Section 411.—Minimum Vesting Standards

Frozen plan; additional accruals; vesting service. This ruling states that the freezing of accruals under a plan is not a plan termination for purposes of determining whether vesting service may be disregarded if accruals resume under the plan. Accordingly, all years of service for the plan sponsor since the plan was established must be counted toward vesting. The result is the same if, instead, the frozen plan is merged into a new plan of the employer with accruals resuming under the merged plan.

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ISSUE

If accruals under a qualified retirement plan are frozen, so that a partial termination of the plan occurs, and accruals under the plan subsequently resume, must all years of service for the plan sponsor following the establishment of the plan be taken into account for purposes of vesting? Is the result different if, instead, a new plan is established that is then merged into the frozen plan after the partial termination?

FACTS

Employer M maintains Plan A, a defined benefit plan qualified under § 401(a) of the Internal Revenue Code, under which benefit accruals were frozen as of December 31, 1996. Under Plan A's benefit formula prior to January 1, 1997, a participant received a specified percentage of his or her highest average pay multiplied by the participant's total years of service. Plan A provides that each participant becomes fully vested in his or her accrued benefit after five years of service. The freezing of accruals under Plan A caused a partial termination in 1997, so that all participants in Plan A became fully vested in their accrued benefits following the freeze. Employer M subsequently amends Plan A to provide that, as of January 1, 2003, participants in Plan A will begin accruing benefits under a different formula. A participant's accrued benefit under Plan A, as amended, will be the sum of the accrued benefit under the old formula and the accrued benefit under the new formula.

LAW AND ANALYSIS

Section 411(a) describes minimum vesting standards that a retirement plan must satisfy in order for the plan to be qualified under § 401(a). These standards include § 411(a)(2), which requires that qualified retirement plans provide that employees who have completed a certain number of years of service have a nonforfeitable right to their accrued benefit derived from employer contributions. Employees must become fully vested in these benefits after no more than five years of service under a cliff vesting schedule or seven years of service under a graded vesting schedule.

Section 411(a)(4) and § 1.411(a)–5(a) of the Income Tax Regulations provide that, in computing the period of service under the plan for purposes of determining the nonforfeitable percentage under § 411(a)(2), all of an employee's years of service with the employer or employers maintaining the plan are taken into account subject to certain exceptions. These include an exception for years of service with an employer during any period for which the employer did not maintain the plan or a predecessor plan. In particular, § 1.411(a)–5(b)(3)(iii) provides that the period for which a plan is not maintained by an employer includes the period after the plan is terminated. For purposes of § 1.411(a)–5, a plan is terminated at the date there is a termination of the plan within the meaning of § 411(d)(3)(A) and the regulations thereunder.

Section 411(d)(3)(A) requires that a defined benefit plan provide that, upon its termination or partial termination, the rights of all affected employees to benefits accrued to the date of such termination or partial termination, to the extent funded as of such date, are nonforfeitable. Section 1.411(d)–2(c) provides rules for determining when a plan has undergone a termination. Section 1.411(d)–2(b) provides rules for determining when a plan has undergone a partial termination. A partial termination of a plan is not a termination.

Under the facts presented, Plan A has not been terminated but has undergone a partial termination. Employer M has continued to maintain Plan A after benefit accruals were frozen. For vesting purposes, § 1.411(a)–5(b)(3)(iii) excludes service after a plan has been terminated but does not exclude service after a partial termination. Accordingly, service with Employer M after the establishment of Plan A and prior to January 1, 2003, during which accruals under Plan A were frozen may not be disregarded for vesting purposes with respect to the future accruals under Plan A.

HOLDING

The freezing of accruals under a qualified retirement plan, so that a partial termination of the plan occurs, does not constitute a plan termination for purposes of determining whether service for the plan sponsor after the plan was established may be disregarded toward vesting if accruals resume under the plan. Accordingly, all years of service for the plan sponsor following the establishment of the previously frozen plan must be taken into account for purposes of vesting. If, instead, the accruals are earned under a new plan maintained by the same employer and the new plan is merged with the frozen plan, then this holding also applies, so that, after the merger, service after the frozen plan was established must be taken into account for purposes of vesting in any benefit accruals under the new plan.

DRAFTING INFORMATION

The principal author of this revenue ruling is Diane S. Bloom of Employee Plans, Tax Exempt and Government Entities Di-

vision. For further information regarding this revenue ruling, contact the Employee Plans taxpayer assistance telephone service between the hours of 8:00 a.m. and 6:30 p.m. Eastern Time, Monday through Friday, by calling (877) 829–5500 (a toll-free number). Ms. Bloom may be reached at (202) 283–9888 (not a toll-free number).