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July 8, 2013

Ms. Joyce Kahn
Acting Director, EP Rulings & Agreements
Internal Revenue Service
1111 Constitution Ave NW
Washington, DC 20224-0002

Re: Forfeitures Used to Fund Safe Harbor Contributions

Dear Ms. Kahn,

The American Society of Pension Professionals & Actuaries ("ASPPA") appreciates the opportunity to supplement its May 8, 2012, comment letter to the Internal Revenue Service ("IRS") regarding the use of forfeitures to fund ADP Test Safe Harbor Contributions and certain other contributions. ASPPA is supplementing the prior comment letter to (1) provide additional support for its position that forfeitures can be used to fund these contributions, and (2) request that, in the absence of a change in ruling policy, Internal Revenue Code ("Code") §7805(b) be applied to provide transitional relief to plan sponsors who may have reasonably believed that, in the absence of an express prohibition, their plan's language permitted forfeitures to be used in this way.

ASPPA is a national organization of more than 15,000 retirement plan professionals who provide consulting and administrative services for qualified retirement plans covering millions of American workers. ASPPA members are retirement professionals of all disciplines including consultants, administrators, actuaries, accountants, and attorneys. ASPPA is particularly focused on the issues faced by small- to medium-sized employers. ASPPA's membership is diverse but united by a common dedication to the employer-based retirement plan system.

Summary

The following is a summary of ASPPA's recommendations which are described in greater detail in the **Discussion** section that follows.

I. **IRS Ruling Policy Should Permit the Use of Forfeitures to Fund ADP Safe Harbor, Qualified Nonelective or Qualified Matching Contributions** - The IRS should change its ruling policy and, to the extent necessary, issue sub-regulatory guidance that confirms forfeitures are permissible sources for Restricted Contributions (as defined below) and that the non-forfeitable status of such amounts is determined at the time they become part of the accrued benefit of the recipient of the Restricted Contributions.

II. **Code §7805(b) Relief** - The IRS should apply the protections of Code §7805(b) liberally in circumstances where plan documents subject to a favorable opinion,

notification or determination letter do not explicitly prohibit the use of forfeitures to fund Restricted Contributions.

Discussion

I. IRS Ruling Policy Should Permit the Use of Forfeitures to Fund ADP Safe Harbor, Qualified Nonelective or Qualified Matching Contributions

ASPPA's recommendation that IRS ruling policy should permit forfeitures to be a permissible source of funding for ADP Test Safe Harbor Contributions, qualified nonelective contributions ("QNECs"), and qualified matching contributions ("QMACs") (collectively referred to in this letter as "Restricted Contributions") was originally set forth in our May 8, 2012, comment letter.[1] This recommendation was made in response to specific language in the master and prototype LRMs which provides that "forfeitures may not be used as ADP Test Safe Harbor Contributions."[2] Based on informal discussions with IRS staff, the apparent concern is that the definitions of QNECs and QMACs in the Treasury Regulations might be read to require such contributions to be fully vested[3] when first contributed to the plan rather than at the time of their reallocation.[4] Although a very narrow reading of the regulation could lead to such a result, there is no mandate for such in the statute. To the contrary, such an interpretation is inconsistent with the purpose of the statutory provision, as well as the treatment of forfeitures within the context of other qualification requirements, and does not further any policy objective.

When forfeitures are used to reduce employer contributions that would have otherwise been made for a plan year, they are acting as a proxy for the employer's current contribution (*e.g.*, they are being "contributed" in lieu of the employer's current contribution). Therefore, the determination of whether an amount is nonforfeitable should be made at the time the forfeiture amount is reallocated to the accrued benefit of a participant and "contributed" as a Restricted Contribution.[5] The relevant statute provides support for this analysis.

Code §401(k)(12)(E)(i) provides that all employer contributions, including matching contributions, that are used to fulfill the safe harbor contribution requirements must satisfy the Code §401(k)(2)(B) vesting rules. Code §401(k)(2)(B) simply provides "[T]hat an employee's right to his ***accrued benefit*** derived from employer contributions made to the trust pursuant to his election is nonforfeitable." (Emphasis added.) A fair reading of the statute would only require that a Restricted Contribution become nonforfeitable at such time as it becomes part of an employee's accrued benefit. The status of such amounts when first contributed is irrelevant

[1] Available at www.asppa.org

[2] *See*, *Cash or Deferred Arrangements Listing of Required Modifications and Information Package* [10-2011] (stating that "forfeitures may not be used as ADP Test Safe Harbor Contributions, and if used as anything other than ACP Test Safe Harbor Contributions, the Plan will not be exempt from Code § 416.").

[3] *See* our May 8, 2012 letter for examples of exceptions to this rule.

[4] Treas. Reg. §1.401(k)-6 (stating that QNECs and QMACs "must satisfy the vesting requirements of §1.401(k)-1(c) ... when they are contributed to the plan.").

[5] ASPPA also identified in the May 8, 2012 comment letter situations where the IRS's interpretation is overly broad (e.g., forfeitures that are attributable to fully-vested contributions, such as when there are lost participants and qualified automatic contribution arrangements which do not require full vesting at the time of the contribution).

under Code §401(k)(2)(B) because they were not, at that time, part of the accrued benefit of a participant entitled to receive a Restricted Contribution. Therefore, it would not be logical to base the nonforeitability requirement of Code §401(k)(2)(B) on how such funds were previously characterized in the original recipient's account before becoming subject to a forfeiture event. The statutory language recognizes this and only requires that Restricted Contributions be non-forfeitable at the time they become part of the accrued benefit of the participant who received the Restricted Contribution.

