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# Employee Turnover & Partial Plan Terminations

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# CHAPTER 6

# Employee Turnover & Partial Plan Terminations

**SAMANTHA J. PRINCE***

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*Who would have expected that a pandemic would bring Congressional awareness of an oft-overlooked concept called Partial Plan Terminations? Congress codified a temporary (and now expired) partial termination safe harbor for qualified retirement plans in the Consolidated Appropriations Act, 2021. This was necessary because qualified plans can experience a partial termination due to layoffs resulting from an economic downturn. The pandemic created such an upheaval for many businesses that without such relief, an overwhelming number of plans would have partially terminated. However, even with businesses reopening, the economy continues to be in flux, and this can portend more employee turnover.*

*It is important to understand the partial termination rules so that employers can recognize whether their plan has experienced one when they terminate employees. This article covers the mechanics of determining whether a plan has experienced a partial termination by defining the applicable time period, calculating turnover, and determining who the affected employees are that will become 100% vested if a plan termination has occurred. This article includes the safe harbor created by Section 209 of the Consolidated Appropriations Act from a short-term and long-term perspective. The article then highlights compliance methods and litigation concerns. Lastly, the article discusses the need for IRS guidance going forward.*

## § 6.01 OVERVIEW

The Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code (IRC) regulate qualified retirement plans—both defined benefit and defined contribution plans. While partial terminations can occur in both types of plans, the focus of this article is on qualified defined contribution plans (primarily plans with a 401(k) component) and companies that experience employee turnover.[1]

When defined contribution plans are established, the company must consider any number of plan design options. Applicable to this article's topic, is whether to have a vesting schedule that will apply to company contributions and whether to have auto-enrollment/immediate participation. Companies that choose to have immediate vesting upon enrollment need not be concerned with partial terminations when mass

[1] Partial terminations within these parameters are generally referred to as "vertical" partial terminations. The term "vertical" was initially penned by Stuart M. Lewis, *Partial Terminations of Qualified Retirement Plans—An Evolving Doctrine*, 13 COMP. PLAN. J. (BNA) 223 (1985) and has been used in court cases such as Halliburton Co. v. Comm'r, 100 TC 216, 227 (1993). For a detailed historical background on partial terminations, *see* Vincent Amoroso, Joseph Wm Belger, Robert B. Davis & Jason Flynn, *A Policy Premise Approach to Partial Terminations*, NYU REV. OF EMP. BEN. & EXEC. COMP. Ch.8, 2–15 (2002).

terminations occur.[2] But companies who use a vesting schedule instead of immediate vesting must be mindful of these rules.

When a partial termination occurs, all affected participants must become 100% vested in the company contributions made on their behalf together with any earnings that have accrued thereon.[3] The general rationale is two-fold: one to prevent abuse (via an employer getting a forfeiture windfall at the expense of the plan participants)[4] and the other to still preserve expected plan benefits for employees who were terminated through no fault of their own.[5] As shown *infra*, there is a presumptive threshold for how many employees (plan participants) must be terminated before a partial termination is deemed to have occurred.

Immediately vesting participants' company contribution balances due to a partial termination does not impose an immediate financial burden on an employer because it has already deposited the money into the plan trust, i.e., it does not cost the company money to immediately vest participants when a partial termination occurs.[6] However, had this money not been required to fully vest, it would have remained in the trust as forfeitures. Forfeitures can be reallocated to remaining participants, used to reduce future company contributions, or to pay plan administration fees.[7] As such, forfeitures present a savings opportunity to employers because employers can re-allocate funds already in the plan trust for expenses or future contributions, and therefore they do not have to contribute as much the next year.[8] But if a partial termination occurs triggering full vesting, the money that would have been forfeited will instead be vested leaving no forfeited money to be used later for other things that save the company money.

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[2] If a plan amendment reduces participants, then a partial termination could occur. However, this article is focused on employee turnover.

[3] IRC § 411(d)(3) requires that a qualified plan must provide that upon a termination or partial termination, "the rights of all affected employees to benefits accrued to the date of such . . . partial termination . . . or the amounts credited to the employees' accounts, are nonforfeitable."

[4] Matz v. Household Int'l Tax Reduction Inv. Plan, 388 F3d 570, 575–6 (7th Cir 2004).

[5] Halliburton *supra* note 1 at 227 (1993); Gluck v. Unisys Corp., 960 F2d 1168, 1182–3 (3d Cir 1992); Chait v. Bernstein 835 F2d 1017, 1021 (3d Cir 1987); Amato v. Western Union Intern., Inc., 773 F2d 1402, 1409 (2d Cir 1985); United Steelworkers of America v. Harris & Sons Steel Co., 706 F2d 1289, 1298 (3d Cir 1983). *See generally*, S. Rep. 93-383, at 1 (1973), 1974-3 CB (Supp.) 80. *But see*, Matz *supra* note 4 at 573. ("We are unconvinced by an alternative rationale sometimes suggested for the rule—to protect nonvested employees' expectations of receiving pension benefits. Until his pension benefits have vested, an employee at will, lacking as he does any job tenure, has no reasonable expectations of receiving benefits. The point of vesting is to create such an expectation.")

[6] Timothy Verrall & Sheldon Miles, *Reductions in Force and Partial Plan Terminations: Another Potential 2020 'Gotcha'*, NAT'L LAW REVIEW (Dec. 15, 2020).

[7] *Id.* The plan provisions outline how forfeitures will be allocated.

[8] Samantha J. Prince, *Megacompany Employee Churn Meets 401(k) Vesting Schedules: A Sabotage on Workers' Retirement Wealth*, 41 Yale L. & Pol. Rev. 1, 16–17 (July 7, 2022) (forthcoming 2022).

If a plan experiences a partial termination and it fails to accelerate vesting for the affected employees, it will no longer satisfy the requirements of IRC § 401(a) and therefore it could be disqualified—certainly not a result anyone wants.[9] The IRS has an Employee Plans Compliance Resolution system that allows plans to proactively correct issues and avoid disqualification, but this can be costly and time consuming.[10] Engaging in litigation with the IRS or former plan participants challenging whether a partial termination has occurred is also quite costly and time consuming. As such, recognizing and handling a partial termination when it occurs is much more preferable.

Determining whether a partial termination has occurred involves some uncertainty because there is no codified definition. Treas. Reg. § 1.411(d)-2(b)(1) tells us that determining whether a partial termination has occurred is a "facts and circumstances test" performed on a case-by-case basis.[11] This regulation continues with a minimal list of facts and circumstances to be considered in making this determination: "Such facts and circumstances include: the exclusion, by reason of a plan amendment or severance by the employer, of a group of employees who have previously been covered by the plan; and plan amendments which adversely affect the rights of employees to vest in benefits under the plan."[12] A statement that the IRS displayed on its website shows how unhelpful this regulation is: "It appears that there still remains confusion in the taxpayer and practitioner community on what constitutes a partial termination and the vesting requirements resulting from a partial termination."[13]

This article endeavors to shed some light on partial terminations by breaking down the essential factors: the corporate event, the time period, the turnover calculation, and the affected participants.

## § 6.02 MECHANICS

### [1] Applicable Period

The question of whether a partial plan termination has occurred is nuanced. "[W]hen a 'significant number' or 'significant percentage' of employees are affected by an event such as a plant closing, sale of a business, or corporate reorganization" then affected employees must become 100% vested.[14] Key factual considerations to unpack will be

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[9] *See generally*, Halliburton *supra* note 1 at 218.

[10] *See infra* notes 116–119 and accompanying text.

[11] Treas Reg § 1.411(d)-2(b)(1).

