Correcting Late Deposits

An ounce of prevention is worth a pound of cure

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One of the Department of Labor's (DOL) biggest concerns regarding retirement plans is the deposit timing of employee contributions. For many years, the DOL's regulations regarding the deposits of employee contributions (401(k) deferral and loan repayments) stated that the employer must deposit deferral and loan repayments on "the earliest date on which such contributions can be reasonably segregated from the employer's general assets, but in no event later than the 15th business day following the pay date." However, the DOL stressed that the **earliest date** was the most important part of that sentence and continues to audit and penalize plans for not making their deferral deposits in a more timely manner. Luckily, recently passed law allows small plans (under 100 participants) to deposit deferrals and loan repayments within seven (7) business days following a pay date. That's good news—but if you haven't met this standard, there is a price to pay.

What's the correction?

Late deposits of employee deferral and loan repayments must be reported on the annual Form 5500. The late payments must be recorded every year until they are corrected. If there are amounts reported that are not corrected, you will be increasing your chances of a DOL audit. Correcting the late deposits includes several steps. The plan sponsor must reimburse the plan participants for any "lost opportunity costs" or "make them whole" for their contributions that were not invested in a timely manner. The plan sponsor must also file a Form 5330 and pay an excise tax equal to 15% on the amount of the correction of the lost opportunity costs. There are two different methods for correcting the late deposits of deferral and loan repayments.

1) The DOL Voluntary Fiduciary Compliance Program (VFCP)

The VFCP is a program that allows you to report your late deposits to the DOL. In exchange for applying under VFCP to correct the late deposits, the DOL will issue a "no action" letter that states they will not recommend your plan for audit based on this issue. There are pros and cons to the VFCP program. The desirable attributes of the program are: 1) you are able to use the set IRS interest rate for underpayment (usually 4-6%), which could be much less than the actual plan earnings; 2) If the excise tax is less than $100, you do not have to file the Form 5330; 3) If you give notice to the participants, you can skip paying the excise tax altogether. The undesirable parts are 1) The application is time consuming and cumbersome, so much that it often costs more time to prepare than the amount of the lost earnings; 2) You have to notify the participants if you want to avoid the excise tax.

2) Self-Correction

Correcting the late deposits without going through the VFCP is usually more cost effective. The downside is that you must use the greater of the plan's actual rate of return or the IRS underpayment rate. In some years, this could be a big number. However, self correction involves much less paperwork and can be handled much quicker.

Once the amount of "lost earnings" has been computed, these earnings must be allocated back to the participants in an equitable manner. Often, the DOL will allow the restoration of earnings to just those participants who have a current account balance in the plan. This is great news since trying to track down terminated participants to pay them a small amount of interest would be very time consuming.

After the correction of the late deposits, processes and procedures should be implemented to ensure that this error does not occur again in the future. Often, a payroll company will mail a check or send a wire to the investment company for the amount of the deferrals plus loan repayments. For many plans, we will process an ACH pull from a plan sponsor's corporate account to the plan account on the date of the payroll to keep the deposits timely. Whatever your circumstance, we can use our expertise to help you correct any problems and find a solution for the future!