



# Can Higher Than Normal Turnover Affect My 401(k) Plan? | Part 1 of 3: Overview

## Facts

Our company designs and manufactures boats. Due to some advancements in technology, we will be closing one of our older facilities. While we offered those workers the option to relocate to one of our other facilities, many have elected not to do so and will be terminating employment. That group comprises roughly 20% of our total workforce.

## Question

Is there anything we need to watch out for with respect to our 401(k) plan for those employees who will be losing their jobs as part of this shutdown?

## Answer

We're glad you asked! This type of a situation is referred to as a partial plan termination. It is actually one of the more frequently misunderstood areas of the retirement plan rules, so we'll touch on the highlights here and then explore in a little more detail in our QOTWs over the next few weeks.

For starters, there is really only one thing on the line when dealing with a potential partial plan termination – vesting. Any employee who is affected by a partial plan termination must be accelerated to 100% vesting no matter how long they have worked for the company.

That begs a critical question - how do you know if a partial plan termination has occurred?

## Making The Determination

According to IRS rules, there is what is called a “rebuttable presumption” that a partial plan termination occurs when turnover among plan participations exceeds 20%. That basically means that if more than 20% of plan participants lose the ability to participate in the plan, it is assumed there is a partial plan termination; however, that assumption can be overcome based on relevant facts and circumstances.

This is where things can start to get a little confusing, so let's consider a few questions that go into the determination.

### Why is the turnover occurring?

Regular business turnover is less likely to result in a partial termination; whereas, an event (or series of related events) that triggers layoffs or reductions in workforce are more suggestive that one may have occurred. Such triggering events could range from something specific to your company or industry to something as general as an overall economic slowdown.



## Is the level of turnover normal for your company or industry?

Let's say that normal turnover in your industry averages around 2%, but in a given year your turnover jumps to 8%. While that remains significantly lower than that "magic number" of 20%, it is still a 400% increase in turnover and could trigger a partial termination. On the flipside, if your actual turnover is 30% but the industry norm is 40%, the facts may support that a partial termination has not occurred even though you have exceeded 20%.

## What is the measurement period for making the determination?

This is another confusing part of the equation. Often, the types of events that could trigger a partial termination occur over a lengthy period of time that can span multiple years. For example, during the recession some companies downsized gradually over a period of 2 to 3 years. Even though they might not have experienced more than 20% turnover in any single year, the aggregate turnover that occurred due to the recession was well above that level. Similarly, a company may achieve significant efficiencies through automation, which could result in higher turnover over a period of time.

Based on the facts presented, more than 20% of the participants in your plan will lose the ability to participate due to the company closing a facility. Unless the regular turnover rate for your industry well exceeds that level, it sounds to us that a partial termination is likely to occur.

While your situation appears relatively straight-forward, many are much more ambiguous. As we mention above, the only thing on the line is that affected employees must be immediately vested in their plan accounts. If you have no qualms about fully vesting everyone, an expedient way to cut through the ambiguity is to just amend your plan to vest everyone. Then, the determination no longer matters.

However, if voluntarily vesting everyone via plan amendment is not in the cards, give us a call, and we can help work through the partial plan termination analysis with you.

## Related Resources

- [Can We Change Our Plan's Vesting Schedule?](#)



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