When Does the Employer/Sponsor REALLY Have to Deposit Employee Deferrals into the Plan?

By Marty Heming, Esq.

The rules governing the deposit of 401(k) deferrals are found in the Department of Labor (DOL) ERISA regulations. Those rules state that deferrals must be put in the plan on the earliest date on which the contributions can reasonably be segregated from the employer's general assets, but in no event later than the 15th business day of the month following the month in which the deferrals were withheld.

When does that rule really require that the employee deferrals be deposited into the 401(k) trust?

Because the rule has a 15-day outer deadline, many employers assume that the deadline is the rule. Nothing could be further from the truth. In fact, the DOL enforcement activity focuses on when the deferrals could reasonably have been put in the trust — which is typically within days of the withholding — and long before the 15th business day of the following month.

The best indicator of when the contributions could have been deposited is to look at the actual deposit history. For example, if an employer has a bi-monthly payroll and makes the deposit of the deferrals from the month-end payroll within 10 days after the end of the month, then it is improper to hold the mid-month payroll and make the deposit at the same time. This is true despite the fact that it is administratively convenient. Moreover, if on several occasions the deposit is made within five days and at other times more than five days, and there is no compelling reason for the longer periods, the DOL would probably take the position that the later deposits violated ERISA.

Because the determination of when contributions can reasonably be deposited is based on the facts and circumstances of each case, it is difficult to give a uniform answer for when deposits must be made. Having said that, based on our experience in handling more than 100 of these cases, it is rare that an employer can prove to a DOL investigator that the deposit of the elective deferrals was properly delayed for more than 10 days. Accordingly, if the company's 401(k) elective contributions are not being deposited into the 401(k) trust within 10 days, the company may be violating ERISA's fiduciary and prohibited transaction rules. (As a word of caution, though, we have been involved in cases where the DOL asserted that all of the deposits could have — and, therefore, should have — been made within five days.) Moreover, on several occasions we have been successful in convincing the DOL to permit a delay of up to three weeks.

There are serious consequences for violation of the deposit rule. Failure to timely deposit 401(k) contributions is both a prohibited transaction and a fiduciary breach. It is treated as either a prohibited loan from the plan to the company or as an illegal taking of plan assets. As a result, the company should ensure that procedures are in place for the timely deposit of 401(k) deferrals.

Many third party administrators ("TPAs") ask what are their responsibilities concerning timely deposit of elective deferrals of their clients. Of course, the answer is it depends. If the TPA also is an ERISA fiduciary, then the TPA has a duty to warn the client of the fact that late deposit of deferrals is a violation of ERISA and must be corrected. If the client fails to correct, the TPA has a duty to report this to the DOL.

If the TPA is not an ERISA fiduciary, then his responsibilities to his client are based either on the terms of the written service contract, or if none, then the terms of the oral contract. Under these conditions, if the TPA learns that the deferrals are not being made in a timely manner his responsibility will be dictated by the contract. Generally, this means that the TPA should warn the client of the fact that the late deposit is an ERISA violation and should be corrected. If this warning goes unheeded, the TPA should consider resignation and/or reporting to the DOL. Finally, both TPAs and employers/sponsors should be aware correction of late deposit of 401(k) elective deferrals is a top investigation priority for the DOL and despite the current publicity, remains one of the most common problems for 401(k) plans.

Calculating Correction and Excise Tax

Once the plan employer/sponsor realizes that it is has been making elective deferral deposits to the plan later than is appropriate, what steps must be taken to satisfy the DOL that the problem has been corrected? First it must determine how many days each deposit is late. Once this has been ascertained by comparing the actual deposit dates against the ideal date, the amount of interest that the plan should have earned during the period that each deposit was late must be calculated.

Theoretically, the amount of the lost interest should be calculated using the amount that the plan earned for the

continued on page 8

NIPA Board member Marty Heming is a partner with the law firm of Reish Luftman & Reicher practicing exclusively in the area of employee benefits, emphasizing the resolution of controversies with the IRS, DOL and PBGC. He can be reached at martyheming@reish.com or (310) 478-5656.

