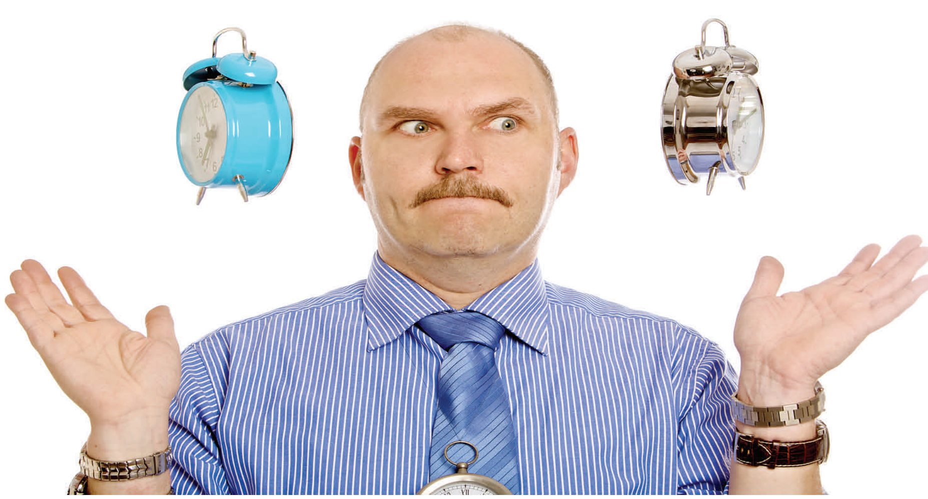
Handling Employee Contributions

Are you protecting your plan from late deferral and loan payments?

The deadlines for depositing employee contributions (such as 401(k) deferrals and loan repayments) might be one of the most misunderstood laws in the field of retirement plans. Proper handling of these contributions is one of the most important duties a plan sponsor has. It is vital the employee 401(k) deferrals and loan repayments be deposited promptly. Otherwise, the employer will incur significant expenses to correct and report the failure. Take steps now to ensure your plan is protected.



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What's the big deal?

To understand why the timing of employee contributions is so important, you have to understand how the different government agencies that regulate the contributions view the issue. The Internal Revenue Service (IRS) deals mostly with employer deductions, non-discriminatory allocations and other tax matters. The Department of Labor (DOL) addresses fiduciary and trustee issues. The DOL is the main agency that oversees the timing of employee contributions.

The DOL states that the employer must deposit the deferrals and loan repayments "on the earliest date on which such contributions can be reasonably segregated from the employer's general assets." The regulations goes on to say that in no event may the deposits be made later than the 15th business day of the month following the pay date. Some plan sponsors interpret this to mean that they have until the 15th business day to make their deposits. However, the DOL has stated that the real deadline is **on the earliest date** which translates into "as soon as possible" and the DOL has shown through their audit practices that they will consider this timing to be 2-3 business days in most cases (or about the same timing as federal tax deposits).

In recent years, the DOL has issued a "bright-line" test for small plans. Small plans are those with less than 100 participants. Small plans will be treated as complying with the regulations if their employee deferrals and loan repayments are deposited to the plan no later than the 7th business day following the pay date in which the contributions were withheld. Plans with more than 100 participants do not have this rule and must continue to deposit "as soon as possible" or within 2-3 business days.

The DOL implemented these rules due to abuses by employers, including the employer's use of employee deferrals as "loans" to the company to avoid bankruptcy. The DOL rules are issued to protect the employee contributions from being used for general business expenses or from having a creditor put a lien on the funds. The main goal is to protect the employees' money as it travels from their paycheck to the plan.

Remember, that the regulation addresses every pay date. It is not acceptable to hold all deferrals and deposit them in a "batch" at the end of the month. If it is too difficult or costly to compute the investment splits each pay, the plan may send the employee contributions to the plan and have them sit in cash until they are invested, or even send them to a checking account in the plan's name. The point is that they must be segregated in some way from the general assets of the employer.

So, what's the big deal? A question on the annual Form 5500 asks about late employee contributions. Not only is the form a matter of public record, but it will greatly increase the chances of a DOL audit if late deposits are not corrected. There are also significant penalties for providing false information on the Form 5500. So, it is important to establish quick and accurate procedures for the timely remittance of employee contributions to avoid problems in the future.