Articles + Publications | August 26, 2026

Cutting Staff? Your Retirement Plan Might Pay the Price

WRITTEN BY

Heather Heath Ryan | Josh C. Trawick

KEY POINTS

- A reduction in force that causes a “partial termination” of a 401(k) or other qualified plan may require an employer to immediately and fully vest all affected employees in employer contributions, regardless of their scheduled vesting timeline.
- The IRS benchmark for a rebuttable presumption of partial plan termination is 20%: if employer-initiated turnover reaches or exceeds that threshold during the applicable period — typically a 12-month plan year — the burden shifts to the employer to rebut the presumption.
- The applicable measurement period is not always limited to a single plan year; a multiphased RIF conducted across multiple years may extend the period, potentially capturing terminations the employer did not initially account for.
- Not all terminations count toward the turnover percentage — the IRS focuses on employer-initiated separations — but courts have found that some voluntary terminations sufficiently related to a RIF may be treated as involuntary for partial termination purposes.
- Failing to recognize a partial plan termination can expose an employer to participant lawsuits alleging vesting failures, IRS or DOL audits, and potential plan disqualification, in addition to the cost of corrective contributions or forfeiture reallocations.

As companies across every major sector of the economy continue to announce significant reductions in force — with layoffhedge.com and other layoff trackers reporting an average of nearly 3,000 workers affected per day in 2026 — plan sponsors and benefits counsel face renewed pressure to navigate the complex intersection of workforce downsizing and employee benefit plan compliance. Layoffs or reductions in force (RIFs) can trigger more than just severance and Worker Adjustment and Retraining Act (WARN) obligations — RIFs may also create unexpected retirement plan liability. If a RIF causes a “partial termination” of a company’s 401(k) or other qualified plan, the employer may be required to treat affected employees as immediately and fully vested in any employer contributions. In those cases, the participants who otherwise would have terminated employment without full vesting would now be fully vested. When preparing for a RIF, employers should consider the effects of planned layoffs on the company’s retirement plan to avoid incurring unexpected liabilities.

WHAT EMPLOYERS NEED TO KNOW

When a partial termination occurs, affected employees become 100% vested in the plan benefits attributable to employer contributions, in most cases. In the 401(k) context, this often involves full vesting of both matching and nonelective contributions. Special rules apply if traditional pension plans are involved.

Identifying whether a plan has experienced a partial termination is not always a straightforward analysis. Courts evaluate partial plan terminations based on the totality of facts and circumstances, with the central question being whether a significant percentage of plan participants lost eligibility during a given period. The widely accepted benchmark — also adopted by the IRS in Rev. Rul. 2007-43 — is **20%**. If employee turnover attributable to employer-initiated severances reaches or exceeds 20% during an applicable period (typically a 12-month plan year), there is a rebuttable presumption of partial plan termination.

Measuring the "Applicable Period"

The IRS has previously indicated that the applicable period—the period used for measuring employee turnover — generally tracks the 12-month plan year. Under certain circumstances, however, the period could extend across multiple plan years. For example, the applicable period could exceed the 12-month plan year if the RIF involved a multiphased approach that included a series of related severances over multiple years.

Do All Terminations Count Towards the Employee Turnover Percentage?

No. The IRS focuses on whether an employee's termination is "employer-initiated" versus voluntary, meaning termination for reasons other than death, disability, or retirement on or after normal retirement age. However, courts have found instances where voluntary terminations were sufficiently related to the RIF to count as "involuntary" for partial plan termination purposes, emphasizing the need for employers to analyze the facts involved in all terminations during the applicable period.

How to Calculate the Turnover Rate?

1. Divide the number of participating employees (those vested and unvested) with "employer-initiated" terminations during the applicable period by
2. The number of participants at the beginning of the applicable period, plus employees who became participants during that period.

If the turnover rate meets or exceeds 20%, the employer bears the burden of rebutting the presumption of partial plan termination. One avenue for rebuttal is demonstrating that the level of turnover was consistent with the employer's historical attrition rates. Supporting evidence may include data on past turnover trends and the degree to which terminated employees were replaced.

WHY THIS MATTERS

If a partial termination occurs, affected employees become fully vested in employer contributions, which may involve reallocating forfeitures to the employees' accounts or making corrective contributions to the plan. In addition, failing to recognize partial plan terminations may expose the plan to heightened scrutiny from its independent auditor, participant lawsuits alleging vesting failures or breach of fiduciary duty, and IRS or DOL audits that could result in plan disqualification or significant penalty assessments.

In short, employers planning a RIF should evaluate retirement plan impact hand-in-hand with other employment law considerations. Proper planning allows employers to minimize exposure across several regulatory frameworks while ensuring that departing employees receive the vested benefits and legal protections to which they are entitled.

RELATED INDUSTRIES + PRACTICES

- Business Litigation
- Employee Benefits + Executive Compensation
- Labor + Employment