

IRS Clarifies Partial Plan Termination Relief Under 2020 Legislation

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On April 27, the Internal Revenue Service (“IRS”) issued informal guidance on partial plan terminations as part of the COVID-related tax relief provided under The Taxpayer Certainty and Disaster Tax Relief Act of 2020 (the “Relief Act”), part of the Consolidated Appropriations Act of 2021. The Relief Act was intended to provide a measure of relief for qualified plan sponsors that experienced layoffs due to COVID-19.

The layoff of a significant number of employees could cause a plan to incur a partial plan termination. Section 209 of the Relief Act provided a temporary rule that may allow a plan to avoid triggering a partial plan termination for 2020 and 2021. The provision modified the current partial plan termination rules to ensure such termination does not occur if the active participant count as of March 31, 2021 was at least 80% of the number of active participants covered by the plan on March 13, 2020. IRS guidance, in the form of Questions and Answers, addresses a number of issues, including the definition of a covered active participant, treatment of partial plan years, calculation of the 80% test and non-COVID related terminations.

A. Partial Plan Termination – Some Background

The Code does not define when a “partial termination” has occurred, but applicable Treasury Regulations state that the IRS determines whether a partial termination has occurred based on all the facts and circumstances of each case, including:

- the exclusion, by reason of a plan amendment or severance by the employer, of a group of employees who have previously been covered by the plan; and
- plan amendments that adversely affect the rights of employees to vest in benefits under the plan.

If you have any questions, please do not hesitate to contact your regular Groom attorney or the authors listed below:

Mark Carolan

mcarolan@groom.com

(202) 861-5424

Joanne Jacobson

jjacobson@groom.com

(202) 861-0185

Louis Mazawey

lmazaway@groom.com

(202) 861-6608

The sole impact of a partial termination is on vesting: under Code Section 411(d)(3), when a qualified retirement plan is partially terminated, 100% vesting is required for employees affected by the partial termination.

B. Determining Whether a Partial Termination Has Occurred

Reduction vs. Retention in Participation – The general rule is that a partial termination occurs if a significant percentage of active participants are terminated during the plan year. Consistent with case law, Revenue Ruling 2007-43 provides that if 20% or more of a plan’s active participants have an employer-initiated severance in a plan year, there is a rebuttable presumption that a partial termination has occurred. An employee’s severance from employment is employer-initiated even if caused by an event outside of the employer’s control, such as severance due to depressed economic conditions. In this regard, employer-initiated severance from employment generally includes any severance from employment other than a severance that is on account of death, disability, or retirement on or after normal retirement age.

Given that so many employers struggled to keep their doors open during the COVID-19 pandemic, the Relief Act offers a different way to calculate whether a partial termination has occurred for 2020 and 2021. Instead of looking at the reduction in participants, the Relief Act looks at the percentage of active participants still in the plan: a plan “shall” not incur a partial plan termination for any plan year that includes the period beginning March 13, 2020 and ending March 31, 2021, provided that the number of active participants covered by the plan on March 31, 2021 is at least 80% of the active participants on March 13, 2020. This is important because instead of just counting the percentage of active participants who were terminated – typically temporarily high during the initial response to COVID-19 – the relief would permit an employer to avoid a partial termination if new employees were hired and enrolled in the plan before March 31, 2021.

The IRS guidance offers some specific details on how to apply this relief and determine whether a partial termination may have occurred in 2020 or 2021.

Who Is a Covered Active Participant? – Q&A 2 of the IRS’s guidance provides that a reasonable, good-faith interpretation of the term “active participant covered by the plan,” applied in a consistent manner, should be used when determining the number of active participants covered by a plan on March 13, 2020, and March 31, 2021. All participating employees – including vested and non-vested participating employees – are considered in calculating the 20% rate of reduction, so one could assume that the same rule would apply in calculating the 80% retention rate.

Calculating the Rate During the Applicable Period – For purposes of calculating the 20% reduction, the turnover rate is determined by dividing the number of participating employees who had an employer-initiated severance from employment during the applicable period by the sum of all of the participating employees at the start of the applicable period and the employees who became participants during the applicable period. The applicable period depends on the circumstances, but is generally the plan year.

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Since the Relief Act defines the applicable period from March 13, 2020 through March 31, 2021, which generally would not coincide with the plan year, Q&A 3 addresses how to apply the 80% retention rate. If any part of the plan year falls within the period beginning on March 13, 2020, and ending on March 31, 2021, then the relief applies to any partial termination determination for that entire plan year. For example, for a calendar year plan, if this relief applies, it will cover both the 2020 and 2021 plan years.

Furthermore, generally whether or not a partial termination of a qualified plan occurs on account of participant turnover depends on all the facts and circumstances in a particular case. Facts and circumstances may include the extent to which terminated employees were actually replaced, whether the new employees performed the same functions, had the same job classification or title, and received comparable compensation. However, since the Relief Act is intended to provide relief to employers who continued to employ workers during the pandemic and presumes that any reduction was due to COVID-19, Q&A 4 clarifies that the 80% test is applied by counting the number of active participants covered by a plan on March 31, 2021, regardless of whether those same individuals were active participants covered by the plan on March 13, 2020.

Must the Reduction Be Related to COVID-19? – The guidance is clear in explaining that the relief is not limited to reductions related to the pandemic, *i.e.*, the 80% test applies regardless of the reason for termination and does not require a facts and circumstances analysis.

C. Some Considerations

As stated earlier, if a partial plan termination occurs on account of turnover during an applicable period, all participating employees who had a severance from employment during the period must be fully vested in the amounts credited to their accounts/accrued benefits. The relief provided by the Relief Act and the related guidance is helpful for plan sponsors that experienced layoffs due to COVID-19. If a plan would have triggered a partial termination under the general rule (*i.e.*, 20% of active participants are terminated), this relief may nullify that partial termination for 2020 and/or 2021. Accordingly, plan sponsors that experienced significant turnover among plan participants in 2020 and 2021 should consider whether a partial termination may have taken place in 2020 or 2021 under the “ordinary” rules, and whether the Relief Act may nullify that partial termination.

If the relief does not apply, and a partial termination has occurred, a plan should confirm that the affected participants become fully vested in their plan benefits.

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