ASPPA's recommended change to the IRS ruling policy would be consistent with the treatment of forfeitures elsewhere within Treasury Department regulations. In particular, the regulations issued under Code §401(m) provide that the term "matching contributions" includes: "Any ***forfeiture*** allocated on the basis of employee contributions, matching contributions, or elective deferrals."[6] (Emphasis added.) This regulation clearly determines the status of a forfeiture at the time it is reallocated (*e.g.*, "contributed") as a matching contribution rather than at the time of its original transfer to the plan. Similarly, the regulations under Code §401(a)(4) apply the "amounts " test to forfeitures in the year they are reallocated and become part of a new participant's accrued benefit.[7] Another example is the application of the rules under Code §415 that limit the maximum annual additions that may be made to a participant's account. Once again, the regulations provide that forfeitures are taken into account for this purpose at the time they are reallocated and become part of the accrued benefit of someone other than the original recipient.[8]

This same treatment should apply to a forfeiture that is reclassified as a Restricted Contribution. In other words, the forfeiture should be deemed to be a Restricted Contribution (and, no longer a forfeiture) when it is reallocated, first classified and "contributed" as a Restricted Contribution. As a consequence, the non-forfeitable status of the reclassified amount should be determined when it becomes part of a participant's accrued benefit because only then it is "contributed" as a Restricted Contribution.

ASPPA's recommendations are consistent with the statute and would not undermine the policies and concerns behind the regulatory language at issue. Although not included in the current regulations under Code §401(k), the prior iteration included an example illustrating concern that plan sponsors would contend that non-elective contributions that became fully vested by reason of completion of a stated number years of service could be treated as Qualified Nonelective Contributions.[9] As the example concludes, such amounts would not qualify because they were not fully vested when originally contributed. In the case of forfeitures used to fund Restricted Contributions, these amounts would be fully vested regardless of age or service, from the moment they became part of the accrued benefit of the participant entitled to their receipt. In this way, the portion of a participant's accrued benefit derived from such contributions would at all time be nonforfeitable.

ASPPA recommends that the IRS reconsider its ruling policy, and as necessary, issue sub-regulatory guidance interpreting the applicable regulatory language to mean that forfeitures are permissible sources for Restricted Contributions and that the non-forfeitable status of such

[6] Treas. Reg. §1.401(m)-1(a)(2)(C).
[7] Treas. Reg. §1.401(a)(4)-2(c)(2)(ii).
[8] Treas. Reg. §1.415-6(b)(1).
[9] See Former Treas. Reg. §1.401(k)-1(c)(2) (1991).

amounts is determined at the time they are reallocated and become part of the accrued benefit of the participant entitled to receive them.

II. Code §7805(b) Relief

In the absence in a change in ruling policy, an issue arises as to the status of plans entitled to reliance under Code §7805(b) (*i.e.* pre-approved or individually-designed plans with favorable determination letters) that either contain language that is specifically contrary to the IRS's interpretation or contains language that does not specifically address the issue. ASPPA members are aware of an IRS informal position that is being used to review pending pre-approved defined contribution plans that were submitted for opinion or advisory letters. The IRS has been applying the protections of Code §7805(b) to permit plan sponsors who have adopted plans that contain specific language that is contrary to the IRS's interpretation to continue to rely on the terms of the plan document until the plan is restated onto a new plan document. The IRS does not appear, however, to provide similar protection for plan sponsors who have adopted plan documents that do not specifically address the issue (but who have operated their plans using an approach that used forfeitures to fund Restricted Contributions). ASPPA believes that Code §7805(b) relief also should be available to plan sponsors with language that did not specifically address the issue.

As discussed herein, a fair reading of the statute supports the use of forfeitures to fund Restricted Contributions. In addition, many pre-approved plans have received favorable opinion and advisory letters even though they contained explicit language allowing the use of forfeitures to fund Restricted Contributions. Many practitioners and plan sponsors were not aware there was even an issue with using forfeitures to fund these contributions. This confusion is understandable given the inconsistent rulings on determination letter applications and in the language permitted in pre-approved plans. As a result, Code §7805 relief should be provided unless the plan sponsor failed to follow plan language that explicitly and specifically prohibited the use of forfeitures to fund Restricted Contributions.

ASPPA recommends that in the absence in a change in ruling policy, the IRS issue sub-regulatory guidance that applies the protections of Code §7805(b) liberally in circumstances where plan documents do not explicitly prohibit the use of forfeitures to reduce Restricted Contributions.

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These comments were primarily prepared by ASPPA's 401(k) subcommittee of the Government Affairs Committee, Frank Porter, Chair, and were primarily drafted by Robert M. Richter, J.D., LL.M. We welcome the opportunity to discuss these issues. If you have any questions regarding the matters discussed herein, please contact Craig Hoffman, General Counsel and Director of Regulatory Affairs, at (703) 516-9300.

Thank you for your time and consideration.

Sincerely,

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