[12] *Id.*

[13] Internal Revenue Service, *Issue Snapshot—Partial Termination of Plan*, https://www.irs.gov/retirement-plans/partial-termination-of-plan#:~:text=The%20presumption%20of%20a%20partial,there%20was%20no%20partial%20termination ("IRS Snapshot").

[14] Jo Ann C. Petroziello & Samantha J. Prince, *Partial Termination of Single-Employer Tax Qualified*

fleshed out when applying the correct time period, calculating that "significant number" or "significant percentage" of turnover, and determining who qualifies as the "affected" employees.

When testing via a facts and circumstances test, it is necessary to consider the underlying circumstances or the "story." After all the story is a recitation *of* the facts and circumstances. First one must determine when the story began and when it ended—or rather, what is the timeframe in which we should measure whether a partial termination occurred.

The story could start with the event that caused the reduction in workforce. Was there a "major corporate event" in connection with the reduction? Neither the IRC nor the Treasury Regulations require that there be a major corporate event that precipitated the reduction. Some cases have noted that a major corporate event "is not necessarily a prerequisite to finding that a partial termination has occurred."[15] Still courts have found the existence of an event as a fact worth considering.[16] Such an event can aid in determining what the necessary timeframe is for considering whether a partial termination has occurred. For instance, if there has been an event that defines the partial termination time period, layoffs outside of that time period may be shown as attributable to routine turnover and not counted in the event turnover calculation.[17]

Courts have "held the closing of a plant or division or restructuring incident to a merger" as qualifying as "major corporate events."[18] Layoffs caused by economic circumstances can cause partial termination of a plan.[19] In *Tipton*, there was a multiple year partial termination without one specific corporate event. The engineering firm was forced to reduce its work force due to the "inherent volatility of the consulting engineering business."[20] The court treated both sets of layoffs as separate partial terminations even though "the discharges were due to a decrease in the volume of

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*Plans: Clarity or Misappropriated Judicial Decision-Making?*, 2 GEO. MASON INDEPENDENT L. REV. 265, 273 (1994); *See*, IRC § 411(d)(3); Treas Reg § 1.401-6; Treas Reg § 1.411(d)-2(b). *See also*, Rev Rul 2007-43 2007-2 CB 45 (2007); Rev Rul 72-439, 1972-2 CB 223 (1972); Rev Rul 72-510, 1972-2 CB 223; *See also*, Weil v. Retirement Plan Admin. Comm. For Terson Co., 750 F2d 10, 12 (2d Cir 1984), on remand, 1988 US Dist LEXIS 5802 (SDNY Jun. 15, 1988).

[15] Halliburton *supra* note 1 at 230 citing Tipton & Kalmbach, Inc. v. Commissioner, 83 TC 154, 160–162 (1984).

[16] *See*, *id* at 230–33; In re Gulf Pension Litig., 764 F Supp 1149, 1169 (SD Tex 1991), aff'd 36 F3d 1308 (5th Cir 1994), cert. denied, 514 US 1066 (1995).

[17] *See infra* § 6.02[2].

[18] Halliburton *supra* note 1 at 230.

[19] Tipton *supra* note 15 at 161; Peter M. Boruta, M.D., P.C. V. Commissioner, 55 TCM 670 (1988).

[20] *Id.* at 155.

petitioner's business, and not to any intent or purpose to deprive these participants of benefits."[21]

In the *Sea Ray* case, the court did not aggregate two different economic downturn-type issues that occurred in consecutive years. In 1989 and 1990, there was a slump in the small boat industry.[22] Then in 1991, the federal government imposed a luxury tax which negatively impacted the large boat business.[23] The court found that these were two separate events that should not be aggregated for purposes of determining a partial termination.

The IRS generally will start with a single plan year as the applicable period.[24] If a plan year is a short plan year (less than twelve months), then the IRS will add the short plan year to the prior plan year.[25] However, if an event (employer-initiated or economic downturn) spans over numerous years, it is appropriate to widen the applicable period to cover the years in which the event caused employee dismissals.[26] The IRS's ability to aggregate events prevents employers from splitting their employee terminations between one plan year and another, such as December of one year and January of the next to avoid a partial termination.[27]

This aggregation concept can be chaotic for companies who unexpectantly experience a deemed partial termination in a subsequent year. For instance, if a corporate event happens in one year but the percentage of terminated employees is only 10%, there will be no partial termination. But if in year 2, the company terminates another 10% of its workforce, and the IRS aggregates the employer-initiated terminations in both years, then the IRS could find a partial termination has occurred. Depending on the methodology selected by the plan, this could create an issue regarding forfeiture allocations. In year 1, the company would not know to fully vest the affected individuals and may therefore forfeit the non-vested account balances. However, under the five-year break in service rule, this is not a problem for those accounts that were not previously distributed because those would not become forfeitures until a five year break in service. However, balances that are cashed-out or otherwise distributed create

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[21] *Id.* at 160.

[22] Admin. Comm. of the Sea Ray Employees' Stock Ownership & Profit Sharing Plan v. Robinson, 164 F3d 981, 988 (6th Cir 1999), *cert. denied*, 528 US 1114 (2000).

[23] *Id.*

[24] Rev Rul 2007-43 *supra* note 14 at 2.

[25] *Id.*

[26] Gulf Pension *supra* note 16 at 1167–8; Matz v. Household lnt'l, 227 F3d 971, 977 (7th Cir 2000). ("We hold that because there is nothing in the language of the rule itself that requires a significant corporate event to occur within a plan year, Matz can combine terminations from 1994, 1995 and 1996, provided that he show that the corporate events of those years were related.")

[27] *See*, Matz *supra* note 26 at 977; Amoroso *supra* note 1 at 18.

immediate forfeitures of unvested employer contributions. In such a case, the plan administrator would have already allocated those forfeitures at the end of year 1. The result is that an employer must now contribute more money to the plan trust to overcome the shortfall or alternatively undo the allocation of those forfeitures.[28] If those forfeitures were allocated to other employees' accounts, and then recaptured, it could disgruntle those employees.

And in this situation, it is difficult at the end of year 1 to determine the proper approach. It is also difficult if the event involves the beginning of the next year, and one does not know if it will be a partial termination or not. This is especially true in times of economic uncertainty or downturn. Proponents of immediate vesting in lieu of applying a vesting schedule (like the author) would suggest that a company could avoid all of this by immediately vesting everyone. But for small companies that believe the use of vesting schedules assists with talent retention, laying off people and being forced to vest eliminates this loyalty incentive.

It is critical that employers compile evidence to show whether the employer-initiated terminations were part of a corporate event or economic downturn. There are many types of evidence that can be helpful. Since the beginning of the pandemic, many managerial meetings and company town halls have been live-streamed or conducted via zoom/teams. Recordings or transcripts of such meetings would be excellent evidence of employer communications regarding the reason for layoffs, as would any media reporting on it.[29] Some states, such as Missouri and Montana, require "service letters," which require employers to notify an employee of why they were terminated.[30] Such letters would be helpful in proving why an employee was terminated. Additionally, notes from employee meetings, press releases, letters to employees, minutes from meetings discussing downsizing, could all be salient.

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[28] Rev Proc 2021-30, 2021-31 IRB 172 (2021).

[29] See for example, the media coverage when the CEO and founder of Better.com, Vishal Garg, laid off 900 employees over Zoom. Kathy Gurchiek, CEO Who Laid Off Workers over Zoom Will Return to Company, SHRM (Jan. 24, 2022) https://www.shrm.org/hr-today/news/hr-news/pages/ceo-who-laid-off-workers-over-zoom-will-return-to-company.aspx#:~:text=Vishal%20Garg%2C%20the%20CEO%20and,to%20the%20organization%20he%20founded.

