



## **ACCELERATED VESTING: PARTIAL PLAN TERMINATIONS**

One of the main reasons cited by companies that establish retirement plans is their desire to attract and *retain* qualified employees. Retaining employees because of a retirement plan often includes a vesting schedule for employer contributions. These schedules delay the date when a terminated employee has a right to 100% of employer provided benefits for up to six or seven years of employment. Congress recognized the employer's right to impose these restrictions, but requires immediate vesting for all participants when a qualified retirement plan terminates. This requirement also extends to the "*partial termination*" of a plan and this provision is one of the most misunderstood of the qualified plan requirements. According to the IRS, whether a partial termination occurs depends upon all of the relevant facts and circumstances. Not surprisingly, a number of court cases have been decided as to whether a partial plan termination occurred.

To begin with, if a plan incurs a partial termination, the only affect of this event on plan operation is that affected participants who were not already fully vested become 100% vested by reason of the partial termination. A partial plan termination involves a group of employees being excluded from plan coverage after being formerly covered by the plan. The exclusion can be due to a) a plan amendment (e.g. employees of a particular division are prospectively excluded), b) the sale of a division or subsidiary, or c) the involuntary termination of employees.

Partial plan termination due to work force reductions or high involuntary turnover have been a concern and IRS auditors routinely examine turnover data to determine whether a partial termination may have occurred during the year or years under examination. The Internal Revenue Manual advises auditors to determine the ratio of participants who were involuntarily terminated

during the year to total plan participants for that year. If the ratio is less than 20%, no further action is taken. Since most auditors don't have ready access to the reasons for employee terminations, they examine all terminations. If 20% or more of the participants were terminated, the auditor generally requests additional data (which should include the number of voluntary employee terminations, so the auditor can ignore them for determination purposes).

If more than 20% of participants were discharged, the auditor may conclude that a partial termination occurred, particularly if the high turnover was associated with an event such as a division closing. Should this happen, the employer is instructed to accelerate vesting for all affected employees who were terminated during the year without full vested plan benefits. Because the audit occurs long after the employees in question have terminated, paying added benefits presents administrative challenges. Furthermore, forfeitures are normally disposed of within a year following their occurrence, so the employer is usually required to pay additional money into the plan in order to pay affected terminated participants their added benefits. Defined benefit plans have less of a partial termination problem because for them, the staff or benefit reduction must also involve a fully funded plan.

The IRS provided some formal guidance concerning partial plan terminations during 2007 (Revenue Ruling 2007-43). The ruling involved an employer who closed one of four business locations and discharged 23% of his profit sharing plan participants. Full and immediate vesting was required for all participants who were discharged from the closed business location. The IRS pointed out that a partial termination occurred because a) more than 20% of participants lost their jobs and



b). there was a separate business event (the location closing) involved, rather than just routine turnover. The ruling cited one of the court cases involving partial terminations: *Matz vs. Household International Tax Reduction Investment Plan*. The revenue ruling and the *Matz* case provide that a rebuttable presumption of a partial termination exists when the turnover rate is at least 20% for the year. The *Matz* decision also holds a). rates under 10% are absolutely not partial terminations and b). rates above 40% absolutely are.

Employers and the Third Party Administrators that serve them would do well to monitor turnover rates from year to year and take necessary action providing for accelerated vesting if a partial termination is determined to have occurred. If the monetary amounts are significant and the employer is not sure whether a partial termination occurred, the matter can be submitted to the IRS who will examine the facts and decide. Since an IRS decision costs money and takes a long time, most employers decide for themselves. Usually, these decisions are on the conservative side – often declaring a partial termination when the courts, or even the IRS, might conclude otherwise. The old adage, “an ounce of prevention is worth a pound of cure” applies in these cases – ask any employer who has been forced to pay added vested benefits on a delayed basis!

### **HEART ACT AND MILITARY SALARY CONTINUATIONS**

The Heroes Earnings Assistance and Relief Tax Act of 2008 (HEART) contains a provision that affects some employers as early as January 2009. While companies are not required to amend their retirement plans for HEART until 2010, they need to implement required changes sooner. If a company continues salary to an employee who has left regular employment for active military duty, these payments are considered compensation for retirement plan purposes *even if the individual is*

*considered to be a terminated employee.* This provision is an exception to the general rule contained in the recently adopted “section 415” amendment that ignores nearly all post termination compensation. Employees who receive continuation payments while on active duty are permitted to continue to make salary deferrals (and receive matching contributions).

### **AND NOW FOR SOME REALLY GOOD NEWS: KEEP AMERICA SAVING!**

October 18 through October 24, 2009 will be “National Save for Retirement Week,” according to U. S Congressional action. This “KEEP AMERICA SAVING” program concentrates on retirement oriented savings by individuals and includes employee educational information on how to plan for and attain specific retirement goals. Interested companies can request a custom analysis of their plan, as well as individualized reports for interested individual participants. It’s described and available at [www.keepamericasaving.com](http://www.keepamericasaving.com).

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