How Do Furloughed Employees Impact our Retirement Plan at Year-End?

Facts

Like many businesses, we had to furlough some employees earlier this year in response to the coronavirus shut-downs. We've been fortunate enough to bring back a few of these employees, but a number still remain in limbo. As we approach year-end, we've started wondering how this might affect our 401(k) plan and potential company contributions.

Question

Are there any plan-related issues we need to keep in mind for year-end with regard to furloughed employees?

Answer

There are definitely a few ways these furloughed employees may impact both plan compliance and company contributions for 2020.

Overview

Before we dive in, let's pause quickly to address the term "furloughed." Its not uncommon to use "furloughed" and "laid off" interchangeably; however, there are some important differences when we get into the regulatory weeds. As a general rule, furloughed employees are not considered to be terminated from employment. In essence, they are active employees who aren't "on the schedule." However, *there are some states that apply timeframes after which a furloughed employee is deemed to be terminated if he or she has not yet returned to work*.

With the above said, we're the 401(k) experts and not employment law attorneys, so if there's any doubt about the appropriate categorization of your employees, we recommend reaching out to your friendly neighborhood attorney for additional guidance (including any state-specific laws that may apply).

Back to your question. How, if at all, can furloughs impact your retirement plan? There are four that we will focus on here:

- Crediting service for eligibility and vesting,
- Eligibility for a company contribution,
- Coverage testing; and,
- Partial plan termination determinations.

Crediting Service

Since furloughed employees are generally not considered to be terminated, it is possible for them to be credited with service for plan purposes while they are on furlough, depending on how the plan document says to calculate service. If it calls for the elapsed time method, the weeks or months of furlough count toward a participant's service. However, if the plan uses the hours method, we look at the number of hours each employee actually works. That means, if the plan requires a specific number of hours for a certain purpose (for example, 1,000 hours to receive a year of vesting credit), a participant could fall short of satisfying any such service requirement while furloughed. This can impact not only vesting but also initial plan eligibility or entitlement to share in any company contribution for the year.

Company Contributions

Speaking of entitlement to share in company contributions, we must again look at certain plan provisions to determine the impact of the furloughs.

It is not uncommon for plans to apply additional conditions that participants must satisfy in order to share in the allocation of any company contributions for the year. These may include requiring participants to work at least 1,000 hours during the year and/or to be employed on the last day of the year.

As noted above, the plan's specified method for counting service can impact whether a participant meets a service requirement in this regard. If elapsed time, the furloughed folks will likely still be credited with sufficient service to meet the requirement. Under the hours method, you would look to the actual hours each person works.

Applying the last day rule is also pretty straight forward. Since furloughed employees are still considered active, anyone on furlough at year end would be satisfy the last day requirement.

Coverage Testing

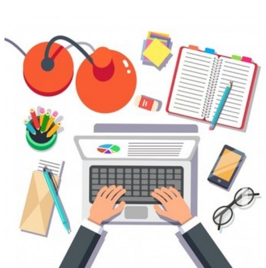
This leads us to mention the minimum coverage test that plans must satisfy each year. In a nutshell, it is a "head count" test that reviews the number of non-highly compensated employees share in a contribution as compared to the number of highly compensated employees. If enough participants (generally 30% of the non-HCEs) do not share in a company contribution because they do not satisfy a service requirement as described above, it could create challenges in passing the minimum coverage test. That could, in turn, require you to amend your plan to eliminate or reduce the service requirement so that enough of the furloughed workers become entitled to a contribution to pass the test. Of course, this only comes into play if the company is making a match or profit sharing contribution for the year. If not, then you can ignore this one.

Partial Plan Termination

Last (for this post, anyway) but certainly not least is the partial plan termination. This rule provides that if enough participants (usually 20% of the workforce but may vary) are terminated due to the same event or series of related events, all such participants must be immediately vested regardless of their length of service.

We won't really spend any more time on explaining this one, because we are happy to report that this is not anything to keep you up at night. Since furloughed employees are not considered terminated, they are generally not included in any counts when determining whether a partial plan termination has occurred.

Not sure how to navigate all of this? We've got you covered. We know when you're managing your business during challenging times, you need a reliable partner to see you through. When it comes to addressing the potential impacts of a furlough on your plan operations and design, DWC is here to walk you through, step-by-step, to make sure you've got strong footing.



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