

Employee Benefits and Executive Compensation Practice

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Temporary Partial Plan Termination Reprieve Under the Consolidated Appropriations Act of 2021

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Many employers in both the for-profit as well as non-profit sectors have responded to the challenges of the pandemic through reductions in force. Depending upon the scope of these reductions in force, the retirement plans that these employers sponsor may have experienced a partial termination. The Tax Code's partial termination rule applies to all retirement programs, including defined benefit plans, 401(k) plans and tax-deferred annuity programs under 403(b). Generally, partial terminations occur when a significant amount of active participants are no longer eligible to participate in the plan. Similar to the rules that apply to total plan terminations, if there is a partial termination, the plan must fully vest the accrued benefits or, as applicable, the accounts of all "affected employees."

Guidance issued by the IRS (Rev. Rul. 2007) looks at the facts and circumstances surrounding the reduction in plan participation and provides that a partial termination is presumed to have occurred when plan turnover during a plan year is at least 20 percent. Specific facts and circumstances, including the employer's normal turnover rate and voluntary quits may be used to rebut the presumption. While this may seem straightforward, its application in practice is complicated. Unfortunately, the complexity of a partial termination determination under this prior IRS guidance as well as applicable case law is beyond the scope of this article.

The Consolidated Appropriations Act of 2021 ("CAA 2021") recognizes that there have been significant reductions in plan participation since the declaration of a national emergency^[1]. The temporary partial plan termination rule in the CAA 2021 provides retirement plan sponsors with more clarity and a new, temporary rule for determining if a partial plan termination has occurred. This CAA 2021 provision reads, as follows:

"A plan shall not be treated as having a partial termination (within the meaning of 411(d)(3) of the Internal Revenue Code of 1986) during any plan year which includes the period beginning on March 13, 2020, and ending on March 31, 2021, if the number of active participants covered by the plan on March 31, 2021 is at least 80 percent of the number of active participants covered by the plan on March 13, 2020."

This temporary rule provides a much easier, fixed and conclusive method for determining whether a partial termination has occurred. To date, there is no additional guidance on this very short provision in the CAA 2021. Based upon our reading of this provision, if an employer maintains a plan with a plan year beginning January 1, 2020 and ending December 31, 2020, instead of utilizing the 20 percent rebuttable presumption partial termination test that looks at plan turnover at the beginning and end of 2020, the employer has the option to determine whether a plan termination occurred by comparing the number of active plan participants on March 13, 2020 and March 31, 2021. If the number of active participants on March 31, 2021 is at least 80 percent of active plan participants as of March 13, 2020, there is no partial plan termination for 2020. Utilizing this rule will delay the partial plan termination determination and, if applicable, vesting of participant accounts until after March 31, 2021.

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Based upon the wording of the provision (above), some commentators believe this temporary rule may also be used to prevent a partial termination in 2021 so long as the percentage of active participants on March 31, 2021 is at least 80 percent of active participation on March 13, 2020. We must wait to see if there is future guidance that clarifies the intent and scope of this temporary relief.

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1. Internal Revenue Service ("IRS") FAQs on the Coronavirus Aid, Relief, and Economic Security Act addressed partial terminations during the pandemic. In its guidance, IRS stated that employees who were terminated, laid off or furloughed in response to the pandemic need not be counted for purposes of the partial termination rules if they were rehired by the end of 2020.

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