[30] Jeffrey M. Hirsch, *The Law of Termination: Doing More with Less*, 68 MD. L. REV. 89, 122 (2008). (Noting two states that require "what is generally described as a "service letter" law, some states have imposed similar notice requirements that require an employer to provide employees with a letter that describes the reasons for a termination." *See* MO ANN STAT § 290.140(1) (2022); MONT CODE ANN § 39-2-801(1) (2021).

## [2] Calculating Turnover

### [a] Rebuttable Presumption

What qualifies as a 'significant number' or 'significant percentage' of employees that have had a severance for partial termination purposes? For companies with a small number of employees, the IRS leans more toward a 'significant number' threshold than toward a 'significant percentage.' The number is one part of the facts and circumstances considered. In other instances, a significant percentage is deemed to occur when the percentage is at least 20%.

When a plan has turnover of at least 20%, the IRS presumes it has experienced a partial termination.[31] A majority of court cases have followed this presumption. The IRS and courts consider the presumption rebuttable. This rebuttable presumption is where the facts and circumstances come into play again. If a plan is close to 20%, further inquiry should be made into the facts and circumstances. The Seventh Circuit in *Matz* introduced an inquiry "band" around the 20%:

> "We assume . . . that there is a band around 20 percent in which consideration of tax motives or consequences can be used to rebut the presumption created by that percentage. A generous band would run from 10 percent to 40 percent. Below 10 percent, the reduction in coverage should be conclusively presumed not to be a partial termination; above 40 percent, it should be conclusively presumed to be a partial termination."[32]

The facts that could persuade the IRS and courts to determine a partial termination with less than a 20% change vary. Notably, the 20% rule seems so entrenched that there has been no deviation from it.[33] "A drop of less than 20 percent has been considered significant *only* if accompanied by egregious abuse on the part of the employer, such as discrimination in favor of the highly compensated, manipulation of the pension rules to obtain tax benefits, creation of a reversion of plan assets to the employer, or an attempt to prevent employees from becoming vested in accrued benefits."[34](*emphasis*

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[31] Rev Rul 2007-43 *supra* note 14 at 3.

[32] Matz *supra* note 4 at 578. *See* Kreis v Charles O. Townley, M.D. and Associates, P.C., 833 F2d 74, 80 (1987) (Stating that sometimes the "percentage may be so high or so low as to be determinative standing alone."); Sea Ray *supra* note 22 at 987.

[33] *See* Matz *supra* note 4 at 576 (table with cases and percentages).

[34] Halliburton *supra* note 1 at 237. *See*, Rev Rul 2007-43 *supra* note 14 at 3. *See also*, Aggarwal v. St. Barnabas Hosp., 263 F Supp 2d 671, 674 (SDNY 2003) ("While there is no absolute measure of what number of employees is considered "significant" for these purposes, the rule of thumb, plaintiffs concede, is 20%, and, indeed, plaintiffs have pointed to no case in which a percentage of less than 20% was considered significant for these purposes absent exceptional or 'egregious' circumstances."); Gulf Pension *supra* note 16 at 1162.

*added*) In *Matz*, the court stated that "it seems the only relevant facts and circumstances should be the tax motives and tax consequences involved in the reduction in plan coverage."[35]

If the IRS notes a 20% change on a Form 5500, it will send a compliance questionnaire seeking clarification.[36] It would seem that it would be most appropriate if the IRS would use the *Matz* inquiry band above when determining the need for additional information, particularly in light of the IRS disclosure that many employers miscalculate the 20%.[37] Perhaps it does, although literature from the IRS seems to indicate that 20% is the trigger point.

### [b] The Computation

The IRS has a simple equation for calculating the turnover rate. The turnover rate is computed by dividing the number of participating employees who had an employer-initiated severance during the applicable period (numerator) by a denominator equal to the sum of the number of participating employees at the beginning of the applicable period *plus* the number of employees who became participants during the applicable period.[38] While the equation sounds simple enough, knowing who to count is often anything *but* simple. Some guidance can be gleaned from Rev. Rul. 2007-43 which requires that both non-vested (not fully vested) and vested participating employees count.[39]

In order to compute turnover, employers will need to show how each employee terminated—voluntarily or involuntarily. For the numerator, an employer needs only count involuntarily (employer-initiated) terminated employees who were not terminated as part of routine annual turnover. *Employer-initiated severance* includes "any severance from employment other than one that is on account of death, disability, or retirement on or after normal retirement age."[40] Notably, terminations for cause[41] and those that did not occur as part of the event need to be carved out and not included in the numerator.[42]

The burden is on the employer to prove that the termination was not employer-initiated. "If a plan sponsor can provide evidence that the turnover rate was not the

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[35] Matz *supra* note 4 at 578.

[36] *See infra* § 6.02[2][a].

[37] *See* note 61 and corresponding text.

[38] IRS Snapshot shows this equation as TR = AA/X+Y.

[39] Rev Rul 2007-43 *supra* note 14 at 3.

[40] Rev Rul 2007-43 *supra* note 14 at 3.

[41] Halliburton *supra* note 1 at 238.

[42] Gulf Pension *supra* note 16 at 1164.

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."[43]

Additionally, the presumption can be overcome with evidence that the severance was routine turnover, particularly when there is not a well-defined corporate event that caused the terminations. Routine turnover can be established if the employer shows that the same turnover rate occurred in other periods, and that the severed employees were regularly replaced. This is another example of the importance of keeping accurate records which is going to be critical here. The IRS has stated that it will "consider whether or not the new employees did the same types of work, had the same job classification or title, and received comparable compensation."[44]

Employers should also be mindful of their turnover rates because if the employees are leaving in droves, it could be attributable to other factors, including working conditions.[45] If this is the case, it is possible that employees could be considered to be constructively discharged and as such their terminations will be deemed employer-initiated terminations.[46] The bottom line is that tracking exit reasons for each employee is going to be of the utmost importance and Human Resource employees should be made aware of its importance. Ideally, personnel files will indicate the facts and circumstances that surrounded the employee's termination as well as a rehiring, if any.

### [3] Affected Employees

When there is a partial termination, the accrued benefits of all affected employees must be fully vested.[47] "Affected employee" is not defined in the IRC or the Treasury Regulations. While there may be some conflicting information from older case law and articles, the IRS takes a broad view of who qualifies as an "affected employee" that must be vested in a partial termination year via its online presence.[48]

The IRS requires that *all* employees who terminated during the applicable period be fully vested.[49] This does not mean only those who terminated as a result of the event.

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[43] IRS Snapshot. *See*, Rev Rul 2007-43 *supra* note 14 at 3.

[44] IRS Snapshot.

[45] Halliburton *supra* note 1 at 240; Kreis *supra* note 32 at 81–82; Young v. Southwestern Savings & Loan Association, 509 F2d 140, 144 (5th Cir1975).

[46] *See generally*, Prince *supra* note 8 at 26.

[47] In order to be a qualified plan under IRC § 401(a), the plan document must require full vesting upon the occurrence of a partial termination.

[48] IRS Snapshot; Retirement Plan FAQs regarding Partial Plan Termination, IRS.gov (Apr. 27, 2022) https://www.irs.gov/retirement-plans/retirement-plan-faqs-regarding-partial-plan-termination.

