

THE
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**TERMINATION OF TAX-QUALIFIED DEFINED CONTRIBUTION
RETIREMENT BENEFIT PLANS**

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TERMINATION OF TAX-QUALIFIED DEFINED CONTRIBUTION
RETIREMENT BENEFIT PLANS

A. Termination Amendment

1. Must include effective date of plan termination.
2. Upon termination a plan must be amended to comply with all current laws (even if the deadline for adopting a compliant amendment does not occur until after the plan's termination date).

B. Determination Letter Application

1. Not required for any plan termination, but advisable especially for a plan with a large amount of plan assets and/or a large number of participants.
2. Types of qualified plan documents for which a determination letter may be sought:
 - a. Individually designed;
 - b. Prototype; and
 - c. Volume submitter.
3. Provides assurance to the plan sponsor that the plan is qualified upon plan termination.
4. Form used: IRS Form 5310.
5. Application Fee:
 - a. \$2,000.00 (for basic application).
 - b. Plan sponsor may use plan assets to pay the application fee (as well as other expenses associated with the determination letter application).
6. Required Enclosures:
 - a. All plan documents from GUST¹ restatement (or initial plan document, if adopted after the GUST deadline) forward, including restatement for the

¹ The term "GUST" refers to the following legislation: the Uruguay Round Agreements Act of 1994 (aka "GATT"), Pub. L. 103-465 (12/8/1994); the Uniformed Services Employment and Reemployment Rights Act of 1994, Pub. L.

Economic Growth and Tax Relief Reconciliation Act of 2001 (“EGTRRA”);

- b. Required interim amendments since GUST (i.e., EGTRRA, 401(a)(9), 401(a)(31)(B), 401(k)/(m), 415, PPA², HEART Act³ and WRERA⁴);
- c. Any discretionary amendments made to the plan; and
- d. Any applicable prior IRS determination letter, opinion letter and advisory letter.

7. Operational Disclosures:

- a. Five-year history of participant count;
- b. Five-year detailed accounting of participants who terminated without full vesting;
- c. Internal Revenue Code Section 410(b) coverage compliance;
- d. Five-year history of annual contribution amounts (salary deferral and employer contributions and rollover contributions); and
- e. Five-year history of forfeitures amounts.

8. Notice to Interested Parties:

- a. Must be sent to all plan participants.
- b. Informs participants of the existence of the determination letter application and their right to request that the Department of Labor send comment to the IRS with concerns regarding the plan.
- c. Must be sent not less than 10 days or more than 24 days prior to the application submission.

C. No Determination Letter Application - Due Diligence

1. Documentary Compliance:

- a. Ensure the plan sponsor has copies of all documents that would be required with a determination letter application.

103-353 (10/13/1994); the Small Business Job Protection Act of 1996, Pub. L. 104-188 (8/20/1996); the Taxpayer Relief Act of 1997, Pub. L. 105-34 (8/5/1997); the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. 105-206 (7/22/1998); and the Community Renewal Tax Relief Act of 2000, Pub. L. 106-554 (12/21/2000).

² The Pension Protection Act of 2006

³ The Heroes Earnings Assistance and Relief Tax Act of 2008

⁴ The Worker, Retiree and Employer Recovery Act of 2008

- (i) All plan documents from GUST restatement forward (including EGTRRA restatement);
- (ii) Required interim amendments since GUST (see above for current list). There are three common types of interim amendments:
 - (a) Those that must be signed by the employer/plan sponsor;
 - (b) “Snap-on” amendments that did not require the employer/plan sponsor signature but required execution by the vendor producing the applicable prototype document; and
 - (c) “Snap-on” amendments for which signature and date are on file with the prototype vendor.
- (iii) Any applicable prior IRS determination letter, opinion letter and advisory letter.

- b. If there are any documentary failures, they must be properly corrected (see discussion of plan corrections below) before the plan is terminated.

