

May 6, 2014



## Employee Plans Phone Forum

### Plan Terminations

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- Required Minimum Distributions
- Retirement Plan FAQs
- Published Guidance
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Web guide to help you compare plans

### [File a Retirement Plan Return](#)

Forms 5500, 5500-SF, 5330, 5558 and 8955-SSA

### [Form 2848 - More Changes](#)

Use the March 2012 version to designate a representative for retirement plan issues.

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Find, Fix and avoid common mistakes in plans

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### Topics for Retirement Plans

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**“Everything has to come to an end,  
sometime.”**

— [L. Frank Baum](#), [The Marvelous Land of Oz](#)



## What Happens with a Termination

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- The date of termination must be set
- The participants' benefits and other liabilities, must be determined up to the date of termination
- All plan assets must be distributed per the plan and as soon as administratively feasible



## IRS Concerns with Plan Termination

- Accelerated vesting - IRC § 411(d)(3)
- Accrual requirements - IRC § 411(b)
- Funding obligations - IRC § 412
- Reversion of assets to the employer  
(maybe excise tax - IRC § 4980)
- Continuing § 401(a) compliance -  
Revenue Ruling 89-87



## Statutory Authority

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- Regulations Section 1.416-1, T-4
  - defines terminated plan
  - distribution of assets should be made as soon as administratively feasible
  - administratively feasible = 1 year



# DB Plan Termination

PBGC → responsible for administering ERISA Title IV

When is a DB Plan terminated? → depends on  
whether plan is covered by ERISA Title IV

- DB plan is covered by Title IV if it has:
  - a favorable DL from IRS or
  - in practice satisfied the qualification requirements of IRC § 401(a) for the preceding 5 plan years





## DB Plan Termination (cont.)

- If covered by Title IV
  - must comply with the procedures under ERISA § 4041
- If not covered by Title IV
  - effective termination date stated in the ERISA § 204(h) notice
  - If ERISA § 204(h) is not applicable, termination date is in employer adopted resolution



# Why is Date of Termination Important?

- Date of plan termination is when:
  - benefit accruals stop
  - contribution obligations stop
  - liability to the PBGC is measured
  - date on which the plan must be amended for all current law



## Title IV Date of Termination

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- The termination date is established by:
  - standard termination – plan administrator
  - distress termination – plan administrator and agreed to by PBGC
  - involuntary termination – PBGC and agreed to by the plan administrator or court



# Defined Contribution Plan Termination

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- Termination date is based on all facts and circumstances
- Resolution is adopted by employer – this is sufficient to establish the termination date



## Profit Sharing Plan Termination

- Form 5500 shows plan terminated when employer marks “the final return/report box”
- Plan participants are notified of the plan’s termination
- Value of the distributed benefits = value of the participant account balances



## Notice to Interested Parties

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- Pension plan administrators must notify plan participants and alternate payees of any amendment that significantly reduces the rate of future benefit accruals.



## Notice to Interested Parties (cont.)

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- Notice must be provided:
  - 15 days before effective date of amendment
  - to all interested parties (Treas. Reg. § 1.7476-1)
  - 10 - 24 days prior to the date plan sponsor submits an application to IRS for a termination letter



## Notice to Interested Parties (cont.)

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- The notice must be delivered to interested parties as described in Reg. § 1.7476-2(c).
  - sent via electronic medium
  - delivered in person
  - posting to bulletin board
  - delivered by mail





## Orphaned Plans

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- Defined contribution plans abandoned by their sponsoring employers
- Regulations permit “qualified termination administrator” to terminate & liquidate orphan plans
- DOL Regulations facilitate the termination and distribution of benefits from orphan plans



## Employer Reversion

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- The amount of cash and the fair market value of other property received by an employer from a qualified plan.



# Overfunded Plans – Limited Circumstances

- Contributions can't be returned to the employer once they've been made, except in these limited circumstances:
  - mistake of fact,
  - disallowance of deduction,
  - plan fails to initially qualify under IRC § 401(a), or
  - reversion of assets upon plan termination.



# Overfunded Plans – Reversion of Surplus Assets

- Before surplus assets can revert to the employer, the plan terms must allow it.
- If reversion is from defined benefit plan:
  - plan terms must have permitted it for 5 calendar years before the termination date
  - the reversion must have been due to an “erroneous actuarial computation” under Treas. Regs. § 1.401-2



## Overfunded Plan – DC Plan

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- DC plan can only have a reversion when the amount is in a suspense account that can't be allocated due to
- IRC § 415(c) limits.



