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Funding 401(k) Corrective Contributions with Forfeitures

The IRS has issued final regulations allowing forfeitures under a 401(k) plan to be used to fund corrective contributions.

IRS rules require forfeitures under a plan to be used as soon as possible to pay administrative expenses, to reduce the employer's contributions or otherwise to be allocated among participants. Although forfeitures can generally be used to fund employer nonelective or matching contributions, certain types of contributions – QNECs and QMACs – were required under IRS regulations to be nonforfeitable at the time they were contributed to the plan. This suggested that forfeitures could not be used to fund QNECs and QMACs because forfeitures, by definition, consistent of amounts that were not nonforfeitable when contributed to the plan. QNECs and QMACs are contributions that are generally used to correct ADP or ACP nondiscrimination issues or to fund 401(k) safe harbor contributions. QNECs can also be used to correct other plan operation failures, such as not offering a deferral opportunity to an employee who was eligible to participate in a 401(k) plan.

On January 17, 2017, the IRS issued proposed regulations that would amend the definitions of QNECS and QMACs to require them to be nonforfeitable at the time they are allocated to participants' accounts rather than at the time they are contributed to the plan. Plans have been permitted to rely on these proposed regulations even before the final regulations were issued on July 20, 2018.

The final regulations also highlight that plan amendments may be necessary to permit the use of forfeitures to fund QNECs and QMACs depending on how these terms have been defined in the plan.