

MEMO# 35062

March 3, 2023

IRS Releases Proposed Rules on Use of Forfeitures in Qualified Retirement Plans

[35062]

March 03, 2023

TO: ICI Members

Pension Committee

Pension Operations Advisory Committee SUBJECTS: Pension

Tax RE: IRS Releases Proposed Rules on Use of Forfeitures in Qualified Retirement Plans

On February 24, 2023, the Internal Revenue Service (IRS) and the Treasury Department released proposed regulations describing when forfeitures may be used or allocated in a qualified retirement plan.[\[1\]](#) Comments on the proposal are due by May 30, 2023.

The Tax Reform Act of 1986 (TRA 86) included changes that provided uniform rules regarding the use of forfeitures under defined contribution plans.[\[2\]](#) Prior to the issuance of the proposal, however, little guidance was available on the rules regarding the use of forfeitures.[\[3\]](#)

Use of Forfeitures

The proposed regulations would clarify that forfeitures arising in any defined contribution plan[\[4\]](#) (including in a money purchase pension plan) may be used for one or more of the following purposes, as specified in the plan[\[5\]](#):

- to pay plan administrative expenses;
- to reduce employer contributions under the plan;[\[6\]](#) or
- to increase benefits in other participants' accounts in accordance with plan terms.

The preamble reminds plan administrators that they are required to keep records necessary to demonstrate compliance of their use of forfeitures.[\[7\]](#)

Timing Requirement

The proposal would generally require that, for defined contribution plans, plan administrators must use forfeitures no later than 12 months after the close of the plan year in which the forfeitures are incurred. Under a transition rule, forfeitures incurred during any plan year that begins before January 1, 2024, are treated as having been incurred in the first plan year that begins on or after January 1, 2024.

Reliance on Proposal

The regulations are proposed to apply for plan years beginning on or after January 1, 2024. However, taxpayers may rely on the proposed regulations for periods preceding the applicability date.

Comments Requested

The IRS and Treasury request comments on all aspects of the proposed rules, but request input on the following two specific questions:

- whether the rules for the use of forfeitures can be further simplified to reduce administrative costs and burdens; and
- whether any issues arise concerning other unallocated amounts (in addition to forfeitures) with respect to qualified retirement plans, and, if issues do arise, whether guidance should be provided addressing those issues.

Comments on the proposal are due by May 30, 2023.

Shannon Salinas
Associate General Counsel - Retirement Policy

Notes

[1] The proposal was published at 88 Fed. Reg. 12282, dated February 27, 2023, available at <https://www.govinfo.gov/content/pkg/FR-2023-02-27/pdf/2023-03778.pdf>.

[2] The conference report accompanying TRA 86 stated that, following these changes, "forfeitures arising in any defined contribution plan (including a money purchase pension plan) can be either (1) reallocated to the accounts of other participants in a nondiscriminatory fashion, or (2) used to reduce future employer contributions or administrative costs."

[3] The most recent guidance was a 2010 IRS newsletter (Retirement News for Employers, Vol. 7, Spring 2010, available at <https://www.irs.gov/pub/irs-pdf/p4278.pdf>), which noted that some defined contribution plan administrators were placing forfeited amounts into a plan suspense account, allowing them to accumulate over several years, but that the Code does not allow this practice. The newsletter advised that a plan document should have provisions detailing how and when a plan will use or allocate plan forfeitures, and it described deadlines for the use or allocation of forfeitures.

[4] The proposal also addresses the use of forfeitures in defined benefit plans. The plan must expressly provide that forfeitures may not be applied to increase the benefits any employee would otherwise receive under the plan at any time prior to the termination of the plan or the complete discontinuance of employer contributions thereunder. However, the effect of forfeitures may be anticipated in determining the costs under the plan.

[5] The preamble notes that nothing would preclude a plan document from specifying only one use for forfeitures; however, the plan may fail operationally if forfeitures in a given year exceed the amount that may be used for that one purpose. 88 Fed. Reg. at 12284.

[6] In the preamble, the IRS notes that this purpose would include the restoration of

inadvertent benefit overpayments and the restoration of conditionally forfeited participant accounts that might otherwise require additional employer contributions. Id. at 12283-4.

[\[7\]](#) See footnote 5, Id. at 12283.

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