

Terminating a Retirement Plan

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When a company has a retirement plan and intends to terminate the plan, it is not required that a filing be made with the Internal Revenue Service. However, it is generally recommended that the filing be made to the Internal Revenue Service to obtain a determination letter.

A determination letter indicates that the plan is qualified and is in conformity with the Internal Revenue Service rules regarding retirement plans. Thereafter, the money in the plan can then be properly transferred into an IRA or another retirement plan. A benefit of obtaining the determination letter is that the money in the terminated retirement plan will not be considered unqualified, and will not be taxed until distributed to the participant.

It is generally recommended that an attorney, knowledgeable in retirement plan law, provide assistance to the employer, so that the plan will obtain the favorable determination letter. In order to obtain a favorable determination letter several requirements must be met.

The plan agreement must be in conformity with all of the Internal Revenue Service rules, prior to the determination. Therefore, it may be necessary for the plan to have amendments made to it to comply with the requirements of the Internal Revenue Service.

Over the last several years, the Internal Revenue Service has promulgated numerous requirements for retirement plans. If the employer's plan has not been amended to comply with these requirements, it would then be necessary, prior to termination that amendments be made. In addition, corporate resolutions must be made to approve the amendments to the plan. An amendment and corporate resolution terminating the plan must also be prepared.

Other requirements to terminate a plan require filing specific Internal Revenue Service forms with the Internal Revenue Service. These Internal Revenue Service forms require information of the plan for the five years prior to the termination of the plan.

Based upon the attorney's review of the plan, amendments may be numerous or minimal, depending upon the attorney's review. In some cases, it may be necessary to amend the plan, in its entirety, prior to terminating the plan, due to all of the recent Internal Revenue Service changes for retirement plans, so that the plan is in compliance. One of the benefits of terminating a retirement plan is that there will no longer be the need to retain the plan and the associated accounting fees and tax return preparation fees of the plan. It should be noted, though, that when a retirement plan is terminated, the participant's account balance is 100% vested. Therefore, a determination needs to be made if it is necessary to retain the plan and continue making contributions, along with the annual costs of retaining the plan, compared to terminating the plan.

For example, recent changes in the law allow defined contribution plans to contribute the lesser of \$40,000, or 100% of the compensation of a participant. Therefore, an owner, or high-income participant, may have a \$40,000 contribution to a retirement plan. In many situations, an employer had a money purchase pension plan, as well as a profit sharing plan in effect, to obtain the maximum contributions of the owner-participant. Current law now allows a deduction of up to 25% of compensation as a deduction. Therefore, because money purchase pension plans are now subject to the same deduction limits as profit sharing plans, in most cases, there is no need for an employer to maintain both plans to achieve its retirement plans objectives. As a result, many employers are either terminating their money purchase pension plans or merging them into their profit sharing plans.