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A MISTAKE A DAY: TOP 5 401(K) COMPLIANCE MISTAKES & BEST PRACTICES

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This week, we are discussing the five most common compliance mistakes made by 401(k) plan administrators and fiduciaries, the potential liability associated with such mistakes, and steps you can take to avoid making them yourself.

On Monday, we discussed failures to timely update plan documents.

On Tuesday, we discussed an SPD's failure to accurately describe the terms of a plan.

On Wednesday, we discussed a plan's definition of compensation.

In this, our penultimate post, we discuss the most common mistake of all: delinquent contributions.

<u>Delinquent Contributions</u>

Description

Employers are required to contribute employees' elective deferrals to the plan on the earliest date that the contributions can reasonably be segregated from the employer's general assets, and in no event later than the fifteenth (15^{th}) business day of the month following the month in which the participant contributions are withheld or received by the employer. The Department of Labor takes the position that this rule requires the employer to deposit elective deferrals into the plan trust as soon as reasonably practicable – which would in virtually all cases be significantly sooner than the above described outside limit. An employer's deposit history may establish a basis for what is possible. When employers contribute withheld amounts later than the time frame described above, the contributions are considered delinquent.

Potential Liability

When an employer mixes an employee's contribution to a 401(k) plan with its general assets longer than necessary, it engages in a prohibited transaction. To correct this mistake, in addition to contributing the delinquent amount plus lost earnings to the Plan, a plan administrator must file Form 5330 and pay the resulting excise taxes, 15% of the amount involved for each year the prohibited transaction remains uncorrected (100% if the error remains uncorrected beyond the taxable period). Additionally, the mistake must be reported on the plan's annual Form 5500.

Example

An employee directs that 5% of compensation be withheld from his/her November 1 paycheck and paid into the employer's 401(k) plan. The employer typically deposits the deferrals into the 401(k) plan within 2 days. However, the employer does not contribute the employee's deferrals to the 401(k) plan until November 7. This contribution is arguably delinquent because it was made later than the 2 day contribution timeframe established with respect to previous contributions. In this case, the amount was withheld November 1, so the IRS would likely take the position that the employer should have contributed the amount to its 401(k) plan no later than November 3rd.

The Fix

The way to avoid delinquent contributions is obvious: deposit employees' 401(k) deferrals on the earliest date that they can reasonably be segregated from the employer's general assets. Pay particular attention when switching plan administrators or payroll vendors, or when modifying payroll programs, as this is when failures commonly occur. Also, review regularly for compliance because these failures can be self-corrected with relatively little pain if discovered early. The Department of Labor's Voluntary Fiduciary Correction Program ("VFCP") provides a vehicle through which delinquent contributions may be formally corrected.

RELATED PRACTICE AREAS

- Employee Benefits & Executive Compensation

MEET THE TEAM

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