

# VESTING IN COMPANY PLANS AND NEW IRS FORFEITURE RULES

Wednesday, March 29, 2023

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When you leave your job and aren't fully vested in your company plan account, the plan will forfeit your unvested portion. Recently, the IRS issued new guidance clarifying the forfeiture rules.

"Vesting" refers to the portion of your plan benefit that you actually own and that can't be taken away from you. In a 401(k), 403(b) or 457(b) plan, employee contributions (pre-tax deferrals, Roth contributions and after-tax contributions), and associated earnings, are always 100% vested. But employer matching or profit sharing contributions, and their earnings, are often subject to a vesting schedule.

Most plans with a vesting schedule credit you with a year of vesting service for each 12-month period that you work at least 1,000 hours. Others credit you with vesting service based on your total period of employment. A vesting schedule can be either "cliff vesting" or "graded vesting," as follows:

Years of Service	Cliff Vesting	Graded Vesting
1	0%	0%
2	0	20
3	100	40
4	100	60
5	100	80
6	100	100

Company plan benefits must become 100% vested, regardless of years of service,

when you reach the plan’s “normal retirement age” (typically age 65) or when the plan terminates. Many plans also provide for 100% vesting if you die or become disabled.

When employees leave their job and aren’t 100% vested, their unvested portion is forfeited. Forfeitures are allocated to a separate account within the plan.

Previously, the IRS had issued confusing rules on when the funds in the forfeiture account must be put to work and how they can be applied. The proposed IRS regulations, published on February 24, 2023, clear up the prior guidance. The new rules require that forfeitures be used no later than 12 months after the end of the plan’s fiscal year in which the forfeiture occurred. This new timing rule should simplify plan administration.

Example: Future Technologies has a layoff in December 2023. As a result of this, the Future Tech 401(k) plan incurred \$200,000 in forfeitures during its calendar 2023 fiscal year. In the past, the plan may have had to use those forfeitures by the end of 2023, which would have been difficult to carry out. With the new IRS guidance, it has until the end of 2024 to apply the 2023 forfeitures.

Forfeitures cannot revert to the employer. The proposed rules specify how they can be used:

- To pay plan administrative expenses;
- To reduce future employer contributions; or
- To be allocated to existing participants’ accounts.

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