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How to Handle and Prevent 401(k) Horror Stories

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Scary Tale # 1– Not Following Terms of Plan Document

- Profit Sharing Deposits Submitted as “Bonuses” for Only Certain Employees (pro-rata formula selected)

- Consequence – Profit Sharing contribution formula is incorrect for every plan year this occurred.

- Resolution – Employer must true up all participants to the highest allocation percentage and use a pro-rata formula.

Scary Tale #2 – Definition of Compensation

- Plan document includes bonuses in the definition of compensation, but plan sponsor did not withhold deferrals from bonuses.

- Consequence – Employees missed out on deferrals being deposited into plan and company matching contributions.

- Resolution – Employer must correct by making up half of missed deferrals, missed company contributions, and lost interest.

Scary Tale #3 – Failure to Provide Timely Participant Notices

- Plan sponsor did not provide the required Safe Harbor notice to newly eligible employees on or before the date they became eligible.
- Consequence
  1. Failure to provide the notice resulted in an operational error that caused eligible employees not to enroll.
  2. Failure to provide the notice is an administrative error.
- Resolution
  1. Corrective contributions must be deposited for any eligible employee who was not given the opportunity to enroll.
  2. Procedures need to be documented showing the error was resolved and the process was revised to ensure timely notices going forward.

Scary Tale #4 – Failure to Submit Timely Employee Deferrals

- Plan sponsor's pay dates are the 15th and last day of the month. The plan sponsor has 80 participants in their retirement plan. They submitted the 15th contribution on the 25th which is more than 7 business days after the pay date.

- Consequence – the plan sponsor must deposit lost earnings to each participants account for submitting the contribution late. An excise tax of 15% for the amount involved will be owed and Form 5330 will be filed with the IRS. The late deposit must also be reported on Form 5500.

- Resolution – submit contributions within 7 business days of the pay date.

Scary Tale #5 – Failure to Offer the Plan to All Eligible Employees

- Plan sponsor's eligibility requirements are 1000 hours and 1 year of service with entry dates on January 1 and July 1. For the July 1 entry date the sponsor did not offer the plan to part-time eligible employees on or before July 1. They were not offered the plan until January 1.

- Consequence – the plan sponsor must deposit a qualified non-elective contribution of 25% of the missed deferrals including missed match (deposit per pay period) plus earnings. A notice must be given to employees explaining the error and when it will be corrected.

- Resolution –review the retirement plan document with personnel who are involved in notifying employees of eligibility to ensure the terms of the document are followed.

Scary Tale #6 – Failure to Satisfy Loan Requirements

- Plan sponsor approved a loan but did not start the employees loan deduction in payroll until 5 months after the loan started.
- Consequence – loan is now in default. The participant could pay taxes on the full amount of the loan.
- Resolution – amortize the loan with higher payments going forward. Review process/procedures to ensure loan payments are started timely.

Super Scary Tale #7 – Failure to Include a New Business in the Plan

- Plan sponsor acquired a business and never offered the plan to the employees of the acquired business.

- Consequence – lots of really scary ones.

- Resolution - contact your ERISA attorney. Al Holifield is standing by!

401(k) Fairy Tale Ending

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