

Guide for assessment of plan forfeitures

Plan sponsors have great flexibility in using forfeited funds in the administration of defined contribution plans, but they must be aware of Internal Revenue Code (IRC) rules and relevant guidance regarding forfeiture use, including proposed regulations issued by the Internal Revenue Service (IRS) in February 2023. Commentary from Vanguard Strategic Retirement Consulting, *Avoiding Pitfalls in Retirement Plan Forfeitures*, on workplace.vanguard.com, provides an overview of the timing and approved uses of forfeitures and forfeiture-related events. As you review your plan document, consider the requirements listed below to determine how forfeitures will be used and administered.

Approved use of forfeitures

The plan document must clearly define how your plan uses forfeitures. The IRC provides for forfeiture use in three ways:

- Paying reasonable plan expenses. The plan fiduciary must evaluate relevant information to determine that fees paid from the plan are reasonable. Consult with counsel as needed for further analysis.
- Reducing future employer contributions.
- Allocating forfeitures among participants as additional contributions.

For administrative flexibility and to ensure compliance with timely forfeitures, a plan may include more than one of these methods. Review your plan document and confirm how the plan will use forfeitures.

Administrative procedure

Although the IRS's proposed regulations have not yet been finalized, they are generally applicable now and plan sponsors may rely on the guidance. The proposed rules impose a strict, single deadline to exhaust forfeitures within 12 months following the plan year in which they are incurred. This simplifies time frames provided in previous guidance that required plan sponsors to use forfeitures during the plan year in which they arose or no later than the following plan year in certain circumstances. Review administrative procedures and the plan document to determine the frequency of forfeiture use and if updates may be warranted to remain consistent and compliant.

Some examples of how forfeitures are used include annual reduction of the employer contribution, per-payroll reduction of the employer contribution, and ad hoc payment of expenses.

Authorized direction

The plan should include established procedures for providing written direction from an authorized individual to the plan's recordkeeper on the timing and use of forfeitures.