

HAS YOUR RETIREMENT PLAN BEEN 'PARTIALLY' TERMINATED?

Employee Benefits Alert
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Employee Benefits

With increasing layoffs and other cutbacks, employers have been confronted with innumerable new challenges. Among them are the recent COBRA rules that provide a federal subsidy for continuing medical plan coverage to workers who are involuntarily terminated.

Increasing the challenge, administrators of pension, profit-sharing, 401(k), and other qualified retirement plans may also be required to determine if there has been a “partial termination” of a plan. Partial plan terminations have always been difficult to identify due to a lack of clear guidelines. The concept has been a “facts and circumstances” test for the most part, although a 2007 Revenue Ruling provides some helpful guidance.

There has long been a rule that, in the event of a “partial termination” of a qualified retirement plan, the “affected participants” must become 100 percent vested as a result. Partial terminations could be steps along the way toward a complete termination of a plan (which also requires 100 percent vesting), or a partial termination could occur in an ongoing plan. Partial terminations can occur as a result of a reduction in the number of eligible participants or from a reduction in future benefit accruals that could create or increase a potential reversion of plan assets to the employer.

For defined contribution plans, a potential partial plan termination will occur as a result of a reduction in the number of eligible participants.

Sponsors of defined benefit plans may face additional issues. A reduction in the number of active participants in a plan may be a reportable event requiring notice to the Pension Benefit Guaranty Corporation (PBGC). Additionally, a cessation of operations at a facility may require that the employer immediately provide substantial financial security to the PBGC even though the defined benefit plan is not terminated.

Revenue Ruling 2007-43 established a presumption that if a plan has a “turnover” rate of at least 20 percent during an “applicable period,” then a partial termination has occurred. All participants affected by a partial termination must become 100 percent vested in their plan benefits following the partial termination. The plan’s turnover rate is determined by dividing the number of participating employees (e.g.



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the participants counted in a 401(k) ADP test) who had an employer-initiated severance from service during the applicable period by the sum of all the participant employees at the beginning of the period plus newly eligible participating employees during the period.

Normally the “applicable period” will be a plan year. Again, however, facts and circumstances could suggest a longer period if there have been a series of related reductions in employment levels. With the current economic downturn, the “applicable period” for some businesses could begin in 2008 and extend through 2009, depending on the situation.

One of the difficulties in this area is that recognition of a partial termination is initially left to the plan sponsor. Effective plan administrators can avoid a surprise in an IRS audit where an auditor might want to go back several years and require that the employer provide full vesting to long-departed plan participants at the cost of additional employer funding to restore forfeited account balances. If you have had cutbacks that have reduced the number of eligible participants in a 401 (k), profit-sharing, pension, or other qualified plan, what should you do? Here are some recommendations:

1. Be cautious about “spending” any plan forfeitures that arise from terminations. If you are required to vest any of these participants because of a partial termination, saving the forfeitures in participant accounts until after year-end may save the potential cost of restoring forfeitures from additional contributions.
2. Consider the impact of partial termination rules, as well as the COBRA Subsidy Law, in structuring any severance arrangements. “Giving away” full vesting in a severance situation can avoid the lack of clarity in defining and identifying a partial termination, and it can be a relatively low-cost and favorably viewed benefit given in a severance package.
3. Check with your friendly employee benefits attorney with regard to any specific questions or problems that may affect your plan. Action taken in a timely manner can minimize audit risks and potential liabilities.
4. If you maintain a defined benefit plan, make sure you coordinate any required notices with your plan actuary or other service provider.