masuda funai



News & Types: Client Advisories

Opening Up Your Workplace Again - Part 7

5/22/2020

By: Jennifer R.M.C. Watson

Practices: Employment, Labor & Benefits

EXECUTIVE SUMMARY

On Thursday April 16, 2020, President Trump unveiled his "Guidelines for Opening Up America Again" (the "Guidelines"). The Guidelines are designed to help state and local officials reopen their economies, get people back to work, and provide some initial topics for employers to consider prior to reopening. Masuda Funai is publishing a series of articles addressing the business, human and safety aspects that employers will need to consider as part of each company's individualized reopening plan.

Today's article will discuss a potential hidden 401(k) issue when employees are not returned to work. Please reach out to your relationship attorney with any questions regarding 401(k) partial plan terminations.

The COVID-19 pandemic created mass layoffs, furloughs or employment terminations that can cause a partial plan termination of a 401(k) plan under the Internal Revenue Code ("Code"). To date, there is no guidance from the Internal Revenue Service ("IRS") on how COVID-19 will impact 401(k) plan partial plan terminations or if laid off or furloughed employees will be counted towards determining if there is a partial plan termination if they are rehired or replaced (for those choosing not to come back to work) after business operations resume.

Thus, this article summarizes Internal Revenue Ruling 2007-43 ("Revenue Ruling") that provides guidance on partial plan terminations. This ruling sets forth the position of the IRS and contains the most recent guidance on the procedure to be followed in determining whether a partial termination has occurred. The guidance essentially consolidated existing IRS guidance and case law.

1. The Code provides that in the event of a termination "*or partial*" termination of a tax qualified retirement plan, the right of affected participants to benefits which have accrued to date must become non-forfeitable. Neither the Code nor the regulations explicitly define a partial termination. The Code and the regulations merely provide that whether a "*partial termination*" of a plan has occurred depends upon the *facts and circumstances of a particular case*.

2. Under prior case law much of the analysis focused on the extent to which employees participating in the plan had a severance from employment and most applied the so-called "significant percentage" test. Prior to the release of the Revenue Ruling there was no specific percentage at which a partial termination of a plan

©2026 Masuda, Funai, Eifert & Mitchell, Ltd. All rights reserved. This publication should not be construed as legal advice or legal opinion on any specific facts or circumstances. The contents are intended solely for informational purposes and you should not act or rely upon information contained herein without consulting a lawyer for advice. This publication may constitute Advertising Material.

was deemed to have occurred, although the IRS indicated through briefs filed in court cases that a partial termination would occur if at least 20% of participants lost coverage. This position was affirmed in the Revenue Ruling. Therefore, under the Revenue Ruling, in the case of a severance of employment, a "*partial termination*" will be presumed to have occurred if the "*turnover rate*" is at least 20%. This is only a presumption and is rebuttable.

3. The "*turnover rate*" is determined by dividing (a) the number of "*participating employees*" in the plan who had an "*employer-initiated severance*" from employment during the "*applicable period*" by (b) the sum of all participating employees at the start of the applicable period and the employees who became participants during the applicable period. In performing the calculation, the following rules apply:

- In determining "*participating employees*", all employees participating in the plan are taken into account in calculating the turnover rate, including vested as well as non-vested participating employees. Also, the analysis is not limited only to the entity employing the employees if more than one entity was participating in the plan. Finally, all employer-initiated terminations would be counted, at least in the first instance, to determine the percentage not just the severances due to COVID-19 closures.
- The "*applicable period*" can vary depending upon the circumstances. It could either be the current plan year and the preceding plan year, or a longer period if there are a series of related severances. This is obviously a gray area as it is not clear how long the COVID-19 pandemic will remain, or if a second wave will hit.
- An "*employer-initiated severance*" is any involuntary severance from employment other than severance on account of death, disability or retirement at normal retirement age. This would mean that valid performance terminations would be counted; not just involuntary lay-offs. An employer-initiated severance would include a transfer to a related entity if the employee is no longer covered by the same 401(k) plan. Also, if a separation is "voluntary" but was pursuant to a window program or other employer-initiated voluntary program, those separations would likely be included.

4. If a partial termination is presumed to have occurred on account of turnover during the applicable period, "*all participating employees who had a severance from employment during the period must be fully vested in their accrued benefit*s." Please note that this mandated vesting is not limited to the participants who were part of the specific employment action (such as a particular layoff or furlough). It would include unrelated terminations; i.e., all employees terminated during the applicable period.

Each sponsor of a 401(k) plan will need to evaluate what the applicable period is for their business to determine if a partial plan termination has occurred. If you have questions regarding your 401(k) plan and if a partial plan termination has occurred, please contact your relationship attorney.

©2026 Masuda, Funai, Eifert & Mitchell, Ltd. All rights reserved. This publication should not be construed as legal advice or legal opinion on any specific facts or circumstances. The contents are intended solely for informational purposes and you should not act or rely upon information contained herein without consulting a lawyer for advice. This publication may constitute Advertising Material.