Benefit Insights

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A non-technical review of qualified retirement plan legislative and administrative issues **April 2010**

When Should the Check be in the Mail?

Every qualified retirement plan has a specific deadline by which employer contributions must be deposited to the plan for each plan year. However, the rules concerning participants' contributions have not been as clear. For example, in 401(k) plans, employees typically defer a portion of their weekly or biweekly paychecks. How soon should these contributions be deposited into the plan?

The question of when participant salary deferrals must be deposited into the plan is a long-standing issue and one about which the Department of Labor (DOL) has been quite vocal. The DOL has also been very active and aggressive in its enforcement in this area. Fortunately, final regulations issued earlier this year have provided welcome guidance for plans sponsored by small employers.

Plan Asset Rule

The regulation describing the deposit requirement is sometimes referred to as the "plan asset rule" since it actually specifies the timing within which participant contributions are deemed to become assets of the plan. This translates into a deposit deadline because it is considered an illegal loan from the plan if an employer is still holding those amounts on or after the date they are deemed to be plan assets. Pre-tax salary deferrals and after-tax employee contributions withheld from payroll as well as loan repayments are considered participant contributions for purposes of the rule.

General Deposit Timing Rule

There are two tests to determine when deferrals have become plan assets and, thus, whether they have been timely deposited. The better known of the two specifies that deferrals become plan assets, at the latest, on the 15th business day of the month following the month in which they were withheld from employees' paychecks. For example, any deferrals withheld during the month of May become plan assets, at the latest, as of the 15th business day of June.

The second test provides that, if it is possible for a plan sponsor to segregate deferrals from its general assets earlier than the 15th business

day of the following month, then those deferrals become plan assets as soon as it is reasonably possible to segregate such amounts. This rule presents several operational issues to consider.

It is not uncommon for an employer to have several payroll periods in a month but to wait to deposit salary deferrals until after the final payroll of that month. However, the DOL has indicated that, if it is administratively possible to make a deposit within a certain number of days following the final payroll of the month, it should also be possible to make a deposit within the same number of days after each mid-month payroll. Therefore, any mid-month salary deferrals and loan repayments held and deposited with the final monthly payroll would be considered delinquent.

Example

ABC Company, Inc. has biweekly payroll with pay dates of Friday, April 16 and Friday, April 30, 2010. Salary deferrals for both pay periods are deposited on Wednesday, May 5th. Since the date of deposit is only 3 business days following the last pay date in April, the DOL would likely assert that deferrals from the April 16th payroll should have been deposited no later than April 21st and treat them as 14 days delinquent.

The Confusion

Since what is "reasonably possible" is open to interpretation, there has been a great deal of confusion in the industry as to how to appropriately determine when deferrals become plan assets. This confusion has been fueled by inconsistent DOL enforcement of the issue. For example, in some regions of the country, DOL investigators have treated 10 to 12 calendar days following payroll as timely while other regions have enforced a 3 to 5 calendar day standard. They set the standard and require plan sponsors to present evidence that a longer timeframe should be allowed.

To make matters more challenging, some DOL investigators have claimed the rule requires that deferrals not only be deposited within the requisite timeframe but also allocated to participant accounts and invested. In an effort to comply with such an ambiguous rule, some employers have gone to the other extreme and deposited deferrals as soon as they knew the amounts, even if prior to the actual payroll date.

While such an approach solves the DOL issue, it creates another problem in that IRS regulations prohibit depositing deferrals prior to the pay date to which they relate.

Safe Harbor Deadline Offers Welcome Guidance for Small Plans

Earlier this year, the DOL finalized new regulations that provide much needed clarity to this rule. In short, the new regulations create a safe harbor timeframe in which to deposit employee contributions and loan repayments. As long as those amounts are deposited into the plan no later than the 7th business day following payroll, they are deemed to be timely, even if the employer is able to make the deposit earlier.

The regulations also clarify that it is only the deposit, not the allocation or investment, that must occur within the requisite window.

