IRS PERMITS FORFEITURES TO FUND EMPLOYER CONTRIBUTIONS USED TO SATISFY 401(K) NONDISCRIMINATION TESTS

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Employer sponsors of 401(k) retirement plans have a new means of satisfying the nondiscrimination tests known as the Actual Deferral Percentage and Actual Contribution Percentage tests ("ADP and ACP"). Under certain circumstances, employers are permitted to make contributions to a 401(k) retirement plan to meet these nondiscrimination requirements, or to correct failed tests.

QNECs (Qualified Non-Elective Employer Contributions) or QMACs (Qualified Matching Contributions) are employer contributions that are 100% vested and may be used to satisfy such testing requirements. Rather than making new QNEC or QMAC contributions to address nondiscrimination testing issues, employer commenters on the proposed IRS regulations regarding the definitions of QNECs and QMACs indicated it would be beneficial for employers to use plan forfeiture accounts to satisfy the nondiscrimination requirements.

Prior to issuance of the proposed IRS regulations in January of 2017, forfeitures could not be used to address ADP or ACP nondiscrimination issues. This was so because of the requirement under prior IRS regulations that employer contributions – QNECs or QMACs – must be non-forfeitable at the time the contributions *are contributed* to the plan. By their nature, forfeitures were not permitted to be used to address nondiscrimination testing concerns because the amounts were subject to a vesting schedule and, hence, subject to forfeitability conditions when the amounts were contributed to the plan.

The IRS has now finalized regulations that permit forfeitures to be used to fund QNECs and QMACs, provided that the amounts are nonforfeitable at the time the amounts *are allocated to participants accounts*, rather than when such amounts *are contributed* to the plan. The final regulations amending the definition of QNECs and QMACs will take effect July 20, 2018, and apply to plan years beginning on or after that date. However, employers may apply the final regulations to earlier periods. *Treasury Regulations §§1.401(k)-6 and 1.401(m)-5.*