

## Employee Benefit Plans Alert

# IRS Proposed Rule: Forfeitures in Retirement Plans

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The IRS released a proposed rule on the use and timing of forfeitures in retirement plans. It was published in the Federal Register on February 27, 2023. The proposed regulation provides clarification of the use of forfeitures for retirement plans subject to the minimum funding requirements [e.g., defined benefit (DB) pension plans] as well as the deadline for the use of forfeitures in defined contribution (DC) plans.

This regulation will be applied to plan years beginning on or after January 1, 2024. A transition rule would treat the forfeitures under defined contribution plans that were incurred prior to the 2024 plan year as if they were incurred in the 2024 plan year for purposes of the 12-month deadline. The proposed regulation may be relied on prior to applicability.

### Use of Forfeitures in DC Plans (Including Money Purchase Plans)

The proposed regulation indicates that forfeitures can be used for one or more of the following purposes: (1) pay plan administrative expenses, (2) reduce employer contributions under the plan and/or (3) increase benefits in other participants' account in accordance with plan terms.

Under this regulation, forfeitures must be used no later than 12 months after the close of the plan year in which forfeitures are incurred. The purpose of this deadline is to ease administrative burdens and simplify administration.

### Use of Forfeitures in DB Plans (Including Money Purchase Plans)

This regulation eliminates the existing requirements that forfeitures under DB plans must be used as soon as possible to reduce employer contributions because it is inconsistent with the minimum funding requirements.

### Review by Auditors

During an audit, forfeitures are reviewed by the auditors at the plan and participant levels. At the plan level, the auditor obtains and reviews the activity in the forfeiture account for the period under audit. Items the auditor would typically review include:

- roll forward of the balances from prior period;
- new forfeitures incurred during the period;
- forfeitures used during the period and for what purposes (i.e., reduce employer contributions; reduce plan expenses; or, allocated to participants);
- financial statement disclosures relating to forfeitures; and,
- compliance with the plan document.

Typically, forfeitures at the participant level are reviewed during benefit payment testing for the participants selected. Auditors review each participant's account for selected participants during the benefit payment testing to make sure the forfeitures are being calculated in accordance with the vesting schedule and that the appropriate benefit payment amounts are being received by participants.

Typical findings on audits relating to forfeitures include:

- not using any forfeitures during the period;
- using forfeitures for something other than the plan document allows; or,

- forfeitures at the participant level are not being calculated in accordance with the vesting schedule.

Findings also may include affected participants not becoming 100% vested upon termination of a plan, which results in forfeitures having to be restored to the affected participant accounts.

To reduce any of these issues, plan sponsors should be reviewing their plan's forfeiture accounts on a regular basis and determine the best way to maintain compliance with the plan document and IRS regulations.

This plan operation is reviewed on the examination of retirement plans by the IRS and Department of Labor (DOL). Most pre-approved plans have contained the language provided by the proposed regulation, or similar language. Other plan document providers will need to amend their plan documents for this provision. On examination the IRS or DOL could conclude the plan was out of compliance by not operating in accordance with its terms. Correction would be required based on all the facts and circumstances applicable to that plan's situation.

## Contact Us

The Employee Benefit Services Group at PKF O'Connor Davies is available to assist employers with the preparation and filing of the needed ACA Forms and to assist in responding to any IRS notice the employer may receive. We also provide a full spectrum of compliance services for qualified retirement plans, nonqualified deferred compensation plans and welfare plans. For more information, please contact your client services partner or any of the following:

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