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The Benefit Insider

# Timely Depositing 401(k) Contributions

## Background

Employees make elections to contribute to a 401(k) plan, but rely on their employer to actually get the contributions deposited into the plan. The Department of Labor (DOL) and the Internal Revenue Service (IRS) take this employer responsibility very seriously. Employers also need to take it seriously. Employee contributions generally occur as often as twice a month so violations can add up quickly.

## What's the Big Deal?

**Late Deposits are a Fiduciary Issue**

Employers that control plan assets have a fiduciary duty to act considering the best interest of participants when handling the plan assets. On a payday when an employee has elected to contribute to a 401(k) plan, the employer is holding plan assets that do not belong to the employer as of the time the employee receives the rest of their pay. If the employer delays depositing the contributions - particularly on a regular basis - employees miss out on earnings. The DOL views the employer as taking an impermissible loan from the loan. Plan sponsors are not permitted to take loans from the plan. This is a type of prohibited transaction subject to excise taxes and other penalties.

**It Could be a Plan Document Issue**

Plan documents will typically set forth a rule that employee contributions must be deposited into the plan as soon as administratively possible (or similar vague language). However, some documents will set forth specific deadlines for the deposit (i.e. no later than 7 days after the pay day). If the employer delays in depositing employee contributions beyond the plan's deadline, it is not following the terms of the plan.

## 401(k) Deposits Must Be Made to the Plan as Soon as Reasonably Possible

The general deadline plans must follow to deposit 401(k) contributions is generally "as soon as reasonably possible" ("the earliest date on which such contributions can reasonably be segregated from the employer's general assets"). While there are a few hard and fast rules of what is and isn't reasonable, the standard depends upon facts and circumstances.

There is a safe harbor deadline of seven business days after pay day for small plans (plans with less than 100 participants). So for small plans, anything within seven business days of pay day is reasonable. Could a deposit to a small plan made in eight business days be reasonable? It will depend on the circumstances. However, it does seem clear that a deposit to large plan made more than seven business days after pay day is likely problematic.

There's also a clear rule that a deposit made after the 15th business day of the following month is never reasonable. However, since this is so much longer than the safe harbor, this limit is not particularly helpful.

The factors that will go into the decision of what's reasonable, include past practices. If an employer has had a plan in place for some time, the plan's prior timeframes for deposits can be illustrative. Also helpful is determining what other plans of a similar size are doing and what their timeframes are like. Your record-keeper or other plan service providers may be able to help you determine what is reasonable for your plan. Most important of all, ensure your payroll department (whether internal or external) understands the importance of timely deposits. Nothing will get this message across better than asking for and reviewing reports of deposit timeframes.

## Penalties

**Prohibited Transaction**

A late deposit will always involve a prohibited transaction. This is a violation of both IRS and DOL rules. There are multiple methods to correct a prohibited transaction and determining how to correct the problem can be a complex process.

One method involves reporting the error on government filings (Forms 5500 and 5300) and paying an excise tax. There is a 15% excise tax based on the amount involved for each year and additional deposits must be made to participants' accounts to make them whole. If the correction is not made in a timely manner, an additional tax of 100% of the amount involved may be due. For example, if there was a late deposit of $15,000 that would have generated $200 in interest, the plan sponsor must make the $15,000 contribution plus interest and pay a 15% excise tax on the $200 interest ($30). If a late deposit is not caught soon enough, interest and taxes can add up quickly.

Another method involves filing with the DOL's Voluntary Fiduciary Corrections Program (VFCP). Lost earnings must still be calculated and a filing must be prepared and sent to the DOL for review. If the DOL accepts the plan's correction, the 15% excise tax may not be due and the plan receives a no action letter from the DOL.

Calculating the lost earnings is not always a simple process. Plans that permit participants to select their investments may have a different and complex calculation for each affected participant. The DOL has a calculator that is a part of their Voluntary Fiduciary Corrections Program (VFCP) (http://askebsa.dol.gov/vfcpcalculator/webcalculator.aspx). Although if not actually filing the correction with the VFCP, it will not be clear if the DOL accepts the calculation. Actual determinations of the loss interest may be required by the IRS.

**Plan Document Error**

Late deposits may constitute an operational error (where the plan does not follow its written terms), giving rise ultimately to plan disqualification. The IRS's Employee Plans Compliance Resolution System (EPCRS) covers all plan corrections. Corrections can be self-corrected by the plan sponsor, submitted to the IRS as a proposed correction or discovered by the IRS on audit.

## Summary

The only way to ensure contributions are made timely is to monitor the process. Once a contribution is deposited later than normal, timely discussing the errors with outside experts will help ensure the correction is not costly for the plan.

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