2004 Business Management Conference *continued from page 1*

Dennis Snow: *Leadership Excellence*

Dennis Snow joined the group on Sunday to share his insights on developing the leader within. From his experiences, most leaders struggle with executing their visions rather than developing them. He emphasized how employees take cues from their employers: they watch to see how committed their leaders are before committing themselves. In other words, he maintained, business leaders need to "walk the talk" of organizational values in order to impart the importance to the entire workforce. Leading by example helps build organizational commitment to a vision and creates a culture of accountability. He stressed the need for all business leaders to continue to evolve as their businesses grow.

Michael Denning: *Dollars and Sense*

Michael Denning rounded out the BMC program with *Dollars and Sense* on Monday morning. He imparted to attendees some sensible business management principles that should always be applied. In addition to the need to make money and forge a successful company, business leaders should consider more than just selling more or cutting expenses. He emphasized the importance of pricing, productivity, diversification and acquisition; the approaches to equity building and income accretion are not mutually exclusive and should be considered as part of an overall owner's strategic plan. His discussion explored ways and means of arriving at the proper mix for an individual business and measuring success in doing so.

Peer Discussions

In this unique educational forum, attendees benefited from the collective knowledge of the entire group. A Leadership Discussion Panel following Sunday's General Session focused even more on the topics addressed during each presentation.

Roundtable Discussions, a new feature for the 2004 BMC, offered the opportunity to exchange views and share knowledge and opinions on operating efficiencies. Attendees separated into groups for facilitated discussions. At the conclusion of this exercise, each group presented the findings of their discussions to the entire group.

In addition to the formal presentations and discussion forums, the BMC's traditional Peer Interaction Groups offered peers a chance to share their professional success stories and pitfalls.

Thank You, Sponsors!

NIPA extends sincere thanks to all of this year's BMC Sponsors, whose support enables us to maintain our high standards of excellence:

When Does the Employer/Sponsor *continued from page 5*

period in question. However, regardless of the actual rate of return of the plan's assets, corrective interest must at least be equal to the IRS minimum rate specified by the DOL in its Voluntary Fiduciary Correction ("VFC") program. Moreover, it is acceptable to use a fixed rate that is at least equal to the commercially equivalent rate for the period, if it is not administratively feasible to ascertain the actual rate earned by the investments in the plan. Having determined the number of days the deposit was late, and the per day interest rate, the amount so calculated must be deposited to the plan. In addition, because the interest calculated should have itself have been deposited to the plan months, if not years ago, the interest so calculated must itself bear interest from the date it should have been deposited, i.e., the date the late deposit was made, until the date in the current year when the interest was in fact deposited to the plan.

After correction of the late deposit is complete, then the employer/sponsor must file a Form 5330 and calculate the amount of the excise tax on the late deposit as if such late deposit was a prohibited loan. The interest from the date of the payroll withholding until the date the elective deferral was put in then plan is the first "amount involved". Thus, the excise tax on this is calculated at 15% of the said interest. However, because the interest wasn't itself timely deposited, it became a second prohibited loan with a separate "amount involved" on which excise tax must be paid. For example, if the $54.80 is treated as a one-year loan, the excise tax is .15 times $54.80 or $8.22. However, in addition, the $5.48 (interest on the interest) is a loan for two years. The pyramided result is that in year one the excise tax on $5.48 is $.82 and in year two is $.82 + {$5.48+$.82} {.15} or $.95 or $1.77.

As can be seen from the above examples, the total amount of the interest to be paid to the plan and the excise tax to be paid to the IRS is, in most cases, a very small number. Nevertheless, the biggest cost is usually re-administration of the plan, and then making sure all of the affected participants are made whole, including, in many cases, locating lost participants. Accordingly, the employer/sponsor must be educated to realize that it is much simpler and cheaper to do it correctly in the first instance, rather than to be forced to make corrections after the fact. ✷