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# Highlight on IRS Proposed Forfeiture Regulations

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In February of last year, the IRS released **proposed regulations** governing the use of plan forfeitures.


**Guidance:**
The proposed regulations build on prior, guidance from IRS on when defined contribution plans, including 401(k) plans, should use any plan forfeitures. The proposed regulations require that forfeitures in defined contributions plans be allocated or otherwise used within twelve months following the end of the plan year in which the forfeiture occurred. The proposed regulations also explicitly provide that plans may use forfeitures to: (1) pay plan administrative expenses, (2) reduce employer contributions, or (3) increase benefits in other participants' accounts (in accordance with plan terms), and the plan document must reflect how the plan will use forfeitures.

**Effective Date:**
The proposed rule has not been finalized. However, plans can rely on the proposal until it is finalized.

**Impact:**
This guidance is not significantly different than what the IRS has been saying in informal guidance for many years. The IRS has routinely stressed that plans cannot place forfeitures into suspense accounts for multiple plan years and should, instead, allocate or otherwise apply forfeitures as permitted by the plan document. However, the proposed regulations do provide some helpful flexibility in when forfeitures must be used and they make it very clearly a qualification requirement—meaning that plan sponsors who do not monitor and use forfeitures timely may be subject to penalties and costly corrections.

Thankfully, the guidance provides relief from prior unused forfeitures. If a plan has any unused forfeitures for a year prior to the 2024 plan year, those will be treated as having been incurred in the first plan year that begins on or after January 1, 2024. And therefore, they must be used no later than the end of the 2025 plan year.

**Action:**
Ensure that your plan sponsor clients have a process in place to review forfeitures as part of the year-end compliance process. Your TPA partner can assist in developing a compliant process. In addition, review your plans as soon as possible to determine whether there are any unused forfeitures from years before 2024 that need to be allocated. If forfeitures were allowed to accumulate, these accounts may be large and may require the sponsor to develop and implement an intentional strategy ASAP to ensure the forfeitures are fully used by the end of the transition period.

## REMINDERS

- **July 29, 2024:** Summaries of material modifications (SMMs) due to participants in calendar year plans, unless such changes have been included in an updated SPD.
- **July 31, 2024:** Form 5330 (used to report excise taxes) due to the IRS.
- **July 31, 2024:** Form 5500 due to the DOL for calendar-year plans that have not filed an extension.