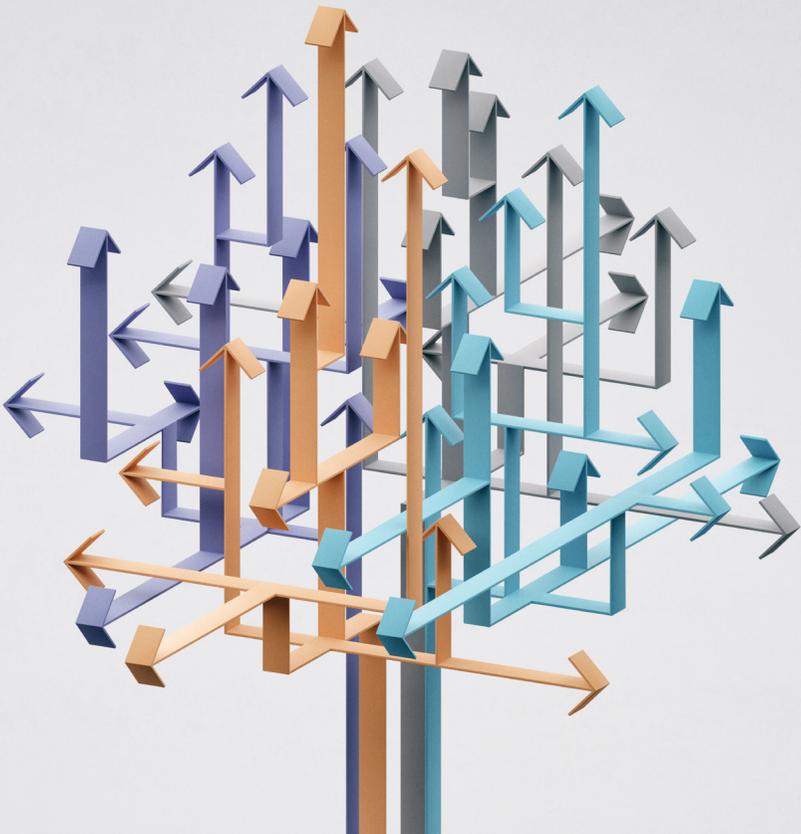




Partial employee benefit plan terminations



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For more information, contact the EBPAQC at ebpaqc@aicpa.org.

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Learn about partial plan terminations

The AICPA Employee Benefit Plan Audit Quality Center (EBPAQC) has prepared this advisory to provide you, the plan sponsor, administrator or trustee, with an understanding of partial plan terminations under the Employee Retirement Income Security Act of 1974 (ERISA) and your related responsibilities. As a plan fiduciary, you are subject to certain responsibilities, such as following the plan document and prudently carrying out your responsibilities.

This advisory describes a partial plan termination; discusses the plan administrators' fiduciary responsibilities related to partial plan terminations, the consequences of a partial plan termination, and rebutting the presumption of a partial plan termination; and also provides suggestions for best practices for evaluating partial plan terminations and references to additional resources.

The sponsor of the plan is the plan administrator under the law unless another individual, committee or group of individuals, or entity is specifically designated to assume this responsibility. The term plan administrator as used throughout this document refers to the party responsible for ensuring that partial plan terminations are appropriately considered and addressed in accordance with the plan provisions.

What is a partial plan termination?

Partial plan terminations may occur when there is substantial employer-initiated employee turnover, either due to a significant event, such as a plant or division closing or as a result of adverse economic conditions or other events that are outside of the employer's control. A partial plan termination may also be the result of plan amendments that adversely affect the rights of employees to vest in benefits under the plan. Certain factual circumstances may affect the assessment of a partial plan termination.

Turnover

In Revenue Ruling 2007-43, the IRS established that a 20% or greater turnover rate in the applicable period (discussed below) creates a rebuttable presumption that a partial plan termination occurred. The determination of whether a partial plan termination has occurred is a legal matter, depending on the facts and circumstances of the turnover rate. Per Section 1.411(d)-2(b)(1) of the Income Tax Regulations, the IRS Commissioner ultimately determines whether or not a partial plan termination of a qualified plan occurs (and the timing of such event) with regard to all the facts and circumstances in a particular case.

All participating employees are taken into account in calculating the turnover rate, including both vested and nonvested participating employees. Furloughed employees do not count in the turnover number unless they are subsequently laid off within the applicable period. Employer-initiated turnover does not include any termination of employment attributable to death, disability or retirement at normal retirement age. As noted above, an employee's termination from employment is considered employer-initiated if caused by an event outside of the employer's control, such as adverse conditions. The [IRS Issue Snapshot – Partial Termination of Plan](#) (Issue Snapshot) provides guidance and examples for calculating the turnover rate in determining whether a partial plan termination has occurred.

