

Rehiring Employees Terminated Due to COVID-19 by the End of the 2020 Plan Year May Help Avoid a Partial Plan Termination

During the COVID-19 crisis, many employers have had to make difficult employment decisions, including large scale furloughs and layoffs. One employee benefits issue that impacts employers who have reduced their workforces is whether such a workforce reduction has resulted in a “partial termination” of the employer’s qualified retirement plans, resulting in the requirement to 100% vest all affected participants. Partial terminations can occur when there has been a significant cutback in an employer’s workforce. For employers who intend to, or are considering, rehiring previously laid off employees in the near term, the question often arises: If we rehire employees, how will that impact the partial termination analysis? In recently issued guidance, the IRS stated that an employee who was terminated due to the impact of COVID-19, and is rehired prior to the end of the 2020 plan year, generally should not be treated as having suffered an employer-initiated severance from employment when determining whether a partial termination has occurred. While the IRS’ position is not a surprising result, it does provide plan sponsors facing rehire decisions with additional clarity regarding how rehires will impact the partial termination analysis.

Background

In general, a partial plan termination may occur if more than 20% of the total number of plan participants have experienced an employer-initiated severance from employment during the applicable period. Typically, the applicable period is a single plan year, but it can be longer if there have been a series of related severances.

The law requires that an “affected employee” be fully vested in his or her account balance as of the date of a partial termination. An affected employee is generally anyone who left employment for any reason during the plan year in which the partial termination occurred and has an account balance under the plan that has not been forfeited.

While the IRS has ruled that there is a presumption that a partial termination has occurred if the turnover rate is 20% or greater, the partial termination analysis is based on all relevant facts and circumstances. For example, if an employer can provide evidence that the turnover rate is a routine part of the employer’s business, an employer can rebut the presumption that a partial termination has occurred, even if the turnover rate meets the IRS’ threshold.

IRS Guidance

As a supplement to a prior Q&A addressing questions related to the CARES Act (our prior information memo on that Q&A can be found [here](#)), the IRS included the following question and answer:

Question: Are employees who participated in a business’s qualified retirement plan, then laid off because of COVID-19 and rehired by the end of 2020, treated as having an employer-initiated severance from employment for purposes of determining whether a partial termination of the plan occurred?

Answer: Generally, no. Subject to the facts and circumstances of each case, participating employees 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 hired by the end of that period. That means 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 occurred during the 2020 plan year.

Plan Sponsor Considerations

As explained above, partial plan termination determinations are based on all relevant facts and circumstances. Depending upon an employer's particular circumstances, rehiring employees by the end of the 2020 plan year to reduce the turnover rate to below 20% may not always result in a finding that a partial termination has not occurred. This is especially true for employers who have engaged in a series of related severance events that have spanned over multiple years.

However, the guidance does provide reassurance to employers who fall into a common fact pattern resulting from the COVID-19 crisis, i.e., those employers who reduced their personnel count at the beginning of the crisis but who intend to bring back some, or all, of those employees by the end of 2020 plan year. While the IRS Q&A is not controlling legal authority, it is helpful in understanding how the IRS likely would rule on a partial termination analysis under these facts. An employer who is assessing the economics of returning employees to work in 2020 may want to include the impact of such a return on the partial termination analysis in that assessment, as rehiring employees prior to the end of the 2020 plan year may avoid a potentially costly vesting event.

If you have any questions about this information memo, please contact [John Godsoe](#), any [attorney](#) in our [Employee Benefits and Executive Compensation practice](#) or the attorney at the firm with whom you are regularly in contact.



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