

# Forfeiture Accounts

## Frequently Asked Questions



**IN 2023, THE INTERNAL REVENUE SERVICE (IRS) PROPOSED NEW RULES FOR PLAN SPONSORS REGARDING FORFEITURE ACCOUNTS.** These rules require that any money in the forfeiture account must be used within 12 months after the plan year's end when the forfeitures happen.

As retirement plan management changes, especially with these new regulations, Plan Sponsors must understand their responsibilities and how to effectively use forfeiture accounts. To help you better understand what forfeiture accounts are, how to use them correctly, and what compliance requirements you need to meet, we've compiled the following information.

### What is a forfeiture account?

Forfeiture accounts hold the non-vested funds from a former employee's account balance in the plan. The amounts that are forfeited must be used for the benefit of the plan and its participants and beneficiaries.

### How can forfeiture accounts be used?

Based on the proposed regulations in 2023, the IRS and the U.S. Treasury Department make it clear that forfeitures may be used in the following ways and consistent with plan documents:

- Offsetting any employer match or non-elective contributions
- Paying for reasonable plan expenses
- Providing an additional match or non-elective contribution
- Reallocating funds to participants

### Is there a specific time frame on when the forfeiture account funds should be used?

Yes. The IRS has historically taken the position that forfeitures should be used in a timely manner. The proposed regulations bring forth a more formal process on when and how forfeitures should be used. In any plan year, forfeitures should be used by the end of the following plan year in which they occurred.

### What is the new proposed regulation for the usage of forfeiture accounts?

In February 2023, the IRS and Treasury Department published proposed regulations on handling forfeiture accounts in retirement plans. These new rules, officially published in February 2023, can be relied upon for plan years starting on or after January 1, 2024, until final regulations are published. It is essential to understand these changes, especially regarding the transition rule for forfeitures from before 2024 and how they might affect your plan operations.

## Based on the proposed 2023 regulations, how does a plan deal with forfeitures that happened before 2024?

Amounts that have been forfeited prior to 2024 are subject to a "grandfathering" provision. This means you have a grace period to dispose of these forfeitures.

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.

Accordingly, those forfeitures must be used no later than 12 months after the end of the 2024 plan year (e.g., allocated by the end of the 2025 plan year).

## What should Plan Sponsors be doing with forfeiture accounts?

On a regular basis, the Plan Sponsor should review their plan's provisions on the use of forfeitures. Ensure your current practices align with the IRS and the U.S. Treasury Department guidelines, including how any older forfeitures are handled.

## What happens if a Plan Sponsor does not use the forfeiture account balance?

The IRS has made it clear that forfeitures should be used on a regular basis. If you don't use forfeitures, you are not operating your plan by the terms of the plan document. You could be subject to fines and penalties if discovered under audit, and you may also be open to potential claims from participants.

## What happens if a Plan Sponsor doesn't use all the forfeitures on plan expenses or employer contributions?

Forfeitures should be allocated to participants if not used for other purposes.

## What is ADP Retirement Services doing to help Plan Sponsors understand and use their forfeiture accounts?

ADP Retirement Services has established an automated process that takes place during the fourth quarter of each calendar year to forfeit and report to Plan Sponsors if there are any unvested account balances for participants who have 5 consecutive one-year breaks in service. This will allow the employer to ensure the unvested amounts are forfeited and utilized in a timely manner.

To view the proposed rules, [click here](#).



If you have any questions regarding the use of forfeitures, please contact your ADP Client Services Team.

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