

Electronic Alert

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Have Layoffs Resulted in Partial Termination of Company Retirement Plans? Why It Matters & What Can Be Done

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As employers continue to address the economic strain imposed by COVID-19, some are continuing to reduce their employee numbers. If your company is contemplating such a reduction, or has recently undergone such a reduction, read on to learn more about how this could affect the retirement plans your company offers.

What Is a Partial Plan Termination?

Partial plan termination is a term that is used to refer to a qualified plan that although still ongoing, has, in light of the facts and circumstances, had a sufficient reduction in the number of participants so as to trigger certain legal consequences for the plan.

How Does an Employer Know If a Partial Plan Termination Has Occurred?

Whether a partial plan termination has occurred is a facts and circumstances determination. One of the most easily quantifiable facts and circumstances is the plan's turnover rate.

The turnover rate is the percentage of plan participants who have an employer-initiated separation from employment during the applicable period, which is generally the plan year. However, employees who experience an employer-initiated separation and who are then rehired within the applicable period are generally not considered when determining the turnover rate. For example, employees who are laid off due to COVID-19 in 2020, and who are then rehired in 2020.

The Internal Revenue Service has provided guidance on how to calculate the turnover rate, as well as what the calculated rate indicates. Under the guidance, there is a rebuttable presumption that the plan has been partially terminated if the turnover rate for the applicable period is 20% or more.

Why Is This Important?

If a qualified retirement plan undergoes a partial termination, the accounts of the participants in the plan who are affected by the termination will become fully vested. Affected participants are those who end their employment with the employer for any reason during the applicable period and who have an account balance in the plan.

This acceleration of vesting affects the degree to which a participant is considered to own the amounts in their plan account at that time. Thus, if an employer is not aware that a partial plan termination has occurred, a participant's benefits may be improperly forfeited. Any such error will need to be corrected, and the employer may be responsible for the amounts necessary to correct the error.

What Should Employers Do?

Employers who are curious about whether a reduction in employee numbers will result in a partial plan termination are encouraged to contact legal counsel to help them analyze the issue. It is possible to use estimations based on a plan's current participation numbers to determine whether an upcoming reduction in numbers could result in a partial plan termination.

Employers who are implementing reductions in force should also keep detailed records about the status of an employee's employment. This is because whether an employee's separation is initiated by the employer or the employee is relevant to determining whether that employee's separation is factored into the partial plan termination analysis. It is also important to keep track of whether an employee has been terminated from employment or is in another status, such as furlough. A furloughed employee has most likely not had a "separation from service" so as to require that they be considered a terminated employee when calculating whether a partial plan termination has occurred.

If you have questions about how a layoff could affect the retirement plans that your company offers, or other questions related to employee benefits, please contact Jeff Robertson, Iris Tilley, or Gabrielle Hansen at 503-228-0500 (or via email at jrobertson@barran.com, itilley@barran.com, ghansen@barran.com).