# Overfunded Plans - IRC § 4980

## Excise Tax on the Reversion

- In addition to any income taxes due:
  - employer must file Form 5330 and pay excise tax on the last day of the month following the month of the reversion
  - excise tax = 20% of amount reverted back to the employer from a qualified plan (IRC § 4980)



## Underfunded Plans

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- For an underfunded plan to terminate via a standard termination, there are two options:
  - provide supplemental employer contributions to make the plan whole
  - forego benefits for the majority owner



# **Underfunded Plans – Supplemental Employer Contributions**

- The employer may make a sufficient contribution to the plan prior to distribution so the assets equal the amount of the liabilities.





## Underfunded Plan – Forego Benefits

- An underfunded plan may permit:
  - a participant who is a majority owner in excess of 50% of the employer (with spousal consent) to “forego receipt” of all or part of his benefit until all other participants’ liabilities are met, or
  - assets to be allocated upon plan termination on a pro rata basis.



## Underfunded Plans – Waiver of Benefits

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- A participant cannot “waive” his or her accrued benefit. This violates IRC Sections 411(d)(6), 411(a) & 401(a)(31)
- Plan amendment waivers violate the Code’s prohibition against the reduction of an accrued benefit by plan amendment



# Accelerated Vesting

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- Accelerated Vesting is triggered upon:
  - plan termination
  - partial termination
  - complete discontinuance of contributions to a PSP
- Full vesting upon these events.



## Complete Plan Termination

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- The accrued benefits of all “affected employees” must become 100% vested
- DC plan – “affected employee” is any employee or former employee who has not forfeited his non-vested interest as of the termination date



# Complete Discontinuance of Contributions

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- Complete discontinuance of contributions to a PSP is treated as a plan termination for vesting purposes and affected employees become 100% vested
- To be qualified, a PSP or stock bonus plan must require full vesting in the event of complete discontinuance of contributions



# Complete Discontinuance of Contributions (cont.)

- Although contributions are not required every year to a profit sharing plan:
  - They must be recurring & substantial,
  - Must be significant enough to reflect an intent to continue the plan, if not IRS will treat contributions as discontinued, and
  - A plan may still receive contributions without regard to the employer's current or accumulated profits.



## Complete Discontinuance - Factors

- Factors used to determine if a plan has had a discontinuance of contributions:
  - the employer uses the term “suspension” to avoid full vesting
  - contributions are recurring and substantial
  - there is a reasonable probability the discontinuance will continue indefinitely



## Complete Discontinuance – Factors

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- An issue of discontinuance arises when the employer has not made substantial contributions for at least 3 years in a 5 year period.





## Complete Discontinuance – 401(k) Plan

- No formal IRS ruling on complete discontinuance when the employer:
  - stops making nonelective contributions to a 401(k) plan, but
  - continues the 401(k) arrangement
- Elective deferrals are treated as ER contributions and the 401(k) arrangement is part of a PSP or stock bonus plan



## Partial Termination

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- Partial terminations can occur with:
  - a significant corporate event (closing a plant or division)
  - employee turnover due to adverse economic conditions or other employer initiated actions



# Partial Termination – Plan Amendment

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- Partial Termination can result from a plan amendment that excludes employees or adversely affects vesting.
- Example – plan amendment to exclude employees in Division Y from participating in the employer's plan.



# Partial Termination – Decreases in Future Accruals

- Defined benefit plans:
  - Decrease in future accruals resulting in potential reversion could trigger a partial termination.



## Partial Termination – Plan Merger

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- MPP Plan is merged/converted → PSP
- Benefits under the MPP Plan stop
- No partial termination because:
  - all employees remain covered under PSP,
  - assets & liabilities retain MPP Plan attributes, and
  - vesting is the same



## Partial Termination – Percentage Test

- Turnover rate of participating EEs is at least 20% (Rev. Rul. 2007-43)
- Court found that less than 20% could still be a partial termination “if accompanied by egregious abuse on the part of the employer.”