[49] *Id.*

This also does not mean only those who involuntarily terminated. The IRS means all employees that terminated during the year in which the partial termination occurred are considered affected employees. The IRS Snapshot sums up the IRS position by stating that when there is a partial termination, "the affected participants, *including those who voluntarily terminated during the applicable period*, must be fully vested."[50](emphasis added) One might wonder if there are potential non-discrimination testing concerns in cases where there are more (former) highly compensated employees that receive the accelerated vesting due to a partial termination. According to Treas. Reg. § 1.401(a)(4)-11(c)(4) the answer is "no."[51]

Some plans have automatic cash-out thresholds that trigger the forfeiture of unvested account balances upon the cash-out distribution. The employees who are cashed out count as affected employees. Many plans wait until employees have a five consecutive one-year breaks in service before forfeiting their unvested account balances. In this case, employees who terminated during the plan year of the partial termination and who have not yet had their five consecutive one-year breaks in service are affected employees.[52] To reiterate, all plan participants that terminated during a plan year in which a partial termination has occurred must be immediately vested.

### [4] Section 209 of The Relief Act

On December 27, 2020, Congress enacted the Consolidated Appropriations Act, 2021, which contained the Taxpayer Certainty and Disaster Tax Relief Act of 2020. Section 209, Prevention of Partial Plan Termination, provides a "temporary rule for preventing partial plan terminations" and reads:

> A plan shall not be treated as having a partial termination (within the meaning of 411(d)(3) of the Internal Revenue Code of 1986) during any plan year which includes the period beginning on March 13, 2020, and ending on March 31, 2021, if the number of active participants covered by the plan on March 31, 2021 is at least 80 percent of the number of active participants covered by the plan on March 13, 2020.[53]

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[50] *Id.*

[51] Treas Reg § 1.401(a)(4)-11(c)(4) Ex. 3. *See generally*, Amoroso *supra* note 1 at 10–11 (When discussing the 1962 concept of partial terminations—partial terminations were not codified until ERISA in 1974—Amoroso states, "the vesting sanction applies without regard to the earnings makeup of the adversely affected group.").

[52] *See*, IRC § 411(d)(3); Rev Rul 2007-43 *supra* note 14 at 3.

[53] Taxpayer Certainty and Disaster Tax Relief Act of 2020 § 209, Consolidated Appropriations Act, 2021, HR 133. *See*, Coronavirus-related relief for retirement plans and IRAs questions and answers, IRS.gov (Apr. 27, 2021) https://www.irs.gov/newsroom/coronavirus-related-relief-for-retirement-plans-and-iras-questions-and-answers#partial-termination.

This 80% rule gave employers unprecedented flexibility when calculating a possible partial termination. It also provided most employers with relief in two plan years—the years in which March 13, 2020 and March 31, 2021 fell.

Despite the expiry of Section 209, it is noteworthy to discuss this safe harbor because Congress quickly reacted to the pandemic in a way that was designed not just to assist businesses but also to encourage them to employ workers during a time when so many people were unemployed.[54] Specifically, Section 209 helped businesses by flipping the dynamic of the partial termination calculation. Instead of focusing on the group of terminated employees and computing "turnover," the focus was placed on the number of "active participants." This change was designed to incentivize businesses to hire employees.[55] "This is important because instead of just counting the percentage of active participants who were terminated—likely temporarily high during the initial response to COVID-19—the relief would permit an employer to avoid a partial termination if new employees were hired and enrolled in the plan on or before March 31, 2021."[56]

Another important aspect of Section 209 is that it created a safe harbor.[57] If the 80% was met, then no facts and circumstances could cause a partial termination. Section 209 temporarily usurped Treasury Regulation 1.411(d)-2(b)(1), even though the "facts and circumstances" part of the test—which includes employer motivation—has been a part of partial termination considerations since the beginning. With the establishment of the safe harbor, there was no need to prove that terminations were a result of the pandemic. In other words, temporarily the reason and motivation for the employee turnover do not matter. It is all about those two dates.

A lacuna exists where employee turnover does not matter—that gap in time between March 31, 2021 through the end of the plan year. For example, consider Corp. X has 800 active participants on both March 13, 2020 and on March 31, 2021. The plan uses a calendar plan year. During the summer of 2021 an economic downturn negatively impacts its business. Corp. X lays off half of its workforce, leaving it with 400 active participants on December 31, 2021. Corp. X has not suffered a partial termination for the 2021 plan year because on March 31, 2021—the snapshot for the 80% computation

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[54] This incentive to hire/retain employees aligned well with Payroll Protection Program Loan forgiveness for employers who continued to employ people through the pandemic.

[55] Plan enrollment is an important part of this since the determination is based on the number of plan participants, not simply new hires. A plan that has auto- or immediate enrollment likely benefited more from this safe harbor.

[56] Elizabeth Thomas Dold & David N. Levine, *Employee Benefits Corner-Partial Plan Terminations-IRS Takes a Closer Look (as Should Plan Sponsors)*, THE TAX MAGAZINE, CCH 2 (Jun. 17, 2021).

[57] Taxpayer Certainty and Disaster Tax Relief Act of 2020 § 209, Consolidated Appropriations Act, 2021, HR 133.

within the 2021 plan year—the plan did not have a reduction in plan participants as compared to the number on March 13, 2020. For partial plan termination purposes, it is meaningless that 50% of the plan participants were terminated between March 31, 2021 and December 31, 2021, the end of the plan year. As such, no partial termination occurred, and no vesting would occur for the 50% that were terminated during the gap period. The existence of this lacuna flouts the policy of providing expected plan benefits for employees who were terminated through no fault of their own.[58] It could also protect an employer who has dishonest motivations. Fortunately, Section 209's application has expired but see Section 6.04[2], *infra*, for its continuing impact on future testing for partial terminations.

## § 6.03 COMPLIANCE

The Employee Plans Compliance Unit (EPCU) of the IRS will send questionnaires (compliance check letters) to plan sponsors when it notices erroneous or conflicting information on Form 5500, W-2, 1099R or 1098.[59] EPCU "compliance checks" are not audits per se but they can lead to examinations if the plan sponsor fails to respond.[60] Compliance checks are to "help educate practitioners, plan sponsors and participants about plan qualification and reporting requirements . . . ."[61]

In a recent compliance project, the EPCU targeted partial plan terminations.

> "In its Partial Termination/Partial Vesting Project, the EPCU contacted Form 5500 return filers that reported a decrease in plan participants and had participants that were not 100% vested and were terminated from employment. The contact made was to determine if the plan experienced a partial termination. If a partial termination did occur, the goal of this project was to determine whether plan administrators were complying with the vesting requirements of IRC Section 411(d)(3)."[62]

Through this project the EPCU noted that errors were made on the Form 5500s with prevalence. "Over a span of three years, nearly 2,000 letters were sent. Approximately half of the contacts were due to errors on the Form 5500 return. In many of these cases, the plan sponsors amended their returns and corrected the errors. Taxpayers made errors in participant counts."[63] Even though at times the plan administrator identified that a partial

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[58] *See* note 5 and accompanying text.

[59] Rebecca Moore, *Understanding the IRS Employee Plans Compliance Unit*, PLANSPONSOR (Aug. 28, 2015); Dold *supra* note 56 at 3.

[60] Internal Revenue Service, Internal Revenue Manual https://www.irs.gov/irm/part4/irm_04-071-022.

[61] *Id.*

[62] Rebecca Moore, *IRS Releases Information About Compliance Projects*, PLANSPONSOR (Oct. 14, 2016).

[63] *Id.*

termination had occurred and vested participants,[64] in "almost 10% of the cases, it was determined during the compliance check that a partial termination had occurred and affected participants had not been fully vested."[65]

While this "project" is no longer ongoing, when the IRS allocates this much time to an issue, one can reasonably assume that the IRS considers it important. Despite IRS staffing issues, one should take partial termination determinations seriously. Ideally, a plan administrator would notice a plan termination before the IRS does and then take action to address it.[66] Even if the partial termination is noticed in a subsequent year, self-correction—when available—is the most efficient way to handle things.[67] The correction goes beyond the mechanics of the vesting itself. Amending Form 5500 should also be considered after the correction. This is important to do so that the IRS has accurate data on the number of employees who terminated without being vested—Form 5500 line 6h.[68] The Form 5500 would originally have shown a number on line 6h, whereas if all affected employees (which are all employees who terminated during the plan year regardless of the reason) are vested through a later correction, line 6h should be zero. Amending the Form 5500 to reflect the partial termination correction—vesting of the unvested terminated participants—would keep the Form 5500 from being flagged for partial termination purposes.

