



Sep 17, 2020

Categories:

[Coronavirus Response](#)

[Team](#)

[Publications](#)

Authors:

[Michael T. Bindner](#)

COVID-19 Layoffs Can Cause Partial Retirement Plan Termination

The COVID-19 pandemic has caused nationwide “shelter-at-home” proclamations from state and local governments resulting in nonessential businesses having to temporarily shut down. Businesses are handling this crisis in varying ways, some by temporarily paying employees to stay home, others beginning layoffs and furloughs of employees. For those businesses that have (or plan to) lay off employees, they need to be aware of the qualified retirement plan partial termination rules, which require immediate 100% vesting of accounts if a partial plan termination is deemed to have occurred.

Background

Employee contributions to an employer’s qualified retirement plan are fully vested when contributed, which means that an employee will be entitled to a distribution of all the employee’s contributions plus earnings when the employee is eligible for and elects a distribution from the plan. Employer contributions to a qualified retirement plan can be fully vested when contributed, but many times are subject to a vesting schedule which requires employees to complete a certain number of years of service before being fully vested.

The laws which govern qualified retirement plans require that (i) all employees be 100% vested in their retirement plan account balance upon the termination of a plan, and (ii) certain employees be 100% vested in their retirement plan account balance upon a “partial termination” of the plan, regardless of the plan vesting schedule or the number of years of service they have with the employer.

IRS regulations provide that whether or not a partial termination has occurred shall be based on “all the facts and circumstances” in a particular case, which include (i) 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 (ii) plan amendments which adversely affect the rights

of employees to vest in benefits under the plan.

If a partial termination has occurred, all participants who terminated employment during the “applicable period” (referred to as “affected employees”) must be 100% vested in the amounts credited to their accounts as of their termination date, including employees who terminated employment voluntarily. The applicable period is generally a single plan year, but the period can span more than one plan year if the termination events are related, such as a series of related severances from employment due to business sales or closures or other events which occur over a period of years.

IRS Position

The IRS’s position is that a partial termination is generally considered to have occurred when a group of participants is involuntarily eliminated from a retirement plan and the reduction in the number of participants in the plan is significant. The IRS has prescribed a “Turnover Rate” formula to determine whether the reduction is significant. If the Turnover Rate is higher than 20%, the IRS presumes that a partial termination has occurred. The presumption can be rebutted with evidence of extenuating facts and circumstances (e.g., a showing that the rate of turnover is routine for the employer). However, the higher the Turnover Rate, the more difficult it is to rebut the presumption.

Federal Court Perspective

Sometimes the issue of whether a partial termination has occurred ends up in court either because plan participants dispute an employer’s initial determination that a partial termination has not occurred, or an employer disputes an IRS determination that a partial termination did occur. A leading decision in this area issued by the U.S. Seventh Circuit Court of Appeals in 2004 (*Matz v. Household Int’l Tax Reduction Inv. Plan*) somewhat expanded on the IRS 20% presumption, by outlining the following Turnover Rate categories: (i) under 10% – conclusively no partial termination; (ii) 10% – 20% – rebuttable presumption of no partial termination; (iii) 20% – 40% – rebuttable presumption that a partial termination has occurred; and (iv) over 40% – conclusively a partial termination has

occurred.

Factors that can rebut a presumption include whether employees are replaced, whether the employer had a bad motive (i.e., may obtain a reversion from the plan or has realized a tax benefit for prefunding the plan), and whether the terminations were related to a major corporate event (e.g., plant closing) or increased the possibility of prohibited discrimination. An employer can also be proactive and ask the IRS for a determination of whether a partial termination has occurred (using IRS Form 5300).

COVID-19 Issues

Businesses that terminate the employment of retirement plan participants can cause a partial termination to occur, depending on the percent of plan participants that are affected. In some cases, instead of laying off or terminating employees, employers (for the time being) have used furloughs, which are generally the equivalent of an unpaid leave of absence. Though furloughed, employees are initially not seen as being terminated, and therefore not factored into an initial partial termination analysis, if they are not brought back to work within a reasonable period of time, they will likely need to be considered as terminated and counted for purposes of whether a partial termination has occurred. This analysis will include other employees who have been laid off or terminated and can extend over more than one year (for example in 2020 and 2021) if the circumstances that resulted in the layoffs and furloughs are the same.

Employers may consider amending retirement plans to count a certain amount of furlough time due to COVID-19 as hours of service that count for plan vesting purposes. This likely will not cost much to the employer, can go a long way in fostering goodwill with employees, and will not result in lost vesting service for employees who return from furlough.

The IRS recently published retirement plan Q&As about COVID-19 related issues. One of the Q&As addressed the issue of how to treat employees laid off in 2020 because of COVID-19 but rehired by the end of 2020 for purposes of determining whether a partial

termination has occurred. The IRS said that participating employees terminated due to the COVID-19 pandemic and rehired by the end of 2020 generally would not be treated as having an employer-initiated severance from employment for purposes of determining whether a partial termination of the retirement plan occurred during the 2020 plan year. This position is consistent with the IRS' general rule that participating employees generally are not treated as having an employer-initiated severance from employment for purposes of calculating the Turnover Rate used to help determine whether a partial termination has occurred during an applicable period if they're rehired by the end of that period.

Employers should consider other [employment law](#) and [employee benefit](#) issues that may arise under federal and state law when furloughing employees.

For more information, please contact [Mike Bindner](#) or any attorney in Frost Brown Todd's [Employee Benefits](#) Practice Group.

To provide guidance and support to clients as this global public-health crisis unfolds, Frost Brown Todd has created a [Coronavirus Response Team](#). Our attorneys are on hand to answer your questions and provide guidance on how to proactively prepare for and manage any coronavirus-related threats to your business operations and workforce.

© 2026 FBT Gibbons LLP. May be considered attorney advertising in some jurisdictions.