



IRS issues proposed rules allowing forfeitures to fund QNECs and QMACs

On January 18, 2017, the IRS issued welcome proposed rules that amend the definition of qualified non-elective contributions (QNECs) and qualified matching contributions (QMACs). The proposed rules apply to 401(k) and 401(m) plans. While the rules will not be effective until after they are finalized, plan sponsors may immediately rely on them.

Background

A 401(k) plan sponsor may make Qualified Nonelective Contributions (QNECs) or Qualified Matching Contributions (QMACs) to some or all non-highly compensated employees (NHCEs) to correct failed Actual Deferral Percentage (ADP) or Actual Contribution Percentage (ACP) tests. Plans may also use QNECs and QMACs to satisfy ADP/ACP safe harbor provisions or as part of certain correction methods.

Under the current rules, QNECs or QMACs must be nonforfeitable (100% vested) when contributed to the plan, are subject to special withdrawal restrictions, and cannot be combined with other employer contributions for recordkeeping purposes. Due to the fact that forfeitures are not 100% vested when contributed to the plan, forfeitures were unable to be used as QNEC or QMAC contributions. As a result, plan sponsors needed to contribute additional funds when making QNEC and QMAC contributions.

Proposed rules

The proposed rules amend the definitions of QMACs and QNECs to provide that these contributions must be non-forfeitable at the time they are *allocated to participants' accounts* instead of when they are *contributed to the plan*. As a result of these changes, amounts in a plan's forfeiture account may be used to fund QNEC and QMAC contributions, as well as safe harbor contributions, thus alleviating some of the need for plan sponsors to contribute additional funds to the plan.

The IRS is accepting comments on the proposed rules through April 18.

Plan amendments

If a sponsor's plan document contains language requiring that QNECs and QMACs be 100% vested when contributed to the plan, an amendment will be needed to revise the document language accordingly. Plan documents that need to be amended must do so by the last day of the plan year to which the change applies.

However, for plans that reallocate forfeitures, making a mid-year amendment may result in a cutback issue if participants have already satisfied conditions for forfeiture allocation. As a result, sponsors of these plans may need to wait until the beginning of the next plan year to adopt such a change.

Sponsors of individually designed plans that want to have the flexibility to use forfeitures for QNEC or QMAC contributions should review their plan document and make amendments as necessary. For sponsors of plans that use Prudential's document services, Prudential will contact you regarding amendments when they are available, if applicable.

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