These Small Things That 401(k) Plan Sponsors Shouldn't Neglect

By Ary Rosenbaum, Esq.

When it comes to certain Jewish holidays, I am more observant with some more than others. One of my favorite holidays is Passover, where I don't eat leavened items from five species of grain (wheat, barley, and three similar grains) for 8 days. One of the dumb rules out there for Jews of Europe (Ashkenazic, which I'm unfortunately part of it), is we also don't eat Kitniyot, which includes rice, corn, sunflower seeds, sesame seeds, beans, peas, and lentils. While the definition of Kitniyot in Hebrew is legumes, it encompasses "these little things." When it comes to 401(k) plan sponsors, little things can cost employers a lot of grief on an Internal Revenue Service or Department of Labor audit. This article is about little things that plan sponsors should focus on.

The Late Deposit of Salary Deferrals

The bulk of 401(k) plan assets are funded by the salary deferrals of your employees. It stands to reason that if it's their money, it should be invested in the investment options that a participant selects as soon as possible. Years ago, plan sponsors followed a Department of Labor (DOL) safe harbor that said they could deposit employee salary deferrals into the 401(k) plan as long as it was done by the 15th business day of the following month. The only problem is that DOL reinterpreted the safe harbor and essentially said that you need to deposit salary deferrals as quickly as possible. So you must understand that you have to get your deferrals into the plan's trust as soon as possible, essentially just a few days after taking out the deferrals through payroll. The reason you need to deposit the deferrals as quickly as possible is that late deferral deposits are a question on Form 5500, so any late deposits must be corrected using the DOL's voluntary compliance program unless you want the DOL to audit you based on your yes answer to the late deposits. The DOL is floating the idea that they will allow a plan sponsor to self-correct without a voluntary compliance program application because they must be inundated with applications since it's such a frequent error. It is one of the easiest and most frequent plan errors, so depositing deferrals as soon as you can is one of those small things you need to take care of.

Getting the right definition of Compensation

One of those small things that have tripped up 401(k) plan sponsors is the definition of Compensation. The problem is that the definition of Compensation in the plan document may say one thing and the administration of the plan says another. One example of this problem is when a 401(k) plan sponsor pays out bonuses without taking out salary deferrals and making employer contributions based on it because they assume the plan document definition of Compensation doesn't include it when it actually does. Not allowing participants to defer their bonus or failing to make employer contributions on bonuses, despite being included in the definition of compensation would require you to make corrective contributions that are going to come out of your pockets. When it comes to the definition of Compensation, don't be cute. A lot of errors happen when a 401(k) plan sponsor has a definition of compensation that is outside the normal W-2 or 415 or 414(s) definition of compensation, usually by excluding a certain part of salary such as fringe benefits, vacation time, or a car allowance. Any out-of-the-box definition of compensation may lead to errors by improperly including this party of salary in compensation, so it's my advice that you try to keep it as simple as possible by using the basic W-2 compensation. The problem with these compensation issues is that the errors aren't usually one and done, they are usually errors that last several years and are only discovered many years later. I was once contacted by a bank that had a 401(k) plan where bonuses weren't included in the definition of compensation as required for over 20 years, even their auditors didn't pick up on the error. So it's important that you pick a basic definition of compensation and annually review that the plan document is consistent with plan operation.

Filling out the census information request correctly

Annually, your third-party administrator (TPA) will send you a census request in order for them to properly perform the required compliance testing on your plan. They can't complete it if you don't fill out the census. They will also not perform it accurately if you don't fill out the census information correctly. As I say: it's garbage in and garbage out, which means that if you don't answer correctly, your testing will likely be wrong. The census request not only asks about your employees and their salaries, but it will also ask you the ownership business breakdown of your business and any interests you own in other businesses. Answering the ownership breakdown of your business and other companies is extremely important because there might be a controlled group or affiliated service group issues that might have coverage issues and be costly to fix if not detected early. Filling out a census might be a small thing, but the information must be correct.

Use of forfeitures

In a 401(k) plan, a "forfeiture" refers to the non-vested portion of a former employee's employer contribution account balance in the plan. For example, if a participant is 40% vested in their profit-sharing account source when he or she terminates, the remaining 60% of his or her profit-sharing account balance will become a forfeiture. An employee is always fully vested in their salary deferrals. The problem with forfeitures is that the plan document specifies what can be done with them and the plan sponsor may forget that. They can be used to pay administrative expenses, they can be reallocated to remaining participants as an employer contribution, or used to reduce an employer contribution. Many 401(k) plan sponsors forget to follow the terms of the plan and the forfeitures grow from year to year until it becomes a huge war chest. Thankfully, the Internal Revenue Service (IRS) has created proposed regulations that give guidance to 401(k) plan sponsors as to how to dispose of forfeitures. The proposed regulations expand and amend the general regulation on forfeitures, which clarifies that forfeitures in 401(k) plans must be used or allocated under the terms of the plan no later than 12 months following the close of the plan year in which the forfeitures occurred. Under a transition rule, any forfeitures incurred before January 1, 2024, will be treated as if they were first forfeited in the first plan year beginning on or after January 1, 2024. The new regulation states that a 401(k) plan may use forfeitures for one or more of these purposes: payment of plan administrative expenses; to reduce employer contributions; and; reallocated to plan participants as an additional employer contribution. Don't be like many 401(k) plan sponsors and. neglect the terms of your plan, as it pertains to forfeitures. It's not a mistake you want the IRS and DOL to find out.

Not having the right ERISA bond coverage

Fidelity bonds are a form of insurance against illegal acts. The coverage required by the Employee Retirement Income Security Act (ERISA) is usually called an ERISA fidelity bond, as it is specifically limited to financial losses from employee benefit plans, and not, for example, from a company's general coffers. It is also known as a fiduciary bond. When a plan fiduciary steals or embezzles from the plan, the ERISA fidelity bond will cover those losses up to the coverage limit. If you have employees, your plan is subject to ERISA and it is required that every fiduciary of the plan be bonded. The fidelity bond must be at no less than 10% of plan assets with a minimum of $1,000 and a maximum of $500,000. If you don't have a fidelity bond in place or don't have enough coverage, you are supposed to note that on Form 5500 and that alone is a trigger for an audit by the government. One of the small things you do need to take care of, is making sure that your ERISA bond meets that 10% requirement, it may have to be increased as your assets increase.

THE ROSENBAUM LAW FIRM P.C.

The Rosenbaum Law Firm P.C.
734 Franklin Avenue, Suite 302
Garden City, New York 11530
(516) 594-1557

http://www.therosenbaumlawfirm.com
Follow us on Twitter @rosenbaumlaw