious order and who have taken a vow of poverty where the religious order provides for the support of such employees in their retirement. However, other rules may provide relief with respect to individuals who are under a vow of poverty and university professors on leave as visiting professors at another institution. *See* preamble to the final 403(b) regulations (T.D. 9340), 72 *Fed. Reg.* 41128 (July 26, 2007) at 41134 and 41135.

7. Note that employees who are eligible to make elective deferrals under a 457(b) plan of a Code § 501(c)(3) employer cannot be excluded on that basis from making elective deferrals to a 403(b) plan of the employer. A 457(b) plan of a Code § 501(c)(3) employer is a type of "top hat" plan maintained by the employer primarily for the purpose of providing deferred compensation for a select group of management of highly compensated employees under ERISA § 201(2).
8. Except for certain "grandfathered" 401(k) plans adopted by a governmental entity prior to May 6, 1986, governments cannot maintain a 401(k) plan for their employees. *See* Code § 401(k)(4)(B)(ii). Effective for plan years beginning after December 31, 1996, the Small Business Job Protection Act of 1996 (SBJPA) permitted Code § 501(c)(3) organizations to adopt a 401(k) plan. The pre SBJPA prohibition did not apply to certain "grandfathered" 401(k) plans adopted by a tax-exempt organization prior to July 2, 1986. *See* Code § 401(k)(4)(B)(i). *See also* the Senate Committee Report on § 1426 of the SBJPA.
9. Code § 410(b)(3)(C) describes nonresident aliens who receive no earned income (within the meaning of Code § 911(d)(2)) from the employer that constitutes income from sources within the United States (within the meaning of Code § 861(a)(3)).
10. Students performing services described in Code § 3121(b)(10) are excepted from Federal Insurance Contributions Act (FICA) and Federal Unemployment Tax Act (FUTA) taxation. The question of who is a student excepted from FICA and FUTA taxation had been an area of some contention between the IRS and various organizations for a number of years. For instance, several federal court cases had held that medical residents and interns at teaching hospitals and hospitals associated with universities were eligible for the exception under prior rules and regulations, despite the IRS's interpretation to the contrary. The IRS issued revised regulations under Code § 3121(b)(10) to clarify the exception for students in January of 2005, along with Revenue Procedure 2005-11 that sets forth standards intended to provide objective and administrable guidelines to determine whether services performed by a student employee qualify for the exception.
11. Note also that the language does not say a 403(b) plan is subject to Code § 410(b)(4), but rather that the exclusion of such employees is subject to the *conditions applicable* under Code § 410(b)(4). It is also interesting to note that governmental plans, as defined by Code § 414(d), are expressly excepted from the application of Code § 410(b) and are treated as meeting the requirements of Code § 410(b) for purposes of Code § 401(a) plan tax-qualification. *See* Code § 410(c).
12. *See* Treas. Reg. § 1.403(b)-5(b)(4)(i).