In some cases, the determination may be made that a partial plan termination has occurred even when the turnover rate is lower than 20%. For example, a plan sponsor closes an entire division that comprises 17% of the plan's participants. The plan sponsor, along with ERISA counsel, may determine that this results in a partial plan termination and, as a result, 100% of the participants related to that division become fully vested.

Applicable period

The applicable period *generally* is defined as one plan year; however, it may be longer if there are multiple terminations from employment that are related to a particular event. For example, Company A laid off 75 of its 500 employees (15%) in May 20X0 as a result of a significant downturn in the local economy due to a severe storm in the area, assuming no further cuts would be required once the area was rebuilt. By February 20X1, the local economy had not sufficiently rebounded, and the company laid off an additional 50 employees. It was determined that all layoffs resulted from economic fallout due to the 20X0 storm. As such, 25% of Company A's employees were terminated from employment during the applicable period, resulting in a partial plan termination.

If there is a short plan year, the applicable period includes the short plan year and the immediately preceding plan year.

Plan amendments

A partial plan termination may occur for reasons other than turnover. If a plan sponsor adopts amendments that adversely affect the rights of employees to vest in benefits under the plan, excludes a group of employees that previously had been included, or reduces or ceases future benefit accruals that can result in a reversion to the employer in a defined benefit plan, the IRS may find that a partial plan termination has occurred. For example, if a plan is amended to exclude certain categories of employees from further participating in the plan, resulting in the exclusion of 120 out of 170 participants, it would be deemed a partial plan termination (Revenue Ruling 72-439, 1972-2 C.B. 22).

Calculation of turnover rate for terminated participants

$$T / (P + N)$$

- T = Terminated by the employer (not voluntary, death, disability, retirement)
- P = Participants at the beginning of affected period
- N = New participants during affected period
- Affected period — generally equals the plan year unless terminations occur over a longer time period when more plan years will be included
- Includes all vesting levels of participants

Threshold — 20% or higher dictates rebuttable presumption for partial plan termination.

Special rule for defined benefit plans

IRC Section 1.411(d)-2(b)(2) provides a special rule that applies to a defined benefit plan that ceases or decreases future benefit accruals under the plan. Under this rule, a partial plan termination is deemed to occur if a potential reversion to the employer maintaining the plan is created or increased as a result of such cessation or decrease. If no such reversion is created or increased, no partial plan termination is deemed to occur by reason of such cessation or decrease. However, the Commissioner may determine that a partial plan termination of such a plan occurs pursuant to the IRC for reasons other than such cessation or decrease. This special rule does not apply to defined contribution plans.

Fiduciary responsibilities

As a plan sponsor, administrator, or trustee, you are considered a fiduciary under ERISA. As such, you are subject to certain responsibilities, and with these fiduciary responsibilities comes potential liability: Fiduciaries who do not follow the basic standards of conduct may be personally liable to restore any losses to the plan, or to restore any profits made through improper use of the plan's assets, resulting from their actions.

You should be aware that carrying out your duties prudently and following the plan document (unless inconsistent with ERISA) are fiduciary responsibilities. Following the terms of the plan document – which serves as the foundation for plan operations – is an important responsibility. IRC Section 411(d)(3) requires that qualified plans include in the plan document a provision that upon its termination or partial plan termination the rights of all affected parties accrued to the date of such termination or partial plan termination, to the extent funded as of such date, or the amounts credited to the employees' accounts, are nonforfeitable. As this requirement applies to all qualified plans, if your plan experiences a partial plan termination, you are responsible for ensuring that this provision is properly followed.

Consequences of a partial plan termination

If a partial plan termination occurs, all “affected employees” must be fully vested in their account balance or their accrued benefits, to the extent funded, as of the date of the partial plan termination. They must become 100% vested in all employer contributions (including matching contributions) regardless of the plan’s vesting schedule (employee salary deferrals are always 100% vested).

“Affected employee” is not defined in the IRC or IRS Regulations. However, the court in *Borda v. Hardy*, 138 F. 3d 1062, 1067, reasoned that an “affected employee” should be an employee who had separated from service and was one who still stood to be “affected” by the termination of the plan. An affected employee in a partial plan termination generally is anyone who left employment for any reason during the plan year in which the partial plan termination is deemed to have occurred and has a partially vested account balance in the plan. For plans that wait until an employee has five consecutive 1-year breaks in service before he or she forfeits their nonvested account balance, employees who left during the year of the partial plan termination and have not had such breaks in service are considered affected employees.

If a partial plan termination occurs, the employer must identify participants who require an acceleration of vesting due to the partial plan termination. If participants improperly incurred forfeitures, the benefits must be restored. If those forfeitures have already been distributed to other participants and cannot be recovered, the employer is responsible for making the participants who improperly incurred forfeitures whole.