2. Operational Compliance:

- a. Be sure contributions were made on timely basis.
- b. Be sure contributions were calculated accurately.
- c. Ensure that the plan passed all required nondiscrimination and coverage testing.
- d. Be sure that participants have been properly vested.
- e. If any operational failure occurred, such failures must be properly corrected.

D. Correcting Plan Failures - IRS Employee Plans Compliance Resolution System (“EPCRS”)

1. Documentary Failures:

- a. A common documentary failure is the failure to timely adopt a required interim amendment.
- b. The IRS’ streamlined Voluntary Correction Program (“VCP”) procedure may be used to correct many common documentary failures.

2. Operational Failures:

- a. IRS Rev. Proc. 2008-50 discusses the types of operational failures that may be corrected under EPCRS, as well as acceptable methods of correction.
 - b. Some operational failures may be “self-corrected” and, therefore, require no disclosure to the IRS.
3. Determination letter application may be submitted together with a VCP application.

E. Vesting Upon Plan Termination

1. IRC Section 411(d)(3) states that all “affected employees” must become fully vested upon plan termination.
2. The IRS’ position is that the term “affected employees” includes any partially vested participants who terminated employment within the five years preceding the plan’s termination and who still have not received a distribution prior to plan termination.
3. The Sixth Circuit Court of Appeals has held that a participant is not an “affected employee,” and thus not entitled to full vesting upon plan termination, in the event the employer that sponsored the terminating plan has ceased to exist, because there is no possibility that the participant will return to that employer to continue accruing vesting service. The IRS has not adopted this position.

F. Distribution of Plan Assets

1. Distributions must occur as soon as administratively feasible following plan termination.
2. The plan sponsor may automatically cash out account balances of \$5,000.00 or less.
3. Distributions of salary deferral contributions may not be made if the employer maintains an “alternative defined contribution plan.”
4. Missing Participants:

- a. PPA extended the availability of the Pension Benefit Guaranty Corporation (PBGC) missing participant program to defined contribution plans.
- b. Department of Labor Field Assistance Bulletin 2004-02:
 - (i) The plan sponsor is required to perform due diligence in search for missing participants.
 - (ii) The Bulletin mentions several options for distributing missing participants' accounts:
 - (a) Rollover to individual retirement account;
 - (b) Interest bearing FDIC insured bank account; and
 - (c) Escheat to the state.

5. Taxation:

- a. Income taxation on distribution of a participant's account is deferred if rolled over in a trustee-to-trustee transfer to an IRA or another qualified plan.
- b. An "eligible rollover distribution" that is not rolled over in a trustee-to-trustee transfer to an IRA or another tax-qualified plan is subject to mandatory 20% income tax withholding.
- c. If not rolled over, a distribution may also be subject to an early distribution penalty of additional 10% income tax (not required to be withheld), unless an exception under IRC Section 72(t) applies.

6. Reporting:

- a. Distributions from qualified plans are reported on IRS Form 1099-R.
- b. Form 1099-R must be furnished to the participant by the January 31st following the year in which the distribution occurred (if that day falls on a Saturday or Sunday, the deadline is the next following weekday).
- c. Form 1099-R must be submitted to the IRS by the last day of February, or March 31st if electronically filed (if the applicable deadline falls on a Saturday or Sunday, the deadline is the next following weekday).

7. Reversion of Plan Assets.

- a. Plan assets can only revert to the plan sponsor if:
 - (i) All of the plan's liabilities and debts have been met; and
 - (ii) The plan document permits reversion.
- b. Reversions are generally subject to a 50% penalty tax.
- c. Reversions are reported on IRS Form 5330, due on the last day of the month following the month in which the reversion occurred.

G. Form 5500, Annual Return/Report

1. Forms 5500 are required for each plan year up through the plan year in which all assets are distributed.
2. Final Form 5500:
 - a. Due on the last day of the seventh month following the complete distribution of plan assets;
 - b. Must show zero assets and zero participants as of the last day of the plan year; and
 - c. Must check box indicating that it is the final Form 5500.

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