

Qualified Retirement Plans
Practice Alert
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Seven Day Safe Harbor for Small 401(k) Plans

On January 14, 2010 the Department of Labor issued final regulations regarding the remittance of 401(k) employee contributions including salary deferrals and loan repayments. This safe harbor only applies to small plans which are defined as those with fewer than 100 participants as of the first day of the plan year and is effective as of the issue date January 14th. The original regulations were issued in 1988 and amended in 1996. The 1996 regulations provided that plan sponsors had to deposit employee deferrals and loan payments as of “the earliest date on which such contributions can reasonably be segregated from the employer’s assets, but not later than the 15th business day of the month following the month in which the participants’ contributions are withheld from the employee’s compensation.” Many plan sponsors focused on the “15th business day” rather than the “reasonably segregated” reference. As a result it was believed that the 15th day was itself a safe harbor – IT WAS NOT! Any plan that underwent a DOL audit was subject to the reasonably segregated rule in many cases resulting in a prohibited transaction. This required the plan sponsor to contribute lost earnings from the date the DOL determined that the contributions should have been deposited to the date they were actually deposited, and pay excise taxes on the amount involved in the prohibited transaction.

The final regulations issued January 14th has now established a safe harbor rule providing that deposits of employee contributions are deemed to be timely if deposited with the plan no later than the 7th business day following the date the contributions are received by the employer, or following the date the amounts would otherwise have been paid to the employee as compensation. Employee contributions include both salary deferrals and loan repayments.

The safe harbor applies to each payroll period. This is good news. In the absence of this rule failure to comply with the safe harbor in one payroll period would require the plan to satisfy the general rule, i.e. the reasonably segregated rule. If the safe harbor is not satisfied in one payroll period it does not effect other payroll periods in which the safe harbor is satisfied.

Now that there is a safe harbor and the guidelines are clear plan sponsors should be even more diligent in compliance. A question on the form 5500 asks if the plan has complied with these rules. The Third Party Administrator must answer this question accurately. No longer is there the excuse that the rule wasn’t clear.

Stephen Abramson, CPC, CLU, ChFC
APS Pension & Financial Services Inc.
(516) 228-8444 E-mail steve@apsension.com