

Washington Pulse

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IRS Releases Proposed Forfeiture Guidance

The IRS recently released [proposed regulations](#) regarding the use of forfeitures within qualified retirement plans. This proposed rule clarifies how and when defined contribution plans must use forfeitures, provides a transition rule for defined contribution plans that have accumulated forfeitures over several plan years, and removes a requirement that conflicts with the minimum funding rules for defined benefit plans. The IRS proposes that the forfeiture regulations apply for plan years beginning on or after January 1, 2024.

Background

Many defined contribution plans require participants to complete a certain period of service before becoming 100% vested in employer contributions. Participants who separate from service with less than 100% vesting, forfeit the unvested amount of their account balance. This unvested amount is removed from the participant's account and held in a segregated forfeiture account for the plan administrator to use according to the method(s) described in the plan document. Employers will often use forfeiture account assets to pay the plan's administrative expenses. Plan provisions may also allow employers to direct forfeitures into other participants' accounts. But in some cases, plan administrators do not use their forfeitures as they accrue, allowing forfeiture balances to accumulate over time. The IRS informally addressed unallocated forfeitures several years ago in a 2010 newsletter [Publication 4278 \(Rev. 5-2010\)](#).

Defined Contribution Plans

The proposed regulations specifically state how and when a defined contribution plan must use forfeited assets. In addition, the proposed regulations provide transition relief for defined contribution plans that have permitted forfeiture assets to accumulate over a period of several years.

- **How forfeitures may be used.** The proposed forfeiture regulations state that a qualified retirement plan may use forfeitures to
 - pay plan administrative expenses,
 - reduce employer contributions (including restoring conditionally forfeited participant accounts), or
 - increase benefits in other participants' accounts in accordance with the terms of the plan document.
- **When forfeitures must be used.** Forfeitures must be allocated no later than 12 months following the close of the plan year in which the forfeitures were created. So defined contribution plan forfeitures created during the 2024 plan year must be used within 12 months after the end of that plan year.
- **Transition relief in 2024.** The proposed forfeiture regulations also provide for a transition rule that permits accumulated forfeitures generated in any year before 2024 to be allocated as if the forfeitures originated during the 2024 plan year. This broad transition relief applies regardless of the circumstances that caused forfeitures to accumulate over previous plan years.

- **Effect on interim document amendments.** Employers should review their plan document to determine whether current forfeiture provisions comply with the proposed regulations. Employers may need to amend plan documents that do not comply with the regulations - once finalized – including amending to include the ability to use the transition rule. And an interim document amendment may be necessary for those employers who will use the transitional rule to allocate accumulated forfeiture balances in 2024. Such an interim document amendment would need to be adopted by December 31, 2026, based on the proposal, but in many cases, these provisions will likely be included with other amendments (e.g., amendments for SECURE and SECURE 2.0).

Defined Benefit Plans

The original forfeiture regulations required pension plans to use forfeitures as soon as possible to reduce employer contributions. But none of the defined benefit plan minimum funding standards allow required contributions to be offset by forfeitures of accrued benefits. Instead, the modified minimum funding standards require the use of reasonable actuarial assumptions to determine the effect of expected forfeitures on plan liabilities. The proposed forfeiture regulations now eliminate this inconsistency by specifically permitting employers to take forfeitures into consideration when determining costs and applying actuarial assumptions in the calculation of required plan contributions.

Next Steps

The IRS welcomed written or electronic comments on the proposed forfeiture regulations through March 30, 2023. Ascensus will continue to analyze new guidance as it is released. Visit ascensus.com for the latest developments.