While the new guidance removes much of the ambiguity, there are several important points to note. First, as with other plan-related safe harbors, the 7-day safe harbor is optional. Employers who choose to make deposits outside of this window or do so inadvertently lose reliance on the safe harbor and are judged by the "as soon

as reasonably possible" standard which may call for a 3 to 5 day deposit window. Thus, a deposit on the 8th day will not be considered one day late—it will be 3 to 5 days late.

Second, the safe harbor is only available to plans with fewer than 100 participants as of the first day of a given plan year. While many plan sponsors may define a participant as someone who is actively contributing to the plan, the DOL considers anyone eligible to make contributions to be a participant in addition to terminated employees who still have plan balances. This means that larger plans cannot assume that the DOL will consider deposits made within 7 business days to be timely.

What's the Worst that can Happen?

As noted above, the DOL treats late deposits as a loan of plan assets to the plan sponsor. Such a loan is a "prohibited transaction" (PT) and a breach of fiduciary responsibility. As a PT, the delinquency subjects the plan sponsor to a 15% excise tax. The excise tax is applied again for each year (or portion of a year) in which the PT remains uncorrected.

In addition, another PT, subject to its own excise tax, is deemed to occur each year until correction is made. This is often referred to as a cascading or pyramiding excise tax. There is no proration based on the number of days that elapse, so even though a PT occurs near the end of the year, the full excise tax applies.

Form 5500 Reporting of Late Deposits

Late deposits are required to be reported each year on Form 5500 (line 4a of Schedule H or I, whichever is applicable). New rules imposing penalties on service-providers who improperly complete Form 5500 make it unlikely preparers will "look the other way" on this reporting requirement even if the deposit is only a few days late. In addition, CPAs who audit large plans are required to review the timeliness of deferral deposits and note any delinquencies in their reports.

As if the above isn't enough, the DOL issues monthly press releases announcing lawsuits it has filed against large and small companies alike for failure to timely remit salary deferrals of amounts as low as $5,000.

Further, the DOL recently announced the Contributory Plan Criminal Project that could result in criminal prosecution of employers who "may convert employee payroll contributions for their own personal use or may use employee contributions to pay business expenses."

The Fix is In

Since there are numerous avenues for the DOL to become aware of delinquencies, it is in an employer's best interest to voluntarily take corrective action as soon as possible before an investigator knocks at the door. The DOL's Voluntary Fiduciary Correction Program (VFCP) provides specific guidance on how to correct a late deposit.

Step 1

Deposit all outstanding delinquent amounts as soon as possible.

Step 2

Provide an additional contribution to participants to make them whole for any lost investment earnings. This is required even if the stock market has had negative returns during the timeframe in question.

The DOL provides an online calculator on its website to use to determine the lost earnings amount. The following information is required to use the calculator:

- Amount of late deferrals;
- Loss Date: The date the deferrals should have been deposited;
- Recovery Date: The date the deferrals were actually deposited; and
- Final Payment Date: The date the lost earnings amount will be deposited.

If multiple payrolls are delinquent, each must be entered separately into the calculator.

Step 3

Submit documentation of the correction to the DOL and request a no-action letter.

Some employers choose to make the corrective contributions but forego the formal submission. While that approach may make the participants whole, the employer does not have any assurance against DOL action and must still pay the excise tax. As long as the deferrals in question were not more than 180 days delinquent and the employer follows VFCP to apply for a no-action letter, the excise tax is waived.

Conclusion

The new safe harbor regulation greatly clarifies the deposit requirement for employers that sponsor smaller 401(k) plans. Those who choose not to avail themselves of this relief should carefully review their process for transmitting employee contributions to their plans and maintain careful documentation describing the amount of time it takes to complete the process each pay period as well as an explanation of why it cannot be completed more quickly.

The DOL has made it clear that it plans to continue actively enforcing the deposit timing rules, to ensure employee contributions are used for the purpose for which they were intended. Therefore, it is important for all plan sponsors to review their deposit procedures to ensure contributions are being made on a timely basis.

This newsletter is intended to provide general information on matters of interest in the area of qualified retirement plans and is distributed with the understanding that the publisher and distributor are not rendering legal, tax or other professional advice. You should not act or rely on any information in this newsletter without first seeking the advice of a qualified tax advisor such as an attorney or CPA.

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