



# Qualified Plan Terminations and Partial Plan Terminations

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## Agenda

- Introduction
- Recent IRS Guidance
- The Decision to Terminate a Plan
- Consequences of Plan Termination
- Participant Rights
- Process of Terminating a Defined Contribution Plan
- Process of Terminating a Defined Benefit Plan
- Partial Plan Terminations

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## Recent IRS Guidance

- Retirement Topics – Termination of Plan
  - [www.irs.gov/Retirement-Plans/Plan-Participant,-Employee/Retirement-Topics-Termination-of-Plan](http://www.irs.gov/Retirement-Plans/Plan-Participant,-Employee/Retirement-Topics-Termination-of-Plan)
- Terminating a Retirement Plan
  - [www.irs.gov/Retirement-Plans/Terminating-a-Retirement-Plan](http://www.irs.gov/Retirement-Plans/Terminating-a-Retirement-Plan)
- FAQs regarding Plan Terminations
  - [www.irs.gov/Retirement-Plans/Retirement-Plans-FAQs-regarding-Plan-Terminations](http://www.irs.gov/Retirement-Plans/Retirement-Plans-FAQs-regarding-Plan-Terminations)
- FAQs regarding Partial Plan Terminations
  - [www.irs.gov/Retirement-Plans/Retirement-Plan-FAQs-regarding-Partial-Plan-Termination](http://www.irs.gov/Retirement-Plans/Retirement-Plan-FAQs-regarding-Partial-Plan-Termination)
- Plan Terminations – EP Guidelines
  - [www.irs.gov/irm/part7/irm\\_07-012-001.html](http://www.irs.gov/irm/part7/irm_07-012-001.html)

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## Recent IRS Guidance

- “Plan Terminations – What You Need to Know Before You Terminate That Plan” – IRS Phone Forum – May 6, 2014
- “Defined Benefit Terminations” – IRS Phone Forum – July 28, 2014
- DOL and PBGC
  - Fiduciary obligations to conduct reasonable search for missing participants and how terminated defined contribution plan can complete distributions with respect to missing participants (*Field Assistance Bulletin 2014-01*, August 14, 2014)
  - PBGC issues request for information regarding implementation of missing participant program for DC plans (*Missing Participants in Individual Account Plans - Request for Information*, 78 F.R. 37598, June 21, 2013)

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## The Decision to Terminate a Plan

- When established, an employer must intend to have a “permanent” qualified plan, but....
  - Non-pension plan – just needs to be in existence for at least 2 years
  - Pension plan – legitimate business reason needed if less than 10 years

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## The Decision to Terminate a Plan

- Discretionary plan terminations
  - Business restructure
  - Law change
  - New plan due to design change, merger/acquisition, etc.
  - Financial hardship
  - Many other reasons
- Mandatory plan terminations
  - Company dissolution or no employer
  - Sole proprietor death or retirement

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## The Decision to Terminate a Plan

- The decision to terminate a qualified plan is a “settlor” function
- However, the process of actually terminating the plan is driven by regulatory requirements, including the plan qualification, Title I and PBGC rules
- Discontinuance of contributions treated as termination for certain purposes

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## IRS Findings – Plan Termination Project

- Over 75% of sampled employers made errors terminating their plans
  - Did not file Final Form 5500
  - Did not actually terminate the plan
  - Indicated that plan terminated when in fact it was “frozen”
  - Used the wrong plan number
  - Did not mark Form 5500 as final after all plan assets distributed
  - Did not distribute all plan assets as soon as administratively feasible

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## Discontinuing Profit Sharing Contributions

- If complete discontinuance of employer contributions to a profit sharing plan, the plan is treated as terminated
- Contributions must be “recurring and substantial”
- Suspension of contributions may raise discontinuance issue
  - IRS presumption – discontinuance when an employer has failed to make substantial contributions for at least 3 years in a 5-year period
- Discontinuance of employer contributions and matching contributions in a 401(k) plan

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## Consequences of Plan Termination

- Participant rights triggered
  - 100% vesting of “affected” employee accounts/benefits
  - Notices
  - Distribution option selection
- Termination resolutions and amendments for the plan
- Plan sponsor must distribute assets within a reasonable period of time after the termination date
- Plan sponsor must follow other government procedural requirements

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## DC Plan Termination Procedures

- Decide to terminate plan
  - This is a “settlor” function
  - Explore permanency issue
- Establish date of termination
  - Facts and circumstances determination
  - Board of directors resolution
  - Other formal resolution by non-corporate entities
  - As of termination date:
    - contribution obligations stop
    - date on which the plan must be amended for all current laws and regulations
  - Often last day of plan year

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## DC Plan Termination Procedures

