Are Missed Deferrals and Late Deferral Deposits the Same Thing?

Facts

Our company sponsors a 401(k) plan. One of our newer employees, Jane Smith, met the eligibility requirements and should have joined the plan on January 1st. Due to an oversight, we forgot to enroll Jane in the plan until she asked about it a couple months later. We assume that we need to make some sort of correction, and we've done some online research to figure out next steps. We've seen references to missed deferral opportunities and late deferral deposits, but to be honest, it's all a little confusing.

Question

Are missed deferrals and late deferral deposits the same thing? If not, what is the difference, and which one are we dealing with?

Answer

We should start by saying that you are not alone in asking that question. The two are, indeed, different, but we hear them used interchangeably or reversed quite frequently. Let's take a quick look at both.

Missed Deferral Opportunity

An MDO is really any situation when a participant should have been permitted to make 401(k) deferrals but wasn't. Here are a few examples:

- A participant is not timely enrolled in the plan when s/he first becomes eligible;
- A participant makes a deferral election, but it is not implemented timely and/or correctly; or
- Deferrals are not withheld from certain forms of eligible compensation such as bonuses.

The IRS correction program (called the Employee Plans Compliance Resolution System or EPCRS) provides guidance on how to correct MDOs. In these situations, the plan sponsor is making up for the participant's missed opportunity to contribute to the plan on a tax-favored basis and receive applicable matching contributions.

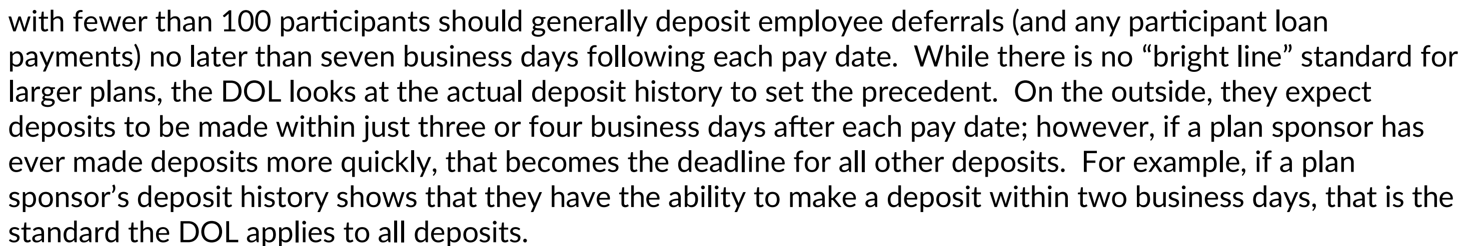
Here is a quick overview of the steps a plan sponsor must take to put the participant in the position he or she would have been absent the MDO:

- Make a corrective contribution equal to 0%, 25%, or 50% (depending on how long ago the MDO occurred) of the amount the participant would have deferred.
- Make the matching contributions the participant would have received.
- Adjust both of the above for any investment gains the participant would have achieved.

For a more detailed description of the correction methodology, check out this Correction of the Quarter.

Late Deferral Deposit

Unlike an MDO where deferrals are not properly withheld from a participant's paycheck, a late deferral deposit occurs when the company properly withholds but them waits too long to deposit those dollars into the plan. That leads to the next question – how long is too long? According to Department of Labor regulations, plans



with fewer than 100 participants should generally deposit employee deferrals (and any participant loan payments) no later than seven business days following each pay date. While there is no "bright line" standard for larger plans, the DOL looks at the actual deposit history to set the precedent. On the outside, they expect deposits to be made within just three or four business days after each pay date; however, if a plan sponsor has ever made deposits more quickly, that becomes the deadline for all other deposits. For example, if a plan sponsor's deposit history shows that they have the ability to make a deposit within two business days, that is the standard the DOL applies to all deposits.

Like the IRS, the DOL has its own correction program (called the Voluntary Fiduciary Correction Program or VFCP), that allows plan sponsors to voluntarily correct fiduciary violations including late deferral deposits. Here is a summary of the correction steps:

- Identify the delinquent amounts, and if not yet deposited, get them into the plan immediately;
- Calculate the lost earnings (usually via the DOL's online calculator);
- Allocate the lost earnings to the affected participants;
- Pay a 10% excise tax to the using Form 5330; and
- Report the late deposits on the Forms 5500 for each year until full correction is made.

The Department of Labor does not officially recognize self-correction without approval so technically VFCP requires that the correction be documented, and an application submitted to DOL for formal approval. With that said, some plan sponsors elect to forego that step and wait for the DOL to ask. In our experience, however, the DOL almost always asks, making it more economical and less stressful to complete the entire correction all at once rather than doing part now and part of it later when under pressure from the DOL. By the way, we have another Correction of the Quarter that covers late deposits in more detail.

Back to Jane

So, what kind of error do we have with Jane? Based on the facts presented, Jane experienced a missed deferral opportunity from January 1st through the date she was eventually enrolled.

When accidental missteps occur, it is important to act quickly as corrections tend to get more expensive the longer they remain open. This can also be a good reminder to take a look at your internal procedures to determine how best to avoid repeat problems. We have assisted many plan sponsors with both, so give us a call if you are not sure where to start.

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Related Resources

- Missed Deferral Opportunities
- Deposit Deadlines: 401(k) Deferrals
- Plan Corrections: When Bad Things Happen to Good Plans

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