*(Haliburton v. Commissioner, 100 TC 216, 237 (16 EBC 1929) (1993))*



## Partial Termination – Rev. Ruling 2007-43

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- Rev. Rul. 2007-43 factors considered when calculating the turnover rate:
  - employer-initiated severance from employment
  - participating employees
  - applicable period
  - routine turnover
  - transferred employees



## Partial Termination – Turnover Rate

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# of participating employees who had an employer initiated severance from employment during the applicable period

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sum of all of the participating employees at the start of the applicable period & the employees who became participants during the applicable period





# Partial Termination – ER Initiated Severance from Employment

- Employer-initiated severance from employment generally includes any severance from employment other than caused by:
  - death,
  - disability, or
  - retirement on or after NRA



## Partial Termination – Other Factors

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- EE severance is employer-initiated even if caused by an event outside of ER's control
- Participating Employees includes vested as well as non-vested participating employees



## Partial Termination – Applicable Period

- Depends on facts & circumstances
- Factors relevant to determine if turnover rate is routine
- Generally a plan year
  - If plan year < 12 months – then it is the plan year + immediate preceding plan year



# Partial Termination – Transfers & Voluntary Terminations

- Transfers to different controlled groups is not severance from employment
- Voluntary terminations don't count towards determination of partial termination
- Constructive Discharge Theory



# Partial Termination – Consequences

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- Employer must:
  - fully vest affected employees due to partial termination
  - return improper forfeitures
  - make affected participants whole even if plan distributed forfeitures to other participants



## Distributions Upon Termination

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- Plan assets must be distributed as soon as administratively feasible after date of termination
  - Administratively feasible determined by facts and circumstances
  - Generally within one year following date of plan termination



# Distribution Payment Methods

- DC non-pension plans:
  - may have mandatory distribution method
  - without annuity option - may distribute account balance without participant's consent
- Rule does not apply if employer maintains another DC plan – transfer of assets



## Distribution – Terminating 401(k) Plan

- Restrictions on distributing 401(k) elective deferrals depend on the existence of a successor plan. Elective deferrals include:
  - pre-tax elective deferrals
  - Roth elective deferrals
  - catch-up elective deferrals
  - qualified non-elective contributions (QNECs)
  - qualified matching contributions (QMACs)
  - safe harbor 401(k) contributions





## Distributions – Successor Plans

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- A successor plan is any alternative DC plan the same employer maintains at any time from:
  - plan termination date to -
  - 12 months after distribution of all assets from the terminated plan.



## Distributions – Elective Deferrals

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- Successor plan exists - elective deferrals can be:
  - transferred to successor plan
  - kept in terminated plan until a distributable event occurs
- No Successor plan - plan must pay elective deferrals in lump sum distributions



# Plan Assets Considerations

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- Non-interest bearing cash
- Receivables
  - Employer / participant contributions
  - income/earnings accruals
  - “other receivables”
- Investments
  - valuations
  - PT/UBTI
  - insurance contracts
  - allocations/distributions
- Loans



## Plan Amendments

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- Rev. Proc. 2013-6 (updated annually) states terminating plans must be amended for all current law applicable to the plan as of the date of termination
- Rev. Proc. 2007-44 section 8 states the remedial amendment period for any law changes in effect as of the termination of the plan is accelerated when the plan terminates



## Remedial Amendment Cycles

- Rev. Proc. 2007-44 established cyclical RAPs for individually designed and pre-approved plans (IRC § 401(b))
- Most IRC § 401(a) individually designed plans have a 5-year RAC (based on last digit of EIN)



## Cumulative List

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- Published annually, generally ~ mid-November
- Intended to identify all changes in the qualification requirements
  - Statutory
  - Regulatory
  - Other guidance
- All remedial & required plan amendments must be adopted with plan termination



## Verifying Prior Law

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- Always verify that the plan was properly amended for prior legislation
- To prove prior law compliance, the taxpayer may provide
  - A copy of the FDL for the plan's prior RAC
  - A timely adopted plan document/adoption agreement for the plan's applicable CL for the prior RAC



# Interim Amendment Requirements

- For disqualifying provisions, or those integral to a disqualifying provision, an interim amendment must be adopted by the later of:
  - the due date (including extensions) of the employer's income tax return for the tax year that includes the date on which the remedial amendment period begins, or
  - the last day of the plan year that includes the first day of the plan's remedial amendment period.





## IRS – Form 5310

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- Use Form 5310, Application for Determination for Terminating Plan, to apply for a determination letter upon termination of a plan.



# IRS – Required Submission Information

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- user fee and Form 8717
- complete copy of the plan document(s) and all amendments made since the last favorable DL
- copy of last favorable DL, 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



## Timeliness of Application

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- File Form 5310 by the later of one year from:
  - the effective date of the termination, or
  - the adoption date of the resolution to terminate the plan



# IRS – Why File?

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- Allows assurance for trustees who may require it to transfer assets
- Gives an extension to distribute if requested prior to PBGC notification
- 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
- Prevents potential issues for plans with excess assets (overfunded)



## DOL – Form 5500

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- The employer must continue to file the Form 5500, Annual Report of Employee Benefit Plans, until all the assets of the trust have been distributed.