- Provide notice of termination to employees
  - Pension plans must provide an ERISA §204(h)
    - Notice of any amendment that significantly reduces (or ceases) the rate of future benefit accruals
    - Timing – Generally, 45 days before effective date (15 days for small plans)
  - Non-pension plans – Some type of notice that employer intends to terminate plan

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## DC Plan Termination Procedures

- Amend the plan to:
  - Establish termination date
  - Update plan for all laws and regulations in effect on the date of termination
  - Cease plan contributions
  - Provide full vesting to all “affected” employees on the date of termination; and
  - Authorize plan to make distributions in accordance with plan terms as soon as administratively feasible after the termination date

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## DC Plan Termination Procedures

- “Affected employee”
  - An employee or former employee who has not forfeited his/her nonvested interest as of the termination date
  - Timing of forfeiture
    - 5-year rule
    - Cash-out rule
    - Deemed cash-out rule
    - Dissolution of employer (6<sup>th</sup> Circuit case)

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## DC Plan Termination Procedures

- File for a determination letter (if desired) as to the qualification status as of termination
  - IRS Form 5310
  - Interested party notice
  - Restatement not necessary (Rev. Proc. 2014-6)
  - Individually-designed plans
  - Pre-approved plans
  - Timing of filing – generally, within one year from the effective date of termination (but not later than 12 months after all assets distributed)

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## DC Plan Termination Procedures

- Form 5310 determination letter submission
  - user fee and Form 8717 (\$2,000)
  - complete copy of the plan document(s) and all amendments made since the last favorable determination letter
  - copy of last favorable determination letter, if applicable
  - copy of latest opinion or advisory letter, if applicable
  - copy of all records of all actions taken to terminate the plan
  - copy of all required attachments and statements

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## DC Plan Termination Procedures

- Why file for a determination letter?
  - Allows assurance for trustees who may require it to transfer assets
  - Provides some certainty plan is qualified upon termination
  - Helps identify any issues prior to distribution
  - Gives IRAs proof that rollover was from qualified plan if they require it

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## DC Plan Termination Procedures

- Distribute plan assets
  - Calculate benefits
  - Provide proper notices to employees 30 – 180 days before date of distribution (Not too early!!)
    - QJSA
    - Consent notices (exception for certain non-pension plans)
    - 402(f) rollover notice

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## DC Plan Termination Procedures

- Distribute plan assets
  - Deadline – general rule, final distribution within one year of plan's termination date
    - Exception for administratively reasonable delay
    - Pending determination letter application
  - Reduce assets to cash
    - Interest-bearing account
    - “In-kind” distributions
    - Participant-directed accounts
    - Illiquid assets
  - Missed deadline – considered an on-going plan with all of the applicable requirements

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## DC Plan Termination Procedures

- Missing participants or beneficiaries
  - Must make reasonable efforts to find missing participants and beneficiaries
  - DOL Field Assistance Bulletin 2014-01
  - Updates guidance on fiduciary obligations to conduct reasonable search for missing participants and permissible actions for distributions when defined contribution plan terminates
  - Plan termination is a settlor function, but steps to implement termination governed by ERISA fiduciary standards

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## DC Plan Termination Procedures

- Missing participants or beneficiaries
  - Guidance reflects discontinuation of IRS and Social Security letter forwarding programs
  - Search methods
    - Plan size does not matter for low cost, high potential methods
    - More expensive methods – account balance may justify
    - Charges may go against participant's account balance

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## DC Plan Termination Procedures

- Missing participants or beneficiaries
  - Search methods in all cases
    - Send notice by certified mail to last known address
    - Look at other employer records
    - Attempt to contact named beneficiaries
    - Make reasonable use of Internet search tools
  - Additional search methods
    - Commercial locator services
    - Credit reporting agencies
    - Information brokers
    - Investigation databases

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## DC Plan Termination Procedures

- Missing participants or beneficiaries
  - Distribution options
    - IRA rollover
      - Primary means of distribution
      - DOL Fiduciary rules apply to selection
    - Transfer to bank account
    - State unclaimed property funds
  - Nonrollover could result in adverse tax consequences
  - 100% withholding violates ERISA
  - Guidance does not apply to plans with annuity options or if employer maintains another defined contribution plan

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## DC Plan Termination Procedures

- Missing participants or beneficiaries
  - PBGC requesting information from private sector regarding implementation of missing participant program for DC plans
    - PPA 2006
  - DOL will revise guidance after (if) PBGC implements missing participant program

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## DC Plan Termination Procedures

- Special distribution restrictions applicable to 401(k) plans
  - Applicable to elective deferrals, QNECs, QMACs, safe harbor contributions
  - If employer maintains a successor plan, the restricted amounts cannot be distributed due to plan termination
    - Amounts must be transferred to successor plan or remain in terminated 401(k) plan until proper distribution event occurs
- Reversion of plan assets
  - Unallocated suspense accounts

