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FAQ: Timely Deposit of 401(k) Salary Deferral Contributions

When are employee salary deferrals required to be deposited to the plan?

Plan sponsors must deposit employee salary deferrals to the plan as soon as administratively feasible. According to DOL guidance, this standard ranges from three to seven business days, depending on the size of the plan:

- *100 participants or less*: Employee deferrals and loan repayments must be deposited within seven days business days from the date they are withheld from an employee's paycheck.
- *101 participants or more*: Employee deferrals and loan repayments must be deposited within 3–4 business days from the date they were withheld from an employee's paycheck.

What penalties apply when employee salary deferrals are deposited late?

The IRS and DOL require the DOL to make the affected participant whole by making an additional contribution to cover the potential lost earnings on the late deposits for the time they were not invested. In addition, late deposits are treated as a prohibited transaction for which an automatic 15% excise tax on the lost earnings applies. The excise tax is paid and reported using IRS Form 5330. The penalty compounds each year that the contributions go unpaid, so it is important to catch any errors as soon as possible.

What are the steps to correct a late deposit?

As soon as the error is discovered, the contribution must be deposited, along with any lost earnings. There are two methods for making the correction:

- *DOL Voluntary Fiduciary Compliance Program (VFCP):* The VFCP allows a plan sponsor to report late deposits to the DOL and, in exchange, they issue a "no action" letter. Using VFCP, lost earnings can be calculated with the set IRS interest rate for underpayment (generally 4–6%), which may be less than the plan's actual rate of return.

  Moreover, if the excise tax is less than $100, the plan is not required to file a Form 5330. The plan sponsor can skip paying the excise tax altogether by giving written notice to participants. While the VFCP may result in a lower overall contribution, the application is extensive and time consuming, to the point that the time and cost of preparation often exceed potential savings.

- *Self-Correction*: Plan sponsors that elect to self-correct must determine the lost earnings based on the greater of the plan's actual rate of return or the set IRS interest rate for underpayment. In some years, this rate can be much greater than the set IRS interest rate; however, the overall time and cost saved by avoiding the more formal VFCP process may still make this a more desirable option for the majority of plan sponsors. If using self-correction, the plan sponsor must file a Form 5330.

How can a plan sponsor avoid untimely deposits?

Most 401(k) recordkeepers and payroll companies will transfer contribution data electronically, then transfer funds via ACH. Errors most often occur when changes are made to payroll, but the amounts to be deposited are not updated to reflect such changes. The best way to avoid this is to reconcile the actual 401(k) deposit with payroll records each pay period. This will ensure that any discrepancies are identified and can be corrected before the contribution due date.

Employers can take the following additional measures to avoid delinquent deposits:

- Review the time period for deposits against other payroll practices to determine any inconsistencies.
- Discuss the importance of timely deposits with payroll staff.
- Establish procedures for continuously monitoring deposit periods and tracking any discrepancies.

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