John Hancock RETIREMENT PLAN SERVICES

**REGULATORY/LEGISLATIVE ALERT**

**BENEFITS CONSULTING GROUP**

**Note: This information is highly important to many plan sponsors.**

# IRS notice validates forfeiture accounts as a source of QMAC/QNEC/safe harbor contributions

ALERT

The Internal Revenue Service (IRS) recently introduced a notice of proposed rulemaking designed to amend the definitions of qualified matching contributions (QMACs) and qualified nonelective contributions (QNECs) under the 401(k) regulations. QMACs and QNECs are employer contributions made to an underlying 401(k) plan to help ensure passage of nondiscrimination testing (ADP and/or ACP testing), or to serve as a safe harbor contribution and, thus, avoid the constraints of such testing. In the notice, the IRS proposes amendments that formally allow plan sponsors to use cash that originates from forfeiture accounts to fund these types of contributions.

## Background and details on the IRS notice

Under the 401(k) regulations, QNECs and QMACs must satisfy certain distribution requirements (e.g., must not be distributable prior to separation from service or age 59½, thus not available for a hardship withdrawal), as well as meet a nonforfeitability requirement. It is the latter condition that has been problematic over the years, as the IRS has taken a restrictive interpretation. In this regard, the IRS has maintained that QNECs and QMACs must be nonforfeitable when first contributed to the plan, as opposed to when allocated to participants' accounts. Consequently, this interpretation means that forfeitures in the underlying plan could not be used as QNECs, QMACs, or safe harbor contributions. Rather, such contributions must be limited to new contributions.

The new proposal greatly liberalizes this rule, as the IRS proposes to revise the nonforfeitability requirement to mean that for QNECs, QMACs, and safe harbor contributions, the applicable contributions must be nonforfeitable at the time they are allocated to participants' accounts rather than when first contributed to the plan. As a result of this change, amounts held in forfeiture accounts may be used as QNECs or QMACs to correct ADP/ACP testing failures, or contributed as 401(k) safe harbor contributions.

Although the proposed regulations will technically apply to taxable years beginning on or after publication of the regulations in final form, they may currently be utilized.

If you have any questions respecting this new development, please contact your plan consultant or other John Hancock representative.