

IRS Q&As Clarify COVID-19 Partial Plan Termination Relief

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On April 27, 2021, the Internal Revenue Service (IRS) published guidance in the form of five questions and answers (the “Q&A Guidance”) on the partial plan termination relief provided under the Consolidated Appropriations Act, 2021 (the “Act”), which was signed into law on December 27, 2020. This partial plan termination relief provided under the Act was enacted to help alleviate economic hardships faced by plan sponsors who were forced to temporarily reduce their workforce in response to the COVID-19 pandemic. This article begins by discussing the partial plan termination rules and the partial plan termination relief provided under the Act. The article then discusses the IRS’s Q&A Guidance and the questions that remain unanswered following the issuance of the Q&A Guidance.

Partial Plan Terminations

When a qualified defined contribution or defined benefit plan experiences a partial plan termination, the affected employees are 100% vested in their plan benefits. A partial termination occurs when there is a significant reduction in the number of covered participants either due to their involuntary termination of employment (e.g., lay-off) or a plan amendment. Whether a partial termination has occurred is a facts-and-circumstances determination but as a general rule, the IRS has provided that if 20% or more of all active plan participants, including both vested and non-vested participants, cease to be covered by the plan in a plan year (the applicable measuring period may be longer if the employer-initiated events are part of a series of related events, such as layoffs triggered by the same business circumstances that stagger two plan years), then there is a rebuttable presumption that a partial termination has occurred.

Example: As of March 13, 2020, ABC, Inc. employs 200 active plan participants. ABC, Inc. sponsors a 401(k) plan, which features a matching contribution subject to a four-year graded vesting

schedule. The plan is a calendar-year plan. On April 1, 2020, ABC, Inc. lays off 50 active plan participants, and does not hire or rehire any employees for the rest of the 2020 plan year.

In this example, the plan has likely incurred a partial plan termination because over 20% of ABC, Inc.'s active participants have been involuntarily terminated for the 2020 plan year. The terminated participants will be 100% vested in their matching contributions to the extent they are not already vested in such contributions.

Partial Plan Termination Relief Under the Act

In an effort to provide relief to plan sponsors negatively impacted by the COVID-19 pandemic, the Act modified the applicable measuring period for determining whether a partial plan termination had occurred. Specifically, the Act provided that a plan shall not be treated as having a partial termination 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 (the "80% test"). The result is that a plan sponsor that laid off a significant number of employees due to the COVID-19 pandemic can avoid a partial termination (and the requisite 100% vesting) if it hires new employees or rehires previously employed employees and enrolls them in the plan before March 31, 2021.

Continuing with the example above: Let us assume that on March 1, 2021 ABC, Inc. hires and/or rehires 20 employees, all of whom are eligible to begin participating in the plan immediately; and thus, as of March 31, 2021, ABC, Inc.'s active participant count is 170. Because of the relief provided under the Act, the plan has not incurred a partial plan termination because on March 31, 2021 the plan will cover at least 80% of the active participant count on March 13, 2020.

The Q&A Guidance

Although the relief provided under the Act was well received by both plan sponsors and employee benefits practitioners, many questions remain unanswered as to how plan sponsors should implement the relief. As such, the IRS issued the Q&A Guidance, which answered the following questions:

Who is an active participant for purposes of the partial plan termination relief?

In the Q&A Guidance, the IRS does not provide the specific definition plan sponsors must use in determining who is an active participant for purposes of applying the partial plan termination relief under the Act; but it stated that plan sponsors should use a reasonable, good faith interpretation of the term "active participant covered by the plan" in a consistent manner when determining the number of active participants covered by the plan on March 13, 2020 and March 31, 2021.

Which plan year(s) does the partial plan termination relief apply to?

The Q&A Guidance states that if any part of the plan year falls during the period of March 13, 2020 to March 31, 2021, then the relief applies to the entire plan year. Therefore, for calendar-

year plans this would include the entire 2020 and 2021 plan years (i.e., the period before March 13, 2020 and the period after March 31, 2021).

For purposes of applying the 80% test, do the participants covered by the plan on March 31, 2021 need to be the same participants covered by the plan on March 13, 2020?

No. In the Q&A Guidance, the IRS states that the plan should apply the 80% test using the total active participant count on March 13, 2020 and March 31, 2021 — and that the active participants on March 31, 2021 need not be the same active participants covered by the plan on March 13, 2020. In other words, active participants who are new hires or rehires should be included in the active participant count for purposes of applying the 80% test.

Does the employer's workforce reduction need to be related to COVID-19?

No. In the Q&A Guidance, the IRS specifies that the employer's workforce reduction does not need to be related to the COVID-19 pandemic in order for the employer to utilize the relief. This means that the 80% test applies regardless of the reasons for workforce reduction.

Unanswered Questions Regarding the Retroactive Application of the Relief

Based on the guidance issued thus far, it is not clear whether the IRS will allow plan sponsors to rely on the relief if the plan sponsor vested affected participants as a result of a partial plan termination prior to the enactment of the Act. If plan sponsors can rely on the relief, then that raises the question of whether it must be applied to all affected participants.

If the relief must be provided to all affected participants, then the participants who took a distribution will have received an overpayment — which requires plan sponsors to attempt to recover the overpayments and to contribute any unrecovered amounts to the plan. The administrative complexity and costs associated with this approach would likely negate any benefit provided under the Act, and plan sponsors may simply decide not to rely on the relief.

The other option is to limit the relief only to those participants who did not take a distribution. This would result in reapplying the vesting schedule only to participants with a current account in the plan and permitting the participants who took distribution to retain their full benefit. The rationale for this approach is that the distributions were made in accordance with the law at the time. It is not clear whether the IRS would permit this approach, and it also could raise employee concerns because they are not being treated in the same manner.

Further guidance is needed on these issues and until such time, plan sponsors impacted by the relief should reach out to legal counsel.

If you have any questions regarding the relief or any other matter, please contact us. We are continuing to monitor all benefits-related developments relating to the COVID-19 pandemic.

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