### [1] Employee Plans Compliance Resolution System

The IRS Employee Plans Compliance Resolution System (EPCRS) is available to assist with corrections and avoid plan disqualification.[69] The three ways to correct errors within the EPCRS are: Self-correction Program (SCP), Voluntary Correction Program (VCP), and Audit Closing Agreement Program (Audit CAP).[70] In situations where an operational failure like a partial termination is "insignificant," executing a correction does not require contacting the IRS.[71] If the failure is determined to be

[64] *Id.*

[65] *Id.*; IRS Snapshot.

[66] Annually, the plan administrator should determine whether a partial termination has occurred. And if the administrator is not sure, the potential can be flagged so the company can do something about it, such as request a determination letter. If the administrator thinks that the plan did experience a partial termination, all employees who terminated that year need to be fully vested.

[67] Self-Correction of Retirement Plans, IRS.gov (May 12, 2022) https://www.irs.gov/retirement-plans/correcting-plan-errors-self-correction-program-scp-general-description.

[68] In another article, this author has proposed that the IRS and Dept. of Labor increase the detail of the data submitted on line 6h.

[69] EPCRS Overview, IRS.gov (Aug. 31, 2021) https://www.irs.gov/retirement-plans/epcrs-overview.

[70] *Id.*

[71] While the IRS will not provide an opinion on whether an operational error is insignificant, employers and their counsel can use the following factors to decide: "(1) the type of failure involved, (2) the practices and procedures under the plan, (3) whether the failure is significant, (4) whether a favorable letter has been issued with respect to the plan, (5) whether the failure is egregious, (6) when the failure is discovered, and

"significant" and extends beyond three years, then the SCP is unavailable and the Voluntary Correction Program (VCP) must be used instead.

> "If the plan sponsor has acceptable practices and procedures and the failure is insignificant, the plan sponsor may use the SCP to correct the failure at any time, even if the plan is under examination. If the failure is significant, the plan would be entitled to correct under the SCP only if the failure is identified and corrected within the three-year correction period under the SCP and only if a favorable letter has been issued with respect to the plan."[72]

In instances where the plan is not being audited, an employer can apply via Form 8950 to use the VCP to fix the failure. In this application, the employer proposes a correction method to fix the missed partial termination.[73] If the IRS approves the proposal, it will then issue a Compliance Statement that can be relied upon to ensure that initially missing the partial termination will not result in plan disqualification.[74] If the IRS is in agreement with the initial proposal, it works with the employer to find an acceptable path.[75] If a resolution cannot be met, the employer will not be granted an IRS compliance statement, which will likely result in an audit.[76] During audit, the IRS will impose sanctions that "will not be excessive and will bear a reasonable relationship to the nature, extent, and severity of the failures."[77] The sanctions will be determined based on the facts and circumstances but they "should not be less than the fee paid under VCP."[78] The relevant factors for partial terminations would likely be: Number of affected employees; The presence of internal controls designed to ensure that the plan had no failures or that such failures were identified and corrected in a timely manner; Length of time failure occurred; and, the reason for the failure.[79]

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(7) the amount of comfort the plan sponsor has with the method used to correct the failure." Self-Correction of Retirement Plans (SCP) FAQs, IRS.gov FAQ 9 (May 16, 2022) https://www.irs.gov/retirement-plans/self-correction-program-scp-faqs; *See* Rev Proc 2021-30.

[72] Self-Correction of Retirement Plans, IRS.gov (May 12, 2022) https://www.irs.gov/retirement-plans/correcting-plan-errors-self-correction-program-scp-general-description.

[73] Rev Proc 2021-30 contains guidance on using the VCP. One must also remit a non-refundable user fee via Form 8951 which is based on the plan's size by assets. Voluntary Correction Program (VCP) Fees, IRS.gov (Sept. 30, 2021) https://www.irs.gov/retirement-plans/voluntary-correction-program-fees.

[74] Voluntary Correction Program (VCP)—General Description, IRS.gov (Sept. 29 2021) https://www.irs.gov/retirement-plans/voluntary-correction-program-general-description.

[75] *Id.* If the employer corrects the errors prior to getting the compliance statement, and the IRS disagrees with the correction method, the employer may have to undo it.

[76] During the VCP process, the IRS will not commence an audit. *Id.*

[77] *Id.*

[78] *Id.*

[79] *Id.*

As can be seen, the IRS has ways that employers can address partial terminations. Rolling the dice and keeping one's fingers crossed that one will not get caught is not the way to proceed—although most attorneys have had clients who prefer to do just that, despite our advice.

### [2] Determination Letter

If one is unsure whether a partial termination occurred whether from a past action or a future one, one could file a Form 5300 to request a determination letter. There are specific instructions for employers who are requesting a determination on a potential partial termination.[80] The Form 5300 requires a "Partial Termination Worksheet" be attach to the submission. Additionally, Form 8717-User Fee for Employee Plan Determination Letter Request must accompany the Form 5300 filing together with the appropriate filing fee. Employers with less than 100 employees may be exempt from the fee.[81]

ERISA § 3001(a) requires that the plan notify current and former plan participants and any other interested parties, such as collective bargaining agents, that a partial plan termination determination letter request is going to be made.[82] Rev. Proc. 2022-4 states that "notice must be given not less than 10 days nor more than 24 days prior to the day the application for a determination is submitted."[83] Notifications, among other things, must specify the procedures that must be followed in order to obtain copies of the materials filed with the IRS.[84] The interested parties have certain rights[85] and are permitted to file written comments with the IRS or Department of Labor.[86] The purpose

[80] *Instructions for Form 5300*, https://www.irs.gov/instructions/i5300.

[81] User Fees for Employee Plans Determination, Opinion and Advisory Letters, IRS.gov (May 17, 2022) https://www.irs.gov/retirement-plans/user-fees-for-employee-plans-determination-opinion-and-advisory-letters.

[82] 29 USC § 1201(a); Treas Reg § 1.7476-1(b)(5).

[83] Rev Proc 2022-4, 2022-1 IRB 161 (2022). (Section 20.02.)

[84] *Id.* at Section 20.03. Note that if the plan has less than 26 participants, the notice content requirements are reduced. *See* section 20.06.

[85] *Id.* Persons who qualify as interested parties under § 1.7476-1(b) have the following rights: (1) To receive notice, in accordance with section 20 of this revenue procedure, that an application for an advance determination will be filed regarding the qualification of plans described in §§ 401, 403(a), 409, and/or 4975(e)(7); (2) To submit written comments with respect to the qualification of such plans to the Service; (3) To request the DOL to submit a comment to the Service on behalf of the interested parties; and (4) To submit written comments to the Service on matters with respect to which the DOL was requested to comment but declined.

[86] *Id.* Comments submitted by interested parties must be received by the 45th day after the day on which the application for determination is received except in the case of requests made to the Department of Labor, in which case comments must be received by the 25th day after the date the application is received.

of the notice requirements is to allow the interested parties to submit their views to the IRS or Department of Labor before they finalize their determination.