13. *See* Treas. Reg. § 1.403(b)-5(b)(1).
14. *See* Code § 403(b)(12)(A)(i) and Treas. Reg. § 1.403(b)-5(a).
15. *See* Code §§ 403(b)(12)(B) and 403(b)(12)(C). Note that a plan maintained by a "church" as defined by Code § 3121(w)(3)(A) or a "qualified church-controlled organization" as defined by Code § 3121(w)(3)(B) is a narrower category than a "church plan" as defined by Code § 414(e).
16. *See* Treas. Reg. § 1.401(m)-3(b), which cross-references Treas. Reg. § 1.401(k)-3(b), and Treas. Reg. § 1.401(m)-3(c), which cross-references Treas. Reg. § 1.401(k)-3(c).
17. The second plan could be another 403(b) plan, a 401(k) plan, or a 457(b) eligible governmental plan, whichever is applicable to the employer and permitted under the circumstances.
18. Treas. Reg. § 1.403(b)-5(b)(4)(iii)(B).
19. All authority of the Secretary of Labor to issue regulations, rulings, and opinions under ERISA § 202 and Code § 410 were transferred to the Secretary of the Treasury by Executive Order: Reorganization Plan No. 4 of 1978, pursuant to the provisions of Chapter 9 of Title 5 of the United States Code.
20. *See* Code §§ 410(a)(3) and 410(a)(4); Treas. Reg. §§ 1.410(a)-1(b)(5), 1.410(a)-4(b), and 1.410(a)5(a); and Example (3) of Treas. Reg. § 1.410(a)-3(e)(2).
21. *See* Code § 410(a)(1) and Treas. Reg. §§ 1.410(a)-1(a)(1) and 1.410(a)3.
22. Perhaps some employers who also sponsor a Code § 401(a) tax-qualified plan, such as a defined benefit plan, with a year of service requirement would like a full-time employee to become eligible for all retirement plans on the same date, and so would like to be able to exclude that employee from making elective deferrals under the 403(b) plan until that date. Again, this seems atypical.
23. For example, in a presentation by Robert Architect, former Senior Tax Law Specialist in the Employee Plans Division of the IRS and one of the authors of the final 403(b) regulations issued in 2007, Mr. Architect paraphrased the second prong of the test to read "For every subsequent plan year or 12-month period the employee actually worked < 1,000 hours in the preceding 12-month period." *See also* the article text following this footnote under the sub-heading "Conditions Applicable Under Code § 410(b)(4)" that discusses the report from the May 2009 Meeting of the American Bar Association.
24. The parenthetical of the second-prong of the test has been deleted because the plan did not provide for the option to base the look back on each 12-month period subsequent to the 12-month period beginning on the date the employee's employment commenced, instead of the plan year ending after the close of the 12-month period beginning on the date the employee's employment commenced.
25. *See* Code § 410(a)(1) and Treas. Reg. §§ 1.410(a)-1(a)(1) and 1.410(a)-3.
26. IRS Announcement 2009-34 can be found at: *http://www.irs.gov/pub/irs-drop/a-09-34.pdf* and the draft 403(b) prototype plan language at: *http://www.irs.gov/pub/irs-tege/draft_lrm_403b_prototypes.pdf.*
27. *See* Code §§ 402(g)(7), 403(b)(3), 403(b)(4), and 415(c)(3)(E) and Treas. Reg. §§ 1.402(g)-1(d)(2), 1.403(b)-2(b)(11), 1.403(b)-2(b)(21), 1.403(b)-4(d)(1), 1.403(b)-4(e), and 1.415(c)-2(g)(1).
28. *See* Example (2) of Treas. Reg. § 1.403(b)-4(e)(9).
29. Bloomberg BNA, Daily Tax Report, Sept. 24, 2012 (Highlights 7505).
30. *See e.g.*, Treas. Reg. §§ 1.410(a)-1(b)(5), 1.410(a)-3, 1.410(a)5(a), and 1.410(a)-7 and 29 C.F.R. § 2530.200b-3(e).

31. *See* 29 C.F.R. § 2530.200b-3(e).
32. *See* ERISA §§ 4(b)(1) and 4(b)(2).
33. For example, the employer may permit annuity contractors (including agents or brokers who offer annuity contracts or make available custodial accounts) to publicize their products to employees; request information concerning proposed funding media, products, or annuity contractors and compile such information to facilitate review and analysis by the employees; enter into salary reduction agreements; collect annuity or custodial account considerations required by the salary reduction agreements, remit them to 403(b) providers, and maintain records of such collections; hold one or more group contracts in the employer's name covering its employees and exercise rights as the representative of its employees under the contract, at least with respect to amendments of the contract; and limit funding media or products available to employees, or annuity contractors who may approach the employees, to a number and selection designed to afford employees a reasonable choice in light of all relevant circumstances. *See* DOL Advisory Opinion 2012-02A. The DOL has indicated that tax-exempt employers will be able to comply with the requirements of the final 403(b) regulations issued in 2007 and effective in 2009 and remain within the DOL regulations exception from ERISA for 403(b) plans funded solely by salary deferrals. However, an employer could not have responsibility for, or make, discretionary determinations in administering the program, such as authorizing plan-to-plan transfers, processing distributions, satisfying applicable qualified joint and survivor annuity requirements, and making determinations regarding hardship distributions, qualified domestic relations orders (QDROs), and eligibility for or enforcement of loans. *See* DOL Field Assistance Bulletin No. 2007-02. Although many, if not most advisors, would agree that providing employer matching or nonmatching, nonelective contributions to a 403(b) plan is not among the limited employer activities allowed under the exception from ERISA coverage, some advisors have argued that providing a matching contribution to a separate defined contribution plan tax-qualified under Code § 401(a) allows the 403(b) plan on which the match was based to remain excepted from ERISA coverage. The DOL recently clarified that such an arrangement, whereby 403(b) plan elective deferrals are matched in a separate 401(a) plan, would make the 403(b) plan subject to ERISA. *See* DOL Advisory Opinion 2012-02A.
34. *See* 29 C.F.R. § 2510.3-2(f) and DOL Advisory Opinion 2012-02A.
35. While there is certainly an administrative cost to allowing part-time employees the option to participate in elective deferrals to a 403(b) plan, the employer can still impose an annual service requirement for employees to receive employer contributions in any plan year. A 403(b) plan could impose a requirement that an employee have 1,000 hours in a given plan year (or a permissible alternative year of service measure) to receive employer matching or employer nonmatching, nonelective contributions for that plan year.