Are You Depositing Salary Deferrals On Time?

By design 401(k) plans allow employees to share in building their retirement nest egg. Plan participants can elect to defer receipt of a portion of their pay, and instead contribute that amount to the plan. To protect participants' contributions, these "salary deferrals" are subject to special rules regarding when they must be deposited to the plan. One of your most important duties as the plan sponsor is to make sure these salary deferrals are deposited promptly in compliance with the deposit timing rules.

The Rule: Timing of Deposits

Department of Labor (DOL) rules provide that you must deposit salary deferrals to the plan on the *earliest date* that the deferrals can reasonably be segregated from your company's general assets. This means deposits must be made ASAP! For smaller companies, the "earliest date" could be within a few days of payroll, while larger companies with multiple locations may take longer. Under no circumstances may salary deferrals be deposited later than the 15th business day of the month following payroll. However, be careful using the 15-day limit! If your facts and circumstances show that you can make the deposit on an earlier date, then you must deposit salary deferrals by that earlier date to be considered deposited timely!

To help you comply with the deposit timing rules, the DOL offers a "safe harbor." If your plan has less than 100 participants, your deposit is considered timely if it is made within 7 business days after payroll, even if you were able to deposit salary deferrals earlier. If you don't deposit salary deferrals within 7 business days after you withhold them, or if your plan has 100 or more participants, to comply with the timing rules you will need to demonstrate that deferrals were deposited as soon as reasonably possible.

The Problem: Late Deposits

Failure to timely deposit salary deferrals results in a breach of your fiduciary duty as well as a prohibited transaction between you and the plan, requiring you to pay the IRS a 15% excise tax each year the error is not fully corrected. To make up for salary deferrals not being invested timely, you must deposit "lost earnings" for all affected participants. Late deposits must be reported on the plan's Form 5500 Return. And, if the plan document states a deposit timeframe that hasn't been followed, the plan's tax-qualified status could be at risk.

Required Corrective Action

- Deposit late salary deferrals.
- Deposit lost earnings.
- Report late deposits on the plan's annual return, Form 5500, until fully corrected.
- Pay a 15% excise tax with Form 5330 each year the late deposit is not fully corrected.

Optional Correction Programs

- In exchange for filing under the Voluntary Fiduciary Correction Program, the DOL will not assess a civil penalty on the deposit error.
- Deposits that don't comply with a plan's terms can be corrected under the IRS' Employee Plans Compliance Resolution System.

Failure to comply with the deposit timing rules can be costly. Please contact us for more information on how we can help you review your procedures for depositing salary deferrals and correct any deficiencies in the process.

Despite your best efforts, mistakes happen. Notify us of any late deposits ASAP so we can work together to fully correct the problem and prepare any filings under the IRS and/or DOL correction programs.

The deposit timing rules apply to:

- *Pre-tax salary deferrals*
- *Designated Roth contributions*
- *After-tax employee contributions*
- *Participant loan repayments*

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