Late Remittances and Lost Earnings

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Late remittances of salary deferrals and loan payments ("participant contributions") are almost a fact of life. They can happen to anyone, regardless of the size of the company. They occur for a variety of reasons. Sometimes, there is a change in plan management that causes a delay, sometimes it's just human error, and sometimes employers don't even know there is a deposit deadline. Regardless of how it comes about, however, late remittances are simple to correct.

Today, we discuss what late remittances are, how to fix them when they happen, as well as some best practices to reduce the likelihood of making late deposits in the future.

I'm Late, I'm Late!

A late remittance occurs when the employer doesn't segregate participant contributions from its general assets in a timely manner. Determining if there has been a late remittance requires asking three questions.

The first question is an easy one: are participant contributions at issue? (There are timing rules for employer contributions, too, but that's a subject for another Flash.)

The second question: when were these participant contributions segregated from the employer's general assets? It's important to note that these timing rules aren't concerned necessarily with the date these contributions are actually deposited into the trust or the date they post to the participant accounts. The important issue is when the contributions cease to be part of the general assets of the employer. Usually this occurs when the deposit is sent to the fundholder for the plan. However, this nuance becomes important during situations where that step may be delayed, such as when the plan is in the middle of transitioning from one service provider to another and neither is able to accept the deposit.

The third question: is the remittance of the participant contributions actually late? This is the trickiest to answer, and probably where we see the most mistakes. The Department of Labor (DOL) requires that the employer deposit participant contributions as soon as possible, but not later than the 15th business day of the following month. It's important to note that this 15-day window is **not** a safe harbor due date, but is the maximum allowable time. The DOL applies the "as soon as possible" part of the rule stringently, and only will accept remittances that late in extraordinarily rare and difficult circumstances. The DOL does offer a safe harbor deadline of seven business days after the payroll date for employers with fewer than 100 participants at the beginning of the plan year. For larger plans, the DOL requires the employer to segregate the contributions as quickly as possible after the payroll date and expects that to be within two or three days.

For example, let's say you normally send the participant contributions to the fundholder for the Plan within five business days of the amounts being withheld from payroll. This deadline is met every pay period of the year, except for one. For one payroll in October, everything aligned for you, and you were able to move the contributions in only three days. You've now established that it is possible for you to remit the contributions in three days, so the DOL could consider the deposit for every other pay period to be two days late.

What Do I Owe You?

If you've determined that late remittances did occur, what do you do to fix it?

In addition to the contributions that were withheld, the participants are also entitled to the earnings those amounts would have made had they been contributed timely, i.e., the period between the expected deposit date and the date of the actual deposit (the "earnings period"). So, if the contributions weren't deposited until 30 days after they should have been, they are 30 days late and the participants are entitled to earnings for that 30-day period.

The DOL requires that, if possible, these lost earnings be based on the actual return the participant contributions would have earned during the earnings period. Some custodians can calculate this based on the actual investment menu selected by each affected participant. Alternatively, the DOL permits the plan to determine the available investment that had the highest rate of return for the period in question and apply that rate for the earnings period. In cases when the market may have fluctuated wildly and the highest rate of return is unreasonably high and was generated by an investment option that was rarely used by any participants, the DOL occasionally accepts the weighted-average rate of return for the plan as a whole.

Once the rate for the lost earnings has been determined, that rate is then applied to the participant contribution for the duration of the earnings period. So, using the 30-day earnings period stated above, whatever rate of return is being used will be applied to the late participant contributions for the 30-day earnings period.

The DOL provides a calculator for lost earnings, but that may be used only if the employer files the late remittance under the DOL's Voluntary Fiduciary Correction Program (VFCP). This program permits the employer to get official DOL forgiveness for the late deposit and also waives applicable excise taxes (which are discussed below), but the costs of preparing the filing is commonly more expensive than the penalties. As a result, it is rarely used. Occasionally, if determining the earnings based on actual rates of return would be extraordinarily costly or difficult, the employer will be permitted to DOL's calculator. However, this is somewhat risky, and using actual earnings is safer.

What Else Do I Need to Do?

The DOL considers late deposits of participant contributions to be a loan from the plan (who "owns" the contributions) and the employer. This kind of loan is a prohibited transaction. The process discussed above corrects the prohibited transaction, but the IRS also levies an excise tax equal to 15% of the interest on the loan – i.e., the lost earnings that are deposited by the employer as part of the correction. This excise tax is reported and paid through the filing of Form 5330 with the IRS, and is due seven months after the employer's year end. This is usually a nominal amount, but be careful: there is no minimum amount that requires the payment of the excise tax. It is *always* due when there is a late remittance.

Additionally, the Form 5500 has a question that asks if there were any late deposits. You must indicate on the Form 5500 that they occurred. (Remember that the Form 5500 is filed under penalty of perjury, so you can be prosecuted for intentionally answering the question incorrectly.) Occasionally, this may result in the DOL inviting you to file under VFCP or to attend one of its presentations on avoiding late contributions in the future. Neither VFCP nor attendance at such a program is required.

Steer Clear

The correction process for late remittances is normally pretty painless, but it is best just to avoid late remittances altogether. Here are some best practices for this:

1. *Set a comfortable timeframe for sending in participant contributions and stick to it*. This should not be more than the seven-day deadline for a small plan, or two or three days for a larger plan. Remember that, in the event of a DOL audit, an earlier deposit can set a standard that is faster than you can usually make, so consistency is critical.
2. *Be careful when changing providers*. If there is a period of time when you're changing service providers and you don't have a place to send the contributions, you can always set up an interest-bearing account in the Plan's name with your bank to hold those contributions. This constitutes the "segregation from general assets" that you are required to do. Once the new provide can accept the money, you can transfer it and close the account.
3. *Correct properly and completely.* If you make a mistake, no problem. Just be sure to deposit the money as soon as possible, pay the lost earnings, and file the Form 5330 with the excise tax.

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