

Doing the Math: Partial Plan Terminations and the Consolidated Appropriations Act

A Practical Guidance® Article by Anne Tyler Hall and Eric Schillinger, Hall Benefits Law



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The Consolidated Appropriations Act, 2021, signed into law on December 27, 2020 (the “Act”), changes a myriad of different rules for employer-sponsored retirement plans and health and welfare benefits. Among the more significant of the Act’s changes is a temporary rule to provide relief for certain events related to COVID-19 that would otherwise be considered partial retirement plan terminations (which can have costly implications for the employer). The partial plan termination rules, and temporary relief in the Act, generally impact employer plan sponsors with a tax-qualified retirement plan (excluding certain governmental and church plans).

Background: Partial Plan Terminations

Under the rules for tax-qualified retirement plans, a partial plan termination is a significant event that can have major implications for both the sponsoring employer and

participating employees. Upon the occurrence of a partial plan termination, affected participants (i.e., those who have experienced an employer-initiated termination), are immediately 100% vested in their matching contribution accounts, including earnings.

For purposes of these tax rules, a partial plan termination is generally defined as a reduction of more than 20% in the number of plan participants during a plan year. For purposes of the 20% determination, the turnover rate is determined by dividing the number of participating employees that experienced an employer-initiated termination of employment during the applicable period by the total number of participants (including all participating employees at the beginning of the period and any additional hired employees who become plan participants during the applicable period). Employers are permitted to verify, through employee records and company documentation, whether employee terminations are voluntary (i.e., generally, employee initiated). The IRS also considers an employer’s typical turnover rate in the partial plan termination calculation.

The applicable period for determining a partial plan termination depends upon facts and circumstances. Such a period can span more than one plan year if employer-initiated reductions of plan participants are related. For example, the IRS would aggregate a series of plan participant terminations related to the sale of a business’s subsidiaries (even if these terminations occur over two plan or calendar years) when evaluating whether a plan experienced a partial plan termination. In contrast, the IRS may also determine that a partial plan termination has occurred when there is a 25% reduction in plan participants over a 3-month period due to, for example, a business cycle downturn.

Temporary Partial Plan Termination Relief

Under the Act, the partial plan termination relief applies to the period beginning March 13, 2020 and ending March 31, 2021 (the "Relief Period"). This relief provides that a plan is not treated as having a partial plan termination if, at the end of the Relief Period (March 31, 2021), the number of active participants covered by the plan is at least 80% of the number of plan participants covered by the plan at the beginning of the Relief Period (March 13, 2020). The temporary relief accommodates an employer who may be required to terminate a significant percentage of employees but is then able to restore or replace those employees during the Relief Period upon, for example, a re-opening after a COVID-19 related shutdown. The plan participants who count towards the 80% requirement do not have to be the same original, terminated employees (i.e., the employer is not required to rehire previously terminated employees to be eligible for the temporary relief). The temporary relief provided for in the Act offers a reprieve from the partial plan termination rules by allowing employers a period of time to replace employees and thus avoid an immediate partial plan termination upon a significant workforce reduction.

The partial plan termination relief under the Act does not appear to be available if new hires are ineligible to participate in the retirement plan. While employer plan sponsors with COVID-19-related layoffs are clearly eligible for the partial plan termination temporary relief, it is unclear whether employers who incurred a partial plan termination over the last year unrelated to COVID-19 are eligible for such relief.

HBL Comment: Because the timing of a partial plan termination determination is facts and circumstances and events-based, the Act possibly offers relief for partial plan terminations that occur in either 2020 or 2021, even if the employer-initiated terminations occurred prior to March 13, 2020 or after March 31, 2021. With the continued impact of COVID-19 to employers and their workforce likely to extend beyond the end of March, legislation extending or modifying the relief period is likely.

Example

Company A had 200 401(k) plan participants on March 13, 2020. Due to COVID-19, Company A laid off 50 employees during 2020. During January and February 2021, Company A hires 10 new employees (who are immediately eligible to participate in Company A's 401(k) plan) and now has 160

plan participants (or 80% of the plan participants on March 13, 2020). Pursuant to the temporary relief, Company A's retirement plan is not treated as having a partial plan termination.