Before filing Form 5300, the above referenced notice must be provided to the interested parties.[87] Form 5300 requires that the employer attach a statement that it provided such notice and provides a checkbox on line 12.[88]

### [3] Litigation

#### [a] Fiduciary Duty Claims

##### [i] Fiduciary Duties

If the compliance requirements and related penalties are not sufficient motivation for an employer to take partial terminations seriously, perhaps the threat of litigation would further convince them. Even if the IRS does not discover the potential partial termination, litigation can be brought by discontented employees who have been dismissed. "[I]f the IRS were to become aware of a partial plan termination due to private party litigation, the employer could be faced with the tax sanctions as well as the cost of providing the benefits to affected employees through litigation."[89] Additionally, attorneys' fees could be awarded under ERISA § 503(g)(1).[90]

Partial plan termination litigation could be brought by an individual or as a class action for wrongful denial of benefits and fiduciary duty breaches.[91] ERISA holds fiduciaries—employers and others involved with the plan—responsible by imposing liability on them for violating ERISA's and/or the plan's provisions.[92] Partial termination cases primarily emanate from three specific fiduciary duties: Duty of Loyalty, Duty of Prudence, and a Duty to Follow the Plan Document.

The Duty of Loyalty, also known as the Exclusive Benefit Rule, provides that

> a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and—
>
> (A) for the exclusive purpose of:

[87] *Id.*

[88] *Id.*

[89] Jane Meacham, Ed., *§ 1010 Partial Plan Termination Issues*, PENSION PLAN FIX-IT HANDBOOK § 1010 (Feb. 2016 Supp).

[90] 29 USC § 1132(g)(1) ("In any action under this subchapter . . . by a participant, beneficiary, or fiduciary, the court in its discretion may allow a reasonable attorney's fee and costs of action to either party."). *See*, Hardt v. Reliance Standard Life Ins. Co., 560 US 242, 243 (2010).

[91] ERISA § 413, 29 USC § 1113. *See*, Gulf Pension *supra* note 16 at 1149. *See generally*, Howard Pianko, *ERISA Fiduciary Duties: Overview*, Practical Law Practice Note Overview 5-504-0060.

[92] 29 USC § 1104(a)(1).

(i) providing benefits to participants and their beneficiaries; and

(ii) defraying reasonable expenses of administering the plan;[93]

Regarding partial terminations, a duty of loyalty claim could be made based on failing to vest terminated participants and forfeiting their employer contribution balances in a manner that inures to the benefit of the employer. This could play out depending on how the forfeitures are re-allocated.

The Duty of Prudence, also known as the Prudent Expert Rule, provides that

> a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and—
>
> (B) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.[94]

Pertaining to partial terminations, a breach of a fiduciary's duty of prudence would likely focus on which participants were counted for the turnover equation, which were counted as terminated via "routine turnover," whether prudent judgment was used to determine whether a partial termination occurred, etc.

The Duty to Follow Plan Documents requires that the fiduciary act "in accordance with the documents and instruments governing the plan" so long as those documents are consistent with ERISA's provisions.[95] Since partial terminations are provided for in the plan document, failing to identify one and failing to vest all affected employees would violate the duty to follow plan documents.

#### [ii] Statutes of Limitations

ERISA § 413 provides that a six-year statute of limitations applies to claims for breach of fiduciary duties.[96]

> No action may be commenced under this subchapter with respect to a fiduciary's breach of any responsibility, duty, or obligation under this part, or with respect to a violation of this part, after the earlier of—
>
> (1) six years after (A) the date of the last action which constituted a part of the breach or violation, or (B) in the case of an omission the latest date on which the fiduciary could have cured the breach or violation, or

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[93] 29 USC § 1104(a)(1)(A).

[94] 29 USC § 1104(a)(1)(B).

[95] 29 USC § 1104(a)(1)(D).

[96] 29 USC § 1113.

(2) three years after the earliest date on which the plaintiff had actual knowledge of the breach or violation;

except that in the case of fraud or concealment, such action may be commenced not later than six years after the date of discovery of such breach or violation.[97]

In partial termination instances, fiduciary breach claims generally must be brought within six years. If the plan participant had *actual knowledge* of the partial termination, then the limitation is three years. The court in Gluck elaborated:

> [ERISA 413] sets a high standard for barring claims against fiduciaries prior to the expiration of the section's six-year limitations period. Although the statute specifically measures the longer six-year period from "the last action which constituted the breach or violation," the statute measures the earlier three-year bar only by reference to the plaintiff's knowledge of the breach . . . We stress that an ERISA plaintiff's cause of action cannot accrue and the statute of limitations cannot begin to run until the plaintiff has actual knowledge of the breach regardless of when the breach actually occurred."[98]

The flexibility in timing to determine actual knowledge is important in partial terminations cases because it can be difficult to know precisely when the partial termination occurred. This is true especially in cases that creep across multiple plan years.

The determination as to what qualifies as "actual knowledge" for Section 413(2) is pivotal. Fortunately, the U.S. Supreme Court clarified in 2020 the term "actual knowledge" for ERISA § 413(2) purposes.[99] In *Intel*, the Court held that the plan participant did not have actual knowledge and therefore his fiduciary duty breach claim was not time-barred.[100] The plan participant sued Intel's retirement plan sponsor (fiduciary) for imprudently managing the retirement plan fund investments. The plan sponsor argued that the case was time-barred because plan participants had website access to disclosures about fund investment allocations and therefore since they had actual knowledge, the suit had to be brought within three years.

The plan participant joined the sponsor's plan in the wake of the 2008 market crash. He periodically accessed the online retirement plan portal that provided several disclosures and notifications about investment strategy.[101] Additionally, the participant had received several e-mails and online messages that alternative investments were

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[97] *Id.*

[98] Gluck *supra* note 5 at 1177.

[99] Intel Corp. Inv. Pol'y Comm. v. Sulyma, 140 S Ct 768 (2020).

[100] *Id.*

[101] The participant also received a copy of the summary plan description.

available. The plan sponsor argued that the participant had actual knowledge, was subject to ERISA § 413(2)'s three-year statute of the limitations, and therefore the claim was time-barred. However, the participant testified that he did not "remember reviewing" the aforementioned disclosures.[102] The question was whether access to information equates to actual knowledge. The Supreme Court unanimously held: "A plaintiff does not necessarily have 'actual knowledge' under [ERISA § 413(2)] of the information contained in disclosures that he receives but does not read or cannot recall reading. To meet [ERISA § 413(2)]'s 'actual knowledge' requirement, the plaintiff must in fact have become aware of that information."[103] As such, because Congress inserted the word "actual" into this section of ERISA, the Court was unwilling to equate access to information as *actually* having knowledge.

### [b] Benefits Recovery Claims

While partial termination cases involve a fiduciary breach, a party can also bring claims pursuant to ERISA § 502(a)(1)(B) which empowers plan participants and beneficiaries to bring a civil action "to recover benefits due to him under the terms of his plan, to enforce his rights under the terms of the plan, or to clarify his rights to future benefits under the terms of the plan."[104] However, ERISA does not contain a statute of limitations provision for § 502 claims. Because benefits recovery claims are contractual in nature, a statute of limitations can come from two different places, the plan document and state contract law.

First, the court will look to the plan document to see if a contractual period of limitations exists—most ERISA covered plans contain such provisions.[105] In *Heimeshoff*, the Supreme Court held that a plan's limitations provision is enforceable: "a participant and a plan may agree by contract to a particular limitations period, even one that starts to run before the cause of action accrues, as long as the period is reasonable."[106] The plan at issue in this case required participants to bring suit within three years after "proof of loss" was due.[107] However, because proof of loss is due before the plan's administrative process could be completed, exhausting administrative

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[102] *Id.*

[103] *Id.*

[104] 29 USC § 1132(a)(1)(B).

