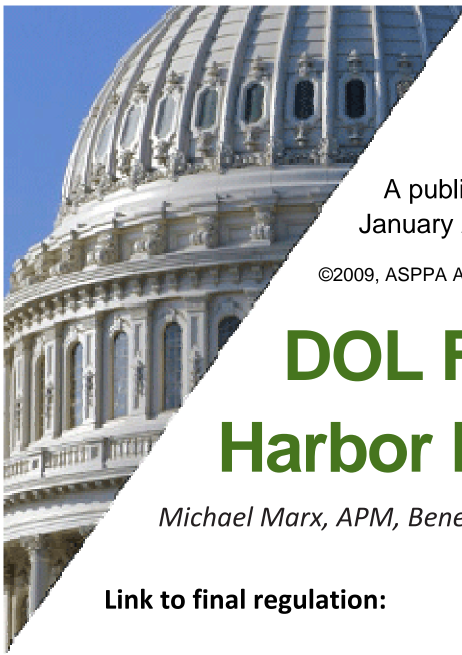

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DOL Finalizes 7 Business Day Safe Harbor Rule for Small Plans

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Link to final regulation:

http://www.dol.gov/federalregister/HtmlDisplay.aspx?DocId=23466&AgencyId=8&DocumentType=2

Background

The Department of Labor (DOL) published final regulations on January 14, 2010 providing a safe harbor rule for the timely deposit of employee contributions. This safe harbor only applies to retirement and health & welfare plans with fewer than 100 participants (often referred to as "small plans") and is effective as of the date of publication.

Regulations were issued by the DOL in 1988 defining when employee contributions become plan assets for purposes of ERISA. In 1996, the regulations were amended requiring plan sponsors to deposit employee deferrals into employee benefit plans 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 employees' compensation (29 CFR 2510.3-102).

The rule often caused confusion for 401(k) plan sponsors and service providers as some overlooked the "earliest date" condition and focused on the "15th business day of the month following the month" portion of the rule. This led to the mistaken assumption that employers had until the 15th day of the following month to deposit employee deferrals into a plan – they do not! The DOL has consistently stated its interpretation in seminars and taken the position in audits that the focus is on the "earliest date" language meaning that the funds must be deposited as soon as they reasonably can be segregated from the general assets of the employer.

The DOL's interpretation of the term "reasonably" still presented problems in enforcement. At times, the DOL referred to the shortest time period in which the employer had ever segregated the assets, applying that as a standard for the timeliness of deposit of all deferrals. DOL agents applied this approach in different ways which resulted in inconsistent enforcement of the rule.

Plan sponsors needed a clear rule in this area. If the deposit of deferrals is determined to be late, the plan assets are deemed commingled with the employer's general assets and the result is a prohibited transaction. Accordingly, the plan sponsor must contribute lost earnings and pay excise taxes on the amounts involved in the prohibited transaction. The DOL notes that about ninety percent (90%) of the applications under the Voluntary Fiduciary Correction Program since 2000 have involved delinquent participant contributions.

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Final Regulations

The final regulations establish a safe harbor period for the deposit of employee deferrals to small retirement and health & welfare plans. These regulations are very similar to proposed regulations issued February 29, 2008.

The safe harbor rule is helpful to employers sponsoring a small pension or welfare benefit plan as it provides that the employee contributions are deemed to be timely if the amounts are deposited with the plan no later than the 7th *business* day following the date the contributions (including loan repayments) are received by the employer, or following the date the amounts would otherwise have been paid to the employee as compensation (note that 7 *business* days normally equates to 9 *calendar* days). This is a safe harbor option and the regulations state that it is not the only means of satisfying the rule that plan assets must be segregated in a timely manner.

Eligibility for this safe harbor is based on a 100 participant measurement as of the first day of each plan year. It is not related to the 80/120 participant rule used in determining Form 5500 status.

The new safe harbor rule is effective as of January 14, 2010 – the date of publication of the final regulations.

Additional Good News

An issue was raised in the April 29, 2008 comment letter provided by ASPPA's Government Affairs Committee (GAC). In that letter, ASPPA GAC requested a clarification on the application of the safe harbor rule and recommended that a failure to satisfy the safe harbor in any payroll period during a plan year should not prevent a plan sponsor from meeting the safe harbor for the rest of the plan year. In other words, we recommended that the safe harbor should apply to each payroll period individually such that a plan sponsor's failure to meet the safe harbor during one payroll period would not result in application of the general rule for determining when participant contributions are plan assets for the entire plan year. In the preamble to the final regulations, the DOL notes that this issue was raised by one commentator and adopts ASPPA's recommendation that the safe harbor be determined on a deposit-by-deposit basis. One failure will not eliminate the safe harbor for other payroll periods.

The Bad News

The safe harbor was not extended to large plans although the DOL had requested comments on this issue. In this regard, the ASPPA GAC comment letter had recommended making this safe harbor available to all plan sponsors. The DOL stated that it did not have a sufficient record to determine that the safe harbor should be extended to large plans. Thus, large plans will have to comply with the basic rules, and most likely will be subject to a faster deposit requirement in many situations.

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