

## Proposed Regulations Allow for Use of Forfeitures to Fund QNECs and QMACs

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On January 18, 2017, the Internal Revenue Service (“IRS”) released proposed regulations (the “Proposed Regulations”) broadening the definition of employer contributions that will qualify as qualified nonelective contributions (“QNECs”) and qualified matching contributions (“QMACs”). This broadened definition allows for the use of forfeitures to fund QNECs and QMACs.

QNECs and QMACs are commonly used to correct a failed ADP or ACP test, and to correct a number of operational failures under the IRS’ Employee Plans Compliance Resolution System (EPCRS). QNECs and QMACs are also used to satisfy employer contribution requirements under safe-harbor 401(k) Plans.

Existing Treasury Regulations provide that QNECs and QMACs must be nonforfeitable (*i.e.*, 100% vested) at the time they are made to the plan. The IRS has long interpreted this language as prohibiting the use of forfeitures to fund QNECs and QMACs, because amounts are allocated to forfeiture accounts only after a participant incurred a forfeiture of benefits and, thus, would have been subject to a vesting schedule when they were first contributed to the plan. The Proposed Regulations mark a pivot from the IRS’ longstanding interpretation and would amend the applicable regulations to clarify that QNECs and QMACs must be fully vested only at the time they are allocated to participants’ accounts, thus allowing for the use of forfeitures to fund such contributions.

Before using forfeitures to fund QNECs and QMACs, it is important to carefully review the terms of your plan document. Many plans (including most pre-approved plans) have provisions prohibiting this use of forfeitures to fund QNECs and QMACs, or providing for limited uses for forfeitures. As a result, the plan may need to be amended to permit the use of forfeitures to fund QNECs and QMACs.

Although the regulations are in proposed form and will not become effective until a final regulation is issued, the preamble provides that Plan sponsors may rely on the guidance immediately. We acknowledge that the White House issued a memorandum on January 20, 2017 resulting in

a regulatory freeze, including a 60-day delay on all published regulations that are not yet effective. However, we do not believe that the freeze impacts the ability to rely on the IRS' updated position that QNECs and QMACs must only be fully vested at the time they are allocated to participants' accounts.

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