If, however, Company A hires these 10 new employees during February 2021 and the plan provides for a 60-day service requirement, the temporary relief does not preclude Company A's 401(k) plan from experiencing partial plan termination in this scenario.

HBL Comment: Prior to the temporary relief under the Act, the IRS would likely treat Company A's retirement plan as having a partial plan termination since the plan experienced a 25% reduction in plan participants. Employers that treated employee reductions during 2020 as a partial plan termination and fully vested impacted participants should work with legal counsel to determine whether terminated employees going forward are eligible for full vesting of their accounts.

Next Steps/Action Items

The temporary relief in the Act is a great reminder to plan sponsors to review plan terms and conditions related to partial plan terminations and related vesting considerations. Employers that are close to or above the 20% year-over-year plan participant turnover rate, and that wish to avail themselves of the partial plan termination temporary relief, may want to consider recruitment and hiring prior to March 31, 2021. Plan sponsors should also consider expanding plan eligibility so that new hires are immediately permitted to participate in the plan. To avoid plan participant claims of a partial plan termination, it is advisable for plan sponsors to carefully document employee terminations with a clear indication of the circumstances surrounding the termination and whether each termination was employer-initiated or voluntary by the employee.

Related Content

Lexis

Statutes

- Consolidated Appropriations Act, 2021 (Pub. L. No. 116-260)

Cases

- *Matz v. Household Int'l Tax Reduction Inv. Plan*, 388 F.3d 570 (7th Cir. 2004) (Seventh Circuit held there is a rebuttable presumption that a 20% or greater reduction is a partial termination; below 10% conclusively presume

no partial termination; over 40% presume partial termination; between 10% and 40% consideration of tax motives or tax consequences could be used to rebut the presumption of a partial termination)

- *Jeffries v. Pension Trust Fund of the Pension, Hospitalization & Benefit Plan of the Elec. Indus.*, 172 F. Supp. 2d 389 (S.D.N.Y. 2001) (what constitutes a partial plan termination typically means a termination of a significant percentage of employees from plan participation in connection with a corporate event such as layoffs or change in plan benefits)
- *Borst v. Chevron Corp.*, 36 F.3d 1308 (5th Cir. 1994) (court considered the distinction of “vertical partial terminations” and “horizontal partial terminations”)

- *Halliburton Co. v. Commissioner*, 100 T.C. 216 (1993) (reduction of participants by 19.85% did not cause a partial termination when the discharges are considered in light of all facts and circumstances)

Treatises

- Lexis Tax Advisor -- Federal Topical § 1C:15A.12, “Partial Terminations”

Practical Guidance

- [Coronavirus \(COVID-19\) Resource Kit](#)
- [Defined Benefit Plan Standard Terminations](#)
- [Freezing Defined Benefit Plan Benefits](#)

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As a business owner representing businesses, Anne Tyler understands first-hand the importance of strategically-designed, legally-compliant benefit plans aimed at attracting, motivating, and retaining top employees. She also understands the importance of responsive and timely legal compliance guidance to businesses who are in six and seven-figure Internal Revenue Service, Department of Labor, or Department of Health and Human Services penalty situations.

Anne Tyler Hall is a 2017 and 2018 Super Lawyers Rising Star, an honor determined through peer nominations, professional achievement, evaluations, and independent research. Anne Tyler also maintains a Martindale Hubbell rating of Preeminent, representing the highest achievement of professional excellence based upon client and peer review.

When not counseling clients on fiduciary matters, healthcare reform, executive compensation, health and welfare benefits, and retirement plan legal issues, Anne Tyler enjoys running 5K races and cycling with her husband and spending quality time with her two daughters.

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Eric Schillinger concentrates his practice in the areas of qualified, health and welfare, and nonqualified employee benefit plans, including pension, defined contribution, deferred compensation, health care, life insurance, disability, fringe, and other employer-provided benefits. He has extensive experience in helping employers comply with the various federal and state laws applicable to those plans, such as the Patient Protection and Affordable Care Act (ACA), ERISA, the Internal Revenue Code, the Securities Act of 1933, the Public Health Service Act, HIPAA, COBRA, FMLA, and Medicare.

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