[105] Eric L. Buchanan, *ERISA and the Supreme Court after 40 Years: Statute of Limitations, Plan Documents, and attorneys' fees under ERISA*, https://www.buchanandisability.com/helpful-resourcesandarticles/attorney-newsletters/erisa-supreme-court-40-years-statute-limitations-plan-documents-attorneys-fees-erisa-eric-l-buchanan/#:~:text=ERISA%20does%20not%20contain%20a,law%20that%20would%20be%20applicable.

[106] Heimeshoff v. Hartford Life & Acc. Ins. Co., 571 US 99, 105–106 (2013). *See*, Order of United Commercial Travelers of America v. Wolfe, 331 US 586, 608 (1947).

[107] *Id.* at 113.

remedies before filing a suit to recover benefits would reduce the contractual limitations period.[108] The Court upheld the provision finding that the plan's limitations provision was not inconsistent with ERISA.[109] But the Court clarified that "plans that offer appeals or dispute resolution beyond what is contemplated in the internal review regulations must agree to toll the limitations provision during that time."[110]

Next, if a plan has not set a limitation, the court will often borrow and apply the forum state's most analogous statutory limitations period.[111] "Since states have a multiplicity of statutes of limitations, the circuit courts have a wide selection."[112] In cases for benefits recovery—like partial plan terminations—courts mostly use the statute of limitations for written contracts.[113] Problematically, states' statutes of limitations vary, and sometimes significantly.[114] This creates a distinct lack of uniformity and can lead to forum shopping. ERISA cases can be brought in any district court "where the plan is administered, where the breach took place, or where the defendant resides or may be found."[115] Forum shopping can easily happen given the increase in participants working remotely. Such participants may work in different states than where the company is located or where the plan is administered, and therefore there can be more forum choices.

* * *

Partial plan termination cases can go on for years, which is time-consuming and costly. Sometimes case longevity can get out of hand. For instance, the *Matz* case took nearly twenty years to resolve.[116] The corporate event that triggered the partial termination in *Weil* took place in 1981; the case was litigated from 1984–1991 (seven years total but ten years after the event).[117] In *Sea Ray*, the partial termination events

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[108] *Id.*

[109] *Id.* at 115.

[110] *Id.*; 29 CFR § 2560.503-1(c)(3)(ii).

[111] Hoover v. Bank of America Corp., 286 F Supp 2d 1326, 1333 (MD Fla 2003); George Lee Flint, Jr., *ERISA: Fumbling the Limitations Period*, 84 NEB. L. REV. 313, 317 (2005).

[112] Flint *supra* note 111 at 319.

[113] *Id.* at 320.

[114] *Id.* at 320–322. Professor Flint also points out that ERISA's legislative history suggests that using state statutes of limitations is not correct, and neither is using contract law as analogous. *Id.* at 335–344.

[115] *Id.* at 361.

[116] Matz v. Household Int'l Tax Reduction Inv. Plan, 774 F3d 1141, 1143 (7th Cir 2014). ("Before us is the fifth appeal in a seemingly interminable class action suit, filed 2 months short of 19 years ago.")

[117] Weil v. Ret. Plan Admin. Comm. of Terson Co., 933 F2d 106, 106 (2d Cir 1991).

occurred in 1989 and 1991, and the litigation ended in 2000.[118] In *Gulf Pension*, the event occurred in 1984 and the litigation ended in 1995.[119]

One might wonder why there are so few partial termination cases. Perhaps because the IRS allows for voluntary compliance, and perhaps employers do the math and determine that it is more cost-effective to allow the plan to vest the affected employees than to fight it. But if one cannot agree with the IRS's determination, and the IRS revokes the plan's qualified status, then the employer has no other recourse than to go to court. And when plan participants have exhausted their administrative remedies, they have no recourse but to go to court. With so many undefined terms—applicable period, turnover rate, routine turnover, affected employees—one can see the need for judicial help to settle parties' differences.

## § 6.04 MOVING FORWARD

### [1] Routine Turnover

The long-term impact of the pandemic, the war in Ukraine, increased interest rates, and inflation will continue to provide crises where employer-initiated terminations will occur, sometimes *en masse*. Ignoring the potential for a plan termination will not serve companies well. As cases come forward, the IRS and courts will need to consider the economic downturn aspect of partial terminations. Businesses will need further guidance and clarity from the IRS on numerous issues because nobody wants to go to court over this.

As discussed in Section 6.02[2][b], *supra*, in order to prove that a plan has not partially terminated, employers can show that dismissals were "routine turnover." But determining routine turnover requires showing a pattern based on past turnover. When looking at past turnover rates to determine what qualifies as "routine turnover," do we skip the pandemic period? 2020 and 2021 were anything but "routine." And since Section 209 was enacted to avoid consideration of the turnover during plan years containing the period from March 13, 2020 through March 31, 2021, it would seem malapropos to use the data from that time to calculate anything that impacts future year partial termination determinations.

Additionally, the pandemic changed the dynamic of many businesses. The choice for many was to pivot or close. For those businesses that successfully pivoted, is it appropriate to try to compute "routine turnover" based on how the business operated prior to the pandemic? Even if the business operations did not significantly change, does it make sense to consider pre-pandemic numbers when trying to determine what turnover is considered routine? Such issues will confront businesses and the IRS going forward.

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[118] Sea Ray *supra* note 22 at 983.

[119] Gulf Pension *supra* note 16 at 1160.

Prior case law could provide guidance. In *Gulf Pension*, the court cited to the then existing IRS Plan Termination Handbook for insight into determining the "normal turnover rate" and quoted the following:[120]

> (6) . . . The facts and circumstances must be considered in each case and may include the extent to which terminated employees are replaced, and the normal turnover rate in a base period. The base period ordinarily should be *a set of consecutive plan years* (at least two) from which the normal turnover rate can be determined, and *should reflect a period of normal business operations rather than one of unusual growth or reduction*. Generally, the plan years selected should be those immediately preceding the period in question.[121] (emphasis added)

Taking this guidance into consideration, the IRS will look for two or more years that are reflective of what is *normal* for the business. The difficulty will be teasing out that normalcy with the intervening economic instability resulting from the pandemic, supply chain issues, war in Ukraine, inflation, labor shortages, etc.

Somewhat unexpectedly, numerous new businesses started or expanded during the pandemic.[122] For example, consider businesses that hired extraordinary amounts of employees during the pandemic only to have to turn around and lay off significant numbers of employees due to a different turn in the economy. If these companies had qualified retirement plans with employer contributions tied to vesting schedules, how would the IRS be able to do an analysis of routine turnover? New businesses may not have been operational long enough to establish routine turnover and therefore will be less able to rebut the presumption if they terminate 20% of their plan participants.[123] And further, the interference of the pandemic, inflation, etc. makes it even more difficult to establish normal turnover. Some businesses had "unusual growth" followed by "unusual reduction" and vice versa.

Also consider the policy behind partial terminations. In the *Sea Ray* case, a reduction of plan participants occurred due to "unfavorable changes in the economy." The court stated that the percentages were not definitive, so it looked to the additional factors as set forth in the *Kreis* case: the effects on the plan of the exclusion of employees from participation and the employer's motives—whether the terminations were motivated by

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[120] *Id.* at 1166.

[121] *Id.*

[122] Jessica Elliott, *Open for Business: What You Need to Know About the Pandemic Startup Wave*, USCHAMBER.COM (Oct. 19, 2021).

