

# 401(k) Plan Sponsors Need To Sweat The Small Stuff

By Ary Rosenbaum, Esq.

**T**hey say that you shouldn't sweat the small stuff. As a kid from Brooklyn, I do sweat the small stuff. When they say that you shouldn't sweat the small stuff, they mean that you should not focus your energy on things that don't hold significant importance in your life. The problem is that you're a 401(k) plan sponsor and a plan fiduciary, so you have to sweat everything and it's the smallest of things that led to the most problems. This article is about the small stuff that 401(k) plan sponsors need to sweat on.

## Not suggesting you don't sweat the big stuff

It's hard to believe I've been an ERISA attorney for 25 years. Like Farmer's Insurance, I know a thing or two because I've seen a thing or two. Like Caine in the TV show, Kung Fu, I have seen many things in my travels. I know 3 people who went to Federal Prison for stealing from plan assets. I had a client being sued by the Department of Labor (DOL) because the actuary gave bad advice and provided no reporting, leading the DOL to believe the owner was embezzling money. I had a client who had a \$3 million defined benefit plan that had all the investments with a financial advisor named Bernie Madoff. I have seen catastrophes and criminal activity, but the big errors like theft and fraud, but those issues are few and far between. You should always sweat the big stuff, but most issues regarding 401(k) plans are about small issues. You don't have to

be George Costanza and proclaim you had no idea what you did was wrong, the big issues are pretty straightforward and common sense, like the Ten Commandments. Thou shalt not steal, that's pretty easy. Thou shalt deposit deferrals on a timely basis, it's not your money. It's common sense that you shouldn't worry about the big stuff.

## That ERISA bond

If you sponsor a 401(k) plan that covers non-owner employees, as a plan fiduciary,

must be answered under penalties of perjury, so you have to be truthful. If you're not properly bonded by not having one or having too low an amount and that answer is reflected on Form 5500, that is an issue. The reason it's an issue is because an answer that you're not properly bonded can be a trigger for an Internal Revenue Service (IRS) or DOL audit. Most of the time, government audits are random, so why give the government a reason for an audit because of a silly mistake? In addition, many plan sponsors think they have an ERISA bond, but they don't because it's actually a crime policy. If you have any questions concerning ERISA bond coverage, call your friendly neighborhood ERISA attorney (yours truly) or your well-seasoned and knowledgeable insurance broker.

## Definition of Compensation

I worked for a union law firm for about a year because I was an odd fit. I'm all for collective bargaining, but I'm more concerned with being efficient for my



you must be bonded for at least 10% of the amount of assets in the plan, subject to a minimum bond amount of \$1,000 per plan. The maximum bond amount that can be required is \$500,000 per plan. However, the maximum required bond amount is \$1 million for plans holding employer securities. Annually, you have to file a Form 5500 for your plan and the form will ask you whether you are properly bonded. That question

clients. In 13 years on my own, I've never had a client complain about my bill. So for this union law firm, a client needed an ancillary 401(k) amendment to conform the plan to new 401(k) regulations. I wanted to use an amendment produced by a plan document publisher I work with, so the client would pay a few hundred dollars for the amendment. The ERISA partner wanted me to draft the amendment from scratch

and probably charge 100 times more. I come from a school where less is more and K.I.S.S. (keep it simple stupid). I worked for 10 years as an attorney for third-party administration (TPA) firms and I still have a handful of TPA clients. As they said in This Is Spinal Tap: "There is a fine line between clever and stupid." I like plan provisions that are simple and not out of the box, to promote easy administration. For the definition of Compensation, I like W-2 and that's it. It is simple, stupid (not calling you stupid). I understand that employers may want to



exclude bonuses, taxable fringe benefits, and car allowances. The problem is like with the proverb: "for the want of a nail." While you may not want to allow salary deferrals and employer contributions on some forms of compensation, you're opening up yourself to potential plan errors. The errors may be because the TPA got it wrong or you got it wrong. For example, if you think compensation excludes bonuses and the plan document doesn't, you will be on the hook for corrective contributions. Not only will you have to make corrective employer contributions (if you made them), but you will also have to fork over a fully vested employer contribution to compensate participants for their missed opportunity to defer on that money. Just because I think plan provisions should be simple, I understand why you may want to exclude certain forms of compensation. If you think you exclude forms of compensation, you can't sweat the small stuff and make sure that your definition squares with what the plan document says, and how the plan is administered.

### **The compliance tests**

For your plan to be qualified for all those financial tax-deferred benefits and tax deductions, you need to comply with the Internal Revenue Code. That means compliance testing to make sure your plan doesn't discriminate in favor of highly compensated employees. While I don't want to bore you with the details of coverage, Top

Heavy, and the ADP/ACP tests, you need to know they exist and that the testing needs to be correct. For example, if your highly compensated employees (\$155,000 for 2024) defer more than 2% more than non-highly compensated employees, you either have to provide deferral refunds or more expensively, make corrective contributions to non-highly compensated employees. The problem is if the testing is incorrect and you discover it years later, your only option is to make that corrective contribution. Most small and medium-sized businesses opt for refunds since no money leaves their coffers. Compliance testing has to be correct. The TPA has to do it correctly, but so must the data you send them. If you provide incorrect testing data, it becomes "garbage in, garbage out." You need to fully answer the TPA's census request, and identify the owners and their relatives, as well as any other businesses with similar ownership. Make sure the payroll data is correct. Generally, I don't like surprises and I hate testing surprises when you find out facts, years after they were supposed to be disclosed. Testing failures are easier and cheaper to fix than when they're detected much later. I've had plan sponsors right checks for 6 digits to fix failed compliance tests, which could have been cheaper if they were fixed when they were first performed.

### **Loans**

There is nothing wrong with offering loans to plan participants. It's their money

and if they need it for a rainy day, it's there for them. What I suggest is making sure that errors aren't made. You need to make sure that payroll payments by participants are made to pay off their loans, per their promissory note. Failure to make a payment for a quarter of a year can make these plans defaulted and taxable to participants. The best way to avoid errors is to limit loans to a \$1,000 minimum and one loan outstanding at a time. Again, K.I.S.S. and less is more.

### **Notices and House-keeping**

This plan is subject to ERISA and that law was promulgated to protect retirement plan participants. You have notice requirements under the Internal Revenue Code and ERISA, you need to make sure that participants receive every required notice. In addition, you need to make sure that participants get enough information to make informed investment decisions when they make the investments in your plan. That means hiring a financial advisor who can help you manage the methodology and criteria in investment selection, and provide investment education to minimize your liability.

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