**Late Deposit of Salary Deferrals - Fixing Common Plan Mistakes**

Employers with 401(k) plans are responsible for depositing their employees’ salary deferrals to the plan’s trust on the earliest date that the deferrals can reasonably be segregated from the employer’s general assets.

The earliest date is based on individual facts and circumstances. If your plan has fewer than 100 participants, your deposit is considered timely if it’s made within 7 business days after you withhold the salary deferrals even if you were able to deposit them earlier. If you don't deposit the salary deferrals within 7 business days after you receive or withhold them, then your individual facts and circumstances will determine whether your deposit was considered timely. For larger plans (100 participants or more), the determination of whether the deposit was timely is based on the individual employer’s facts and circumstances.

Regardless of your individual facts and circumstances, you must deposit the salary deferrals no later than 15 business days in the month following the month in which the amounts would otherwise have been payable to your employees in cash. If your facts and circumstances show that you could have made the deposit on an earlier date, then you must have deposited your salary deferrals by that earlier date for them to be considered timely.

**The problem**

Failing to timely deposit withheld salary deferrals to the plan is a plan error.

**Consequences of not segregating and depositing salary deferrals timely**

* Failing to timely deposit salary deferrals:
  + is a fiduciary violation and could subject your plan to the Department of Labor’s civil penalties.
  + could violate your plan’s terms and jeopardize your plan’s tax-exempt status
* Failing to segregate salary deferrals from your general assets and timely forwarding them to the plan’s trust allows you prohibited use of plan assets. This can result in you engaging in a [prohibited transaction](http://www.irs.gov/Retirement-Plans/Plan-Participant,-Employee/Retirement-Topics---Prohibited-Transactions) for which you can be assessed excise tax.

**The fix - correction programs available to correct this mistake**

* **DOL’s Voluntary Fiduciary Correction Program**You can correct the fiduciary violation for failing to timely deposit salary deferrals using the DOL’s [Voluntary Fiduciary Correction Program](http://apps.irs.gov/app/scripts/exit.jsp?dest=http://www.dol.gov/ebsa/newsroom/fs2006vfcp.html). VFCP isn't available if your plan is under a DOL investigation or an IRS examination.
* **DOL’s prohibited tax class exemption in conjunction with VFCP**You may also be eligible to take advantage of the prohibited tax class exemption in conjunction with VFCP if you:
  + deposited the salary deferrals to the plan’s trust within 180 days from the date the amounts would otherwise have been payable to the employees in cash;
  + satisfied all VFCP requirements;
  + received a no-action letter for your VFCP application; and
  + notified all interested persons in writing within 60 days of submitting your VFCP application. There is an exception to this notice requirement if:
    - your excise tax liability would have been $100 or less;
    - you contributed the amount of your excise tax liability to the plan; and
    - you allocated this amount to participants and beneficiaries according to the plan’s terms for allocating plan earnings.

If the transaction qualifies for the prohibited transactions class exemption, then you won't be liable for excise tax under IRC Section [4975](http://apps.irs.gov/app/scripts/exit.jsp?dest=http://www.law.cornell.edu/uscode/usc_sec_26_00004975----000-.html).

* **IRS Employee Plans Compliance Resolution System**If your plan’s tax-exempt status is in jeopardy, then you can use the IRS [Employee Plans Compliance Resolution System](http://www.irs.gov/Retirement-Plans/Correcting-Plan-Errors).
  + If your plan is **not** under IRS examination and meets the other eligibility requirements, you can use either the [self-correction](http://www.irs.gov/Retirement-Plans/Correcting-Plan-Errors---Self-Correction-Program-(SCP)-–-General-Description) or [voluntary correction](http://www.irs.gov/Retirement-Plans/Correcting-Plan-Errors-–-Voluntary-Correction-Program-(VCP)-–-General-Description) programs.
  + If your plan **is** under examination, you can still self-correct if the failure is insignificant, or you can resolve the issue in a closing agreement through [Audit CAP](http://www.irs.gov/Retirement-Plans/Correcting-Plan-Errors-–-Audit-Closing-Agreement-Program-(Audit-CAP)-–-General-Description).

**DOL and IRS correction programs are not interchangeable**

The goal of the DOL's VFCP is to ensure that the employer isn't subject to DOL’s civil penalties. The goal of the IRS’s correction programs, including VCP, is to ensure that the plan doesn't lose tax benefits arising from its qualified status. It is critical that you know what your objectives are before deciding which program you want to use. Also, you may use both the DOL and IRS programs if you have a dual objective of avoiding the imposition of DOL’s civil penalties and the IRS’s revocation of your plan’s qualified status.

**The fix - correcting the mistake**

* *Salary deferrals never deposited* - If you failed to deposit salary deferrals to the plan, then you must make corrective contributions in the amount of the salary deferrals you should have timely deposited adjusted for earnings. The adjustment for earnings is measured from the earliest date you could have segregated the salary deferrals from your general assets to the date you actually make the corrective contributions.
* *Late deposit* - If you deposited the salary deferrals, but not timely, then to correct this mistake, you must contribute the earnings on the late deposited salary deferrals. Earnings are what the late deposited deferrals would have earned measured from the earliest date you could have segregated them from your general assets to the date you actually deposited them to the plan.

**Differences in the earning adjustment under DOL and IRS programs**  
The general premise of both the DOL VFCP and IRS correction programs is to restore the plan to the position it would have been had you timely deposited the salary deferrals. However, the earnings calculation in both programs could be different.

* *DOL’s VFCP* - earnings are determined using the greater of:
  + lost earnings (earnings that the plan would have earned if you had timely deposited the salary deferrals), or
  + restoration of profits (the profit you earned that is directly attributable to your investment of the salary deferrals that weren’t timely deposited).

You can use DOL’s online calculator when using VFCP to calculate earnings.

* *IRS correction program* - earnings are generally determined based on what the plan would have earned had you timely deposited the salary deferrals. The IRS correction programs do, however, allow you to use reasonable estimates (including the DOL’s online calculator) to calculate the earnings on the late deposited salary deferrals if either:
  + it’s possible to make a precise calculation but:
    - the probable difference between the approximate and the precise restoration of participants’ benefits is insignificant, **and**
    - the administrative cost of determining precise restoration would significantly exceed the probable difference, or
  + it’s not possible to make a precise calculation (for example, where it’s impossible to obtain plan data).

**Making sure it doesn’t happen again**

Establish a procedure for depositing elective deferrals with or after each payroll date, or according to the terms in your plan document. If you have instances when your deferral deposits are later than the normal timely deposit (because of vacations or other disruptions, for example), keep a record of why those deposits were late. Coordinate with your payroll provider and others who provide service to your plan to determine the earliest date you can reasonably make deferral deposits. The date and related deposit procedures should match your plan document provisions, if any, dealing with this issue. If you have a change in the person in charge of making these deposits, make certain the new person understands when he or she must make these deposits.

Keep in mind that despite all of your good efforts, mistakes happen. In that case, the IRS can help you correct the problem so that you retain the benefits of your qualified plan.

*Page Last Reviewed or Updated: 12-Dec-2012*

*From IRS Website*