[123] This is perhaps one reason why some startups offer a retirement plan with a 401(k) component but without employer contributions until they have been in operation several years, at which time they add employer matching. Newer businesses will have these issues frequently since it can take several years for a business to get its footing.

either a tax benefit or a reallocation of non-vested benefits to either the company or a third party.[124] Having found neither, a partial termination was not found.[125]

When the IRS considers whether a plan has partially terminated, looking at the motivation would be helpful during these unstable economic times. During financial stress, some businesses may be tempted to terminate certain employees because they will gain a potential financial windfall that would emanate from forfeitures.[126] This is ill-advised for numerous reasons. In the partial termination context, such a practice would add to the facts and circumstances that lean toward a partial termination. Additionally, such a practice would violate ERISA § 510 and the "pattern of abuse" language in IRC § 411(d)(1)(A). While Section 209 may have potentially insulated such motivations in the partial termination context, employers should remain vigilant and not allow this sort of mindset to take hold—or they risk disqualification.

IRS guidance on how it is going to calculate routine turnover will be useful for businesses surviving economic downturns.

### [2] Section 209 Evergreen Effects

Plans that would have normally experienced a partial termination during 2021 but for Section 209 could be set up well to avoid a partial termination in future years as well. Since the original 20% presumption is effective in 2022, it is important to look at how Section 209 impacts the presumption.

Remember, the turnover rate is computed by dividing the number of participating employees who had an employer-initiated severance during the applicable period (numerator) by a denominator *equal to the sum of the number of participating employees at the beginning of the applicable period plus* the number of employees who became participants during the applicable period.[127] (emphasis added) When considering the number of participants at the beginning of the 2022 plan year, the company could be starting from a lower threshold. If a plan had a reduction in plan participants in 2021 but still passed the 80% rule it was protected by the safe harbor in Section 209. In 2022, the plan starts with a lower participant number perhaps due to a labor shortage. It will be easier for it to meet the 20% threshold as growth continues in part because its denominator will be lower. Consider the earlier example in Section 6.02[4], *supra*, where the plan had 50% of plan participants laid off in 2021 but did not have a partial termination due to the Section 209 safe harbor. In that example, the 400 plan participants at year end will be represented in the denominator of the equation. Since

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[124] Sea Ray *supra* note 22 at 988–9 citing Kreis *supra* note 32 at 79–80.

[125] *Id.*

[126] *See generally*, Prince *supra* note 8 at 26.

[127] *See supra* § 6.02[2][b].

the number is lower than what it normally would have been, it is less likely for the plan to experience a partial termination in 2022 and moving forward.

When the above occurs, it conceivably violates public policy. As explained above, plans in 2022 will be less likely to experience a partial termination. Therefore, participants who experienced an employer-initiated termination in 2022 will be less likely to become vested through the partial termination rule. Essentially, while the 20% presumption "returns" because employers could have a lower denominator, it is less likely that their plans will be considered as partially terminated, and therefore, those employees who would have normally been entitled to full vesting will not become vested.

Consideration as to which workers Section 209 truly impacted is warranted. Section 209 protected businesses and that protection may have helped keep the business' doors open. But Section 209's impact on terminated employees should not be disregarded. During 2020 and 2021, unemployment was high due to the pandemic. And the pandemic impacted groups disparately.

> "Although all demographic groups were affected, persons identifying as Black or Hispanic and younger workers generally experienced relatively high peaks in unemployment and relatively steep declines in labor force participation over the course of the pandemic. Additionally, persons with lower educational attainment have generally experienced relatively higher unemployment rates and lower labor force participation throughout the pandemic."[128]

In July 2021, the unemployment rates by racial group were Black 8.2%, Asian 5.3%, and White 4.8%.[129] Those who identify as Hispanic had a July 2021 unemployment rate of 6.6% compared to those who do not at 5.5%.[130] Low-paid workers regardless of race and ethnicity struggled. And low-paid workers and non-whites are reported as having lower retirement savings overall.[131] A reasonable assumption here would be that

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[128] Gene Falk, Isaac A. Nicchitta, Emma C. Nyhof & Paul D. Romero, Unemployment Rates During the COVID-19 Pandemic, Congressional Research Service, Summary (Aug. 20, 2021) https://sgp.fas.org/crs/misc/R46554.pdf.

[129] *Id.* at 12. While these disparities are exemplified in unemployment rates regularly, the fact remains that when giving a business the ability to terminate employees while still meeting the Section 209 safe harbor without vesting those affected, retirement wealth accumulation is negatively impacted. The same can be said with respect to those terminated during the lacuna created by Section 209.

[130] *Id.*

[131] Dania V. Francis & Christian E. Weller, *Race, Ethnicity, and Retirement Security in the United States*, appearing in J. Hamilton (ed.) OXFORD RESEARCH ENCYCLOPEDIA OF ECONOMICS AND FINANCE (2021) ("Comparing 2016 Black household median retirement savings account balances of $23,000 to $67,000 for White households.") *See generally*, ELLEN E. SCHULTZ, RETIREMENT HEIST 207 (2012)(stating that "401(k)s have been a boon primarily for high-income employees, who can afford to save . . ."); Chris

non-whites and lower-paid were more apt to be those negatively impacted by Section 209. Under normal circumstances, these individuals would have been immediately vested during an economic downturn assuming a partial termination occurred. Instead, their employers' plans were "safe" under Section 209—no partial termination—and therefore no vesting for the employees.

The pandemic certainly brought about numerous issues and Section 209 was designed to help businesses survive. How much did Section 209 help? Businesses would have contributed employer contributions to the plan for all plan participants, so the money would be in the plan trust already. Upon terminating employees, some would have cashed out balances and forfeited the money to cover administrative fees or reduce company contributions. In that respect, Section 209 helped businesses by shielding them from partial terminations which allowed them to use plan trust corpus to cover costs. Had there been no forfeitures like in a partial termination situation, then the company would have to cover those costs with additional funds.

### [3] Aggregation

Teasing out if or how to aggregate years is going to be difficult or impossible. With Section 209 providing a safe harbor, this likely means that "economic downturn" in future years will not be able to reach back and aggregate with 2020 or 2021. Thorough guidance from the IRS is needed. The pandemic started an economic crisis that showed itself in the form of supply chain issues and inflation. These issues could be ongoing for many years. Will each economic downturn be treated separately as in *Sea Ray*? Or will everything the country has been experiencing since the pandemic qualify as one economic downturn?

Additional IRS guidance is necessitated so employers know how years will be aggregated, and whether/when economic downturns will be viewed as separate events. A simple statement that the facts and circumstances will be considered will not suffice alone to address this issue going forward. As quoted earlier, the IRS states that employers and practitioners struggle with partial termination rules and identification. Some guidance would be appreciated here. When contemplating all of this, consideration as to protecting plan participants and their retirement benefits should not be overlooked.

## § 6.05 CONCLUSION

The laws surrounding partial plan terminations are convoluted and ooze uncertainty. The IRS knows it. Specific guidance is needed from the IRS regarding issues emanating

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Farrell, *The Touch Retirement Challenges of Rural Americans*, FORBES (Mar 13, 2020, 01:01pm EDT) https://www.forbes.com/sites/nextavenue/2020/03/13/retirement-challenges-of-rural-americans/?sh=3a770cc13262.

from the recent economic crises experienced by businesses. With more knowledge, businesses will be better equipped to identify and handle partial terminations when they occur.

The consequences for violating these rules, if not corrected through the IRS Employee Plans Compliance Resolution System, are stiff—the worst of which is disqualification of the plan. Litigation over whether a partial termination has occurred can and usually does, drag on for years, costing time and money, and creating administrative flux.

While uncertainty is rampant when it comes to partial terminations, one thing is certain. If the plan provides immediate vesting instead of using vesting schedules, it will never have to vest people due to layoffs—they will already be vested. The number of plans that immediately vest participants is increasing and never having to deal with partial plan terminations is one excellent reason why.[132]

[132] Prince, *supra* note 8 at 52.