



Pension Analyst

Compliance Bulletin

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Forfeiture suspense accounts should have limited lifespans

In the [Spring 2010 issue of its Retirement News for Employers](#), the IRS provided official guidance regarding the maintenance and use of forfeiture suspense accounts by defined contribution (DC) plans. While this guidance was not provided in the form of a regulation or Notice, the IRS considers it to be formal "soft guidance" that taxpayers should take note of and may rely upon.

Generating forfeitures

When a defined contribution plan applies a vesting schedule to employer contributions, there is an expectation that some non-vested contributions will be "recycled" when employees who are not 100% vested terminate employment. While termination of employment itself does not give rise to forfeitures, forfeitures are generated when a terminated employee either takes a distribution of his vested account balance or incurs a five-year break-in-service. Many plans provide that when a participant who is 0% vested terminates employment, his account will be "deemed distributed" and immediately generate forfeitures.

Recycling forfeitures

Plans have three basic options for recycling forfeitures, which can also be used in combination with each other. These three options are:

- Reallocation to remaining participants as additional employer contributions;
- Offsetting employer contributions due in to the plan; and
- Payment of plan expenses.

Generally, forfeitures are generated on an ongoing basis, sometimes daily. However, it is not always practical or possible to use those forfeitures as quickly as they are generated. It is often most practical to accumulate forfeitures throughout the plan year and then deal with them at the end of the plan year or at set times (e.g., quarterly) during the plan year. To this end, most plans establish temporary plan-level suspense accounts to hold the forfeited amounts.

Forfeiture suspense accounts must be temporary

While acknowledging the common practice of placing generated forfeitures in a temporary plan suspense account, the IRS newsletter article (which appeared in a section titled "Fixing Common Plan Mistakes") emphasizes that the Internal Revenue Code **does not allow** the practice of *accumulating such amounts over a period of several years*.

- Plans that provide for the reallocation of forfeitures are expected to allocate those amounts to all eligible participants as soon as possible following the close of the plan year in which they were generated (so that they are allocated "as of" the end of that plan year).
- Plans that use forfeitures to pay plan expenses or offset employer contributions may have until the end of the immediately following plan year to use up these amounts, depending on their plan document provisions.

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Plan document provisions

Prudential's Prototype document offers adopting employers the option of "allocat[ing] the forfeitures in the same Plan Year in which the forfeitures occur or [allocating] the forfeitures in the Plan Year which next follows the Plan Year in which the forfeitures occur." However, it does not currently limit the "next year" option to situations involving the payment of plan expenses or employer contribution offsets.

Prudential's Volume Submitter document does not have a standard provision regarding the timing of forfeiture use, but does offer the option of carrying a forfeiture suspense account forward to the following year.

Of course, some plans contain a combination provision where forfeitures are first used to pay expenses or offset contributions and any amounts that still remain are then reallocated. This type of provision, which is offered under the Prototype document, is designed to prevent the perpetual carry-forward of suspense account balances.

The growth of forfeiture suspense accounts

Over the past couple of years, some plans' unallocated forfeiture suspense accounts may have experienced unusual growth due to the convergence of the following two events:

- Employers being forced to downsize and terminate large numbers of employees, which may have given rise to larger forfeitures than usual, unless the downsizings/terminations were considered partial plan terminations and thereby generated 100% vesting and no forfeitures; and
- Employers cutting back or eliminating their employer contributions, thereby creating a lower liability that needs to be covered by forfeitures.

These actions (separately or in combination) also may have given rise to forfeiture suspense accounts being carried over for more than one year. According to the IRS guidance, this type of situation would be considered an operational defect that is eligible for correction under the [Employee Plans Compliance Resolution System \(EPCRS\)](#).

Correcting an over-ripe forfeiture suspense account

If a plan provides for the reallocation of forfeitures and the suspense account balance has not been reallocated in a timely manner, the acceptable correction is to reallocate each year's forfeitures to all participants, including terminated employees, who would have received allocations if they had occurred on time. Terminated employees who no longer have account balances in the plan would have to receive additional distributions from the plan.

If a plan uses forfeitures to offset employer contributions or pay plan expenses, it may be possible to use prior-year forfeitures to offset current year employer contributions or pay current year expenses.

Avoiding future problems

Plan sponsors must familiarize themselves with their plan's forfeiture provision and monitor forfeitures as they are generated, to ensure that they are promptly used.

To assist plan sponsors in monitoring forfeitures, Prudential makes a forfeiture report available on the Plan Sponsor Website. This report is updated monthly. In addition, we provide a copy of this report as part of the annual Plan Year packages.

To help plan sponsors ensure that forfeitures are used promptly, Prudential offers an "Auto Forfeiture" service that automatically applies a percentage of available forfeitures towards the next employer contributions due in to the plan when a plan uses these amounts to offset employer contributions. In addition, plan sponsors that use Prudential's Compliance Testing Service may ask us to calculate and reallocate their forfeitures in accordance with the provisions of the plan document. For additional information about these services, plan sponsors should contact their Prudential Retirement representative.



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