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Understanding Plan Forfeitures

Are you ready for some football? It's time to gear up in your favorite team apparel. Tents up; tailgates down! Whether you're a fan or not there's something about the game that inspires. It bestows a spirit that motivates and encourages us to never give up. The box office has even tapped into the emotional connection people have with football by producing movies such as *Rudy*, *The Blind Side* and *Remember the Titans* to name a few. Check out this youtube video clip from the movie *Facing the Giants*.

Similar to the coach in this video an employer can use the retirement plan to attract, motivate and retain quality employees by including a vesting schedule for certain employer contributions in the plan. A common vesting schedule is the 6-year graded whereby an employee is granted a year of service for each year in which he works 1,000 or more hours. The employee's vesting increases as his years of service increase based on a schedule such as 0-1 Year = 0%, 2 Years = 20%, 3 Years = 40% and so on. With this vesting schedule an employee who terminates employment (either voluntarily or involuntarily) prior to attaining 6 years of vesting credit will be required to forfeit his unvested balances.

An employer who sponsors a plan that contains a vesting schedule must consider the timing of the forfeiture. Always check your own plan document and follow those forfeiture timing provisions. The common forfeiture triggers for most plans are:

0% cash-out: In the case where a participant terminates with 0% vested in any employer contribution accounts, the plan can deem the participant cashed-out. Keep in mind that if the participant is rehired within five years the previously forfeited account balance must be restored.

Upon distribution: Once the vested distribution is made to the participant the unvested portion is forfeited.

Five-year rule: A non-vested balance will be forfeited after five consecutive one-year breaks in service.

Recent IRS audits have focused on the use of forfeitures. Make sure the plan is handling them properly and according to the plan document provisions. There are generally four ways forfeitures may be used:

1. Reallocate to eligible participants
2. Restore previously forfeited 0% cash out amounts due to rehires
3. Offset or add to other employer contributions
4. Pay reasonable non-settlor administrative expenses

Forfeitures should be used according to the plan terms as soon as possible. Prior to 2017, the IRS prohibited the use of forfeitures to fund safe-harbor, QNEC (qualified non-elective) and QMAC (qualified matching) contributions. This was reversed by the IRS beginning with the 2017 plan year and required a plan amendment to allow forfeitures be used in this manner. Since this language is provided in the basic plan document EBS adopted the amendment on behalf of all plan documents.

It's important to know your plan's forfeiture provisions to ensure they are being used promptly. If you believe a mistake has occurred you may use the Employee Plans Compliance Resolution System ("EPCRS") to self-correct within two years following the close of the plan year in which the mistake occurred. The Voluntary Correction Program ("VCP") must be used after the two-year period. It must also be used if the plan's terms are defective and must be retroactively corrected through a plan amendment.

EBS is here to assist and we won't give up on helping you to better understand how forfeitures work. Contact your retirement plan professional if you have questions about how this article relates to your specific retirement plan.

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