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## DC Plan Termination Procedures

- File final Form 5500
  - Filed in the year the assets have been completely distributed
  - Regular filings continue until all assets distributed
  - Due date – generally last day of the 7<sup>th</sup> month following date of final distribution (unless extension granted)

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## Orphan Plans

- Orphan plan definition - a plan whose sponsoring employer is no longer in existence or has simply abandoned the plan and fails to take any steps to formally terminate and liquidate the plan
  - Former owners “disappear”
  - Death of owner or fiduciary
  - No successor fiduciaries
  - Corporate merger or bankruptcy
- IRS – qualified plan no longer exists
- DOL – special program to terminate and liquidate plan

## DB Plan Termination Procedures

- Establish date of termination
  - Board or other resolution
  - Notice to employees
    - ERISA §204(h) notice
    - PBGC 60-day notice to affected parties
  - Explore permanency issue
  - Plan amendments
    - All laws in effect as of the date of termination



## DB Plan Termination Procedures

- Filings with government
  - Determination letter request
  - File final Form 5500
  - PBGC filing
    - Standard termination (Form 500)
    - Distress termination (Form 601)

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## DB Plan Termination Procedures

- Distribute plan assets
  - Calculate benefits
  - Full vesting of benefits
  - Contribution limits
  - Reduce assets to cash
  - Procedural requirements – notices, etc.
  - Deadlines for final distribution of assets
    - One-year rule
    - PBGC procedures – post-distribution certificate
    - Missing participants

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## DB Plan Termination Procedures

- Reversion of plan assets
  - Plan document must authorize
  - Reversion amount is income to employer
  - Excise tax under Code §4980
    - 50% of reversion amount
    - Reduction to 20% if replacement plan or reallocation of portion of surplus
    - File Form 5330

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## Partial Plan Termination

- Upon a partial plan termination, all “affected” employees must be 100% vested
  - Whether a partial termination occurs is a factual question
  - Rev. Rul. 2007-43 provide guidance
- Partial termination - A significant reduction in plan participation caused by an EMPLOYER-INITIATED action
  - Common causes are layoffs, reduction in force, plant closing, sale of business
  - Amendment that affects vesting also may result in partial plan termination

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## Partial Plan Termination

- Revenue Ruling 2007-43
  - Employer ceases operations at one of four business locations, resulting in a 23% reduction in plan participation (excluding any severance from employment resulting from death, disability or retirement). The plan uses a 3-year “cliff” vesting schedule
  - The ruling concludes a partial termination has occurred under these facts

## Partial Plan Termination

- Presumption of partial plan termination if at least 20% reduction in participation
  - Number of participants experiencing employer-initiated severance divided by sum of participants at beginning of year plus new participants during the year
  - The determination takes into account both vested and nonvested participants.
  - Partial termination may extend beyond one year if series of “related” severances



## Partial Plan Termination

- Employer-initiated severance occurs even if event is outside ER's control, such as depressed economic conditions
- Employer may show severance was purely voluntary
  - Difficult standard - presumption that severance is related to employer action
  - Constructive discharge theory
  - Routine turnover not considered
- Partial termination may occur due to sale of business

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## Partial Plan Termination

- Issue for small employers
  - Suppose a small closely-held business with 6 employees involuntarily terminates 2 of them during the plan year. The involuntary reduction is 33-1/2%, triggering a rebuttable presumption that a partial termination has occurred.
  - Informal IRS discussion – maybe not a partial plan termination

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## Partial Plan Termination

- Consequences of partial plan termination
  - Fully vest “affected employees” due to partial plan termination
  - Return improper forfeitures
  - Make affected participants whole even if plan distributed forfeitures to other participants

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## Partial Plan Termination

- Who is an affected employee?
  - IRS - An affected employee in a partial plan termination is generally anyone who left employment for any reason during the plan year in which the partial termination occurred and who still has an account balance under the plan
  - Other view – Affected employees in a partial termination are the participants eliminated from participation or the participants affected by the plan amendment that resulted in the partial termination. Other participants are not affected and continue to be subject to the vesting schedule with respect to their benefits.

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## Partial Plan Termination

- Use Form 5300 to request determination of partial plan termination
  - Why? – Determination not only effects affected employees, but also other participants
  - Prevents potential disqualification or sanctions
  - Avoids costs if forfeitures awarded and distributed

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## IRS Correction Program

- EPCRS is available for terminated plans
- EPCRS may be a good alternative if partial plan termination not recognized on a timely basis

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# Questions

- Questions or Comments
  
- Thanks for attending!!!

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