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Retirement Plan "Partial Termination" Relief Still in Effect Until March 31, 2021

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This blogpost reviews the "partial termination" rules for certain tax-qualified retirement plans and certain regulatory and statutory rules that have, to the benefit of employers, relaxed the partial termination rules in 2020 and 2021.

The Partial Termination Rules

Retirement plans that are intended to be tax-qualified under Internal Revenue Code (the "Code") Section 401(a) must comply with confusing, and sometimes costly, "partial termination" rules. Section 401(a) plans that must comply will include Section 401(k) plans, profit-sharing plans, money purchase pension plans and defined benefit pension plans ("Section 401(a) Plans").

In general, a partial termination of a plan can occur if there is a significant reduction in the number of active participants in the plan during a particular plan year (see below). For example, a partial termination might occur because of a reduction in force or the sale of part of an ongoing business.

If a Section 401(a) Plan does experience a partial plan termination, the affected participants (e.g., former employees) are required to be immediately 100% vested in their account balances.[1] Typically, this does not result in a direct out-of-pocket expense for an employer. That is because the vesting of the employee's account simply occurs within the plan. However, if an employer misses the partial termination and discovers it later, the employer will have to make out-of-pocket contributions to the plan to make plan participants whole.

In addition, in relation to an employee stock ownership plan (ESOP), there can be ancillary concerns that might be costly. Under an ESOP, an employer could be required to provide an allocation of any previously unallocated funds to each affected employee upon a partial termination. This could be extremely costly if it should accelerate any repurchase obligations and cause severe future funding shortages.

Generally, whether or when a partial plan termination occurs is determined on a facts and circumstances basis. The IRS presumes a partial plan termination exists if there is more than a 20%

reduction in the number of covered participants during a plan year.[2] Moreover, a reduction is measured by an employer-initiated severance from employment.

IRS Relief From the Partial Termination Rules

In July 2020, in its COVID-19-related guidance under the CARES Act, the IRS issued much-needed relief to Section 401(a) Plan sponsors who were managing their workforce through a global pandemic and decided to furlough, layoff or involuntarily terminate their employees. Many of these plan sponsors were able to rehire many of the affected participants by the end of 2020, and the CARES Act relief provided that these employer-initiated severances who were later rehired would not be considered when examining the facts and circumstances pertaining to the existence of a partial termination in 2020.[3] The effect of this relief was that a partial plan termination would not necessarily be triggered in 2020, even if the initial furloughs and layoffs had exceeded 20% of the active employees in the Section 401(a) Plan.

In December 2020, Congress enacted the Consolidated Appropriations Act, 2021 (CAA), which further extended the partial plan termination relief to March 31, 2021. Under the temporary relief provided by Congress in the CAA, a Section 401(a) Plan will not be treated as having a partial plan termination during any plan year that includes the period beginning on March 13, 2020, and ending on March 31, 2021 ("Covered Period"), if the number of active participants covered by the plan on March 31, 2021 is at least 80% of the number of active participants covered by the plan on March 13, 2020.[4] Essentially, the temporary relief provided by the CAA prevents a partial plan termination determination by the IRS if the active participant count on March 31, 2021 is at least 80% of the active participant count on March 13, 2020. Note that if this rule applies, for a calendar year plan, it will apply to both the 2020 and the 2021 plan year.

In the absence of additional guidance, the CAA temporary relief creates a safe harbor under the terms of which if the 80% active participant threshold is met, the facts and circumstances determination does not apply. This safe harbor means that a partial plan termination cannot occur during the Covered Period, even if the change in active participants during the year was not related to the COVID-19 pandemic.

One less thing a plan sponsor needs to worry about – that is until March 31, 2021.

[1] I.R.C. 411(d)(3).

[2] Rev. Rul. 2007-43, 2007-2 C.B. 45.

[3] *Coronavirus-Related Relief for Retirement Plans and IRAs Questions and Answers*, IRS, https://www.irs.gov/newsroom/coronavirus-related-relief-for-retirement-plans-and-iras-questions-and-answers (last updated Sept. 19, 2020).

[4] H.R. 133, Division EE – Taxpayer Certainty and Disaster Tax Relief Act of 2020 § 209.

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