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Intersection of Coronavirus and Partial Qualified Plan Termination

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The Internal Revenue Service (IRS) has provided additional guidance in the form of frequently asked questions (FAQ)[1] with respect to how a coronavirus related furlough or layoff followed by a rehire is treated for purposes of determining whether a qualified retirement plan has experienced a partial plan termination. The guidance indicates that participants will generally not be treated as having an employer-initiated severance from employment for purposes of calculating the "turnover rate" if rehired by the end of calendar year 2020. However, the FAQ leaves a number of issues open and unresolved when it comes to determining whether the plan has experienced a partial termination.

Background. A qualified plan must fully vest all "affected participants" upon a partial termination of the plan. A partial termination occurs if plan participation is reduced by a significant percentage as a result of employer-initiated action or the employees' rights under the plan are adversely affected by a plan amendment. A partial termination is determined based on the relevant facts and circumstances.[2] The IRS has indicated that if the "turnover rate" is at least 20%, there is a presumption that a partial termination has occurred.[3] The presumption can be rebutted (*e.g.*, a showing that the termination was not an "employer-initiated severance from employment").

Unresolved Issues. The FAQ only addresses the situation where an individual who was furloughed or laid off due to the coronavirus is rehired by the end of calendar year 2020. Since the "applicable period" for measuring the "turnover rate" can extend beyond the end of a plan year and it is unlikely that the coronavirus emergency will be resolved by the end of the current year, issues remain unresolved. The FAQ does not address situations where the employer has not rehired a sufficient portion of their coronavirus related furloughed or laid off employees by the end of the current year to avoid a partial termination. In that case, should the "applicable period" be extended to the end of the coronavirus emergency and the "turnover rate" computed over that period? Additionally, if there are additional furloughs or layoffs due to a resurgence of the virus after the end of the current plan year, should those furloughs or layoffs be treated as separate events or part of a single event and aggregated for purposes of determining whether there has been a partial termination? The answer to these questions is unclear.

Another unresolved problem could arise where the employer calls back a furloughed or laid off employee and the employee does not return to work because they have found other employment. Should this employee be treated as a voluntary severance and not included in the numerator of the "turnover rate" fraction? What if the employer extends an offer to the furloughed or laid off employee to return to work but at reduced hours or pay? If this employee declines to return to work and seeks other employment opportunities, should they be treated as a "voluntary termination" or an "employer-initiated severance from employment" for purposes of determining whether the plan experienced a partial termination?[4]

Comment. Given that the burden of demonstrating whether there is a "voluntary severance" is on the employer, plan sponsors should be documenting furloughs and layoffs and the facts and circumstances surrounding rehire carefully in the event that the plan sponsor might need to substantiate why there has been no partial termination of the plan requiring full vesting of the adversely affected participants.

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[1] FAQ-15, posted July 30, 2020. https://www.irs.gov/newsroom/coronavirus-related-relief-for-retirement-plans-and-iras-questions-and-answers (last visited September 4, 2020).

[2] Treas. Reg. §1.411(d)-2(b)(1). A plan could become disqualified if a partial termination has occurred and the plan does not fully vest the affected participants.

[3] Rev. Rul. 2007-43. The "turnover rate" is defined as the number of participants experiencing an "employer-initiated severance from employment" divided by the sum of participants at the beginning of the "applicable period" plus new participants entering the plan during that period. The "applicable period" is generally a plan year but can be a longer period if there are a series of related terminations (*e.g.*, pandemic related furloughs or layoffs extending beyond the end of a plan year). An "employer-initiated severance from employment" includes any severance other than on account of death, disability, or retirement (on or after attaining retirement age) even if caused by circumstances beyond the control of the employer (*e.g.*, pandemic). The IRS generally considers all participant terminations as employer-initiated unless the employer can demonstrate that the severance from employment was voluntary or on account of death, disability or attainment of retirement age. Ann. 94-101.

[4] A given severance from employment may appear "voluntary" but courts have considered the issue of constructive discharge and if it is determined that the employee has been constructively discharged, the individual is treated as experiencing an "employer-initiated severance from employment." *Kreis v. Charles O. Townley, M.D. & Associates, P.C.* 833 F2ed 74 (6th Cir. 1987).