A partial plan termination that is not identified and addressed when it occurs could significantly complicate a later plan termination or sale of the plan sponsor. For example if, in performing due diligence related to the sale of a company, it is determined that the company's 401(k) plan experienced a partial plan termination that was not appropriately addressed when it occurred, the plan sponsor would need to identify all affected participants as of date of the partial plan termination and ensure they are 100% vested as of the termination date. It also would require an analysis of and potential corrections to earnings allocated to those participant accounts. In addition, it may be difficult to find former participants to restore proper benefits that were forfeited.

Rebutting the presumption of a partial plan termination

The IRS Issue Snapshot states that “If the plan sponsor can provide evidence that the turnover rate was not the result of employer-initiated severance from employment and the severance was purely voluntary, the IRS may find that there was no partial plan termination. This type of evidence may include information from personnel files, employee statements or other corporate records. The employer may also provide evidence that the turnover rate is routine.”

Some businesses may experience routine turnover rates of 20% or higher each year. In such cases, the turnover generally would not be considered a partial plan termination. The [IRS Retirement Plan FAQs regarding Partial Plan Termination](#) lists the following factors relevant to determining whether the turnover rate is routine:

- information on the turnover rate in other periods and the extent to which terminated employees were actually replaced,
- whether the new employees performed the same functions,
- whether the new employees had the same job classification or title, and
- whether the new employees received comparable compensation.

Voluntary terminations generally do not count in determining whether a partial plan termination has occurred (although they do count for determining who must vest after a partial plan termination — see “Consequences of a partial plan termination” section above). However, it is important to note that in some cases, it has been discovered that employees who appear to voluntarily terminate their employment actually have terminated involuntarily under a “constructive discharge” (the employee leaves a job because working conditions have grown intolerable, which the law treats as if he or she were fired). Such employees may need to be included in the turnover rate, depending on the event that triggers the partial plan termination.

If the employer cannot provide satisfactory evidence that the turnover rate was routine or was not the result of employer-initiated terminations, the partial plan termination presumption will stand.

Best practices in evaluating partial plan terminations

Based on a review of plans whose Form 5500 returns reported decreases in participants performed by the IRS Employee Plans Compliance Unit (EPCU), it appears that there is confusion in the employee benefit plan community on what constitutes a partial plan termination and the vesting requirements resulting from a partial plan termination. The review found the following where plans' Form 5500 returns reported decreases in participants who were not fully vested:

- Over half of the plans made errors in participant counts
- A significant number had fully vested all participants as a result of the partial plan termination, but reported that the participants were not fully vested on Form 5500
- In 30% of the cases, EPCU concluded there was no partial plan termination
- In 10% of the cases, there was a partial plan termination and affected participants were not fully vested

As discussed above, ERISA requires plan administrators to appropriately consider and address partial plan terminations as they occur. This is especially important in times of increased likelihood of a partial plan termination, such as a major economic downturn. To do so, it is important that a plan administrator understand the applicable rules and establish best practices for ensuring partial plan terminations are adequately considered and addressed, including:

- Obtaining an understanding of partial plan terminations and the related rules.
- Becoming familiar with the plan document as it relates to partial plan terminations and use of forfeitures.
- Establishing a written policy governing how the organization periodically reviews the potential that a partial plan termination has occurred.

- Establishing procedures for monitoring employee turnover and the reasons for the turnover.
- Consulting ERISA counsel when it appears a partial plan termination may occur or may have occurred.
- Considering delaying the use or allocation of forfeitures if it appears a partial plan termination may occur or may have occurred until you are able to verify that participants did not incur improper forfeitures.
- Documenting the processes used to evaluate the potential of a partial plan termination, the conclusions reached, and the actions taken to address a partial plan termination.
- Correcting any related vesting failures using the [Voluntary Correction Program](#).
- Including documentation in the census annual reporting.
- Reviewing participant data and modifying or removing incomplete, incorrect, or duplicate information before sending to providers.

Additional resources

IRS resources

IRS, Treasury Regulation 26 CFR 1.411(d)-2: *Termination or partial termination; discontinuance of contributions*, addresses partial plan terminations and can be found [here](#).

IRS Retirement Plan FAQs regarding Partial Plan Termination can be found [here](#).

[IRS Rev. Ruling 2007-43](#) addresses whether a partial plan termination under § 411(d)(3) of the IRC has occurred based on the facts described in this revenue ruling, and can be found [here](#).

[IRS Rev. Rul. 2002-42](#) provides information about determining when the merger or conversion of a money purchase pension plan into a profit-sharing plan results in a partial plan termination of the money purchase pension plan and what communications must be provided to affected individuals in a money purchase pension plan that is merged or converted into a profit-sharing plan. It can be found [here](#).

[IRS Voluntary Correction Program](#).

DOL resources

[Meeting Your Fiduciary Responsibilities](#)

To meet their responsibilities as plan sponsors, employers need to understand some basic rules, specifically ERISA. ERISA sets standards of conduct for those who manage an employee benefit plan and its assets (called fiduciaries). This publication provides an overview of the basic fiduciary responsibilities applicable to retirement plans under the law.

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