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The Misappropriation of Employee Deferrals

Plan sponsors have a fiduciary duty to timely deposit employee contributions. In some cases, employers facing financial hardships may decide to delay depositing the employee contributions to the plan's trust and instead use the funds to pay company expenses such as payroll. This is a prohibited transaction under ERISA and plan sponsors who choose to delay contributions for this purpose, or any purpose, risk significant penalties. Often these penalties are monetary in nature, but when the violation involves the misappropriation of employees' deferrals, the penalties can be as substantial as actual concrete and bars. This was demonstrated very recently (July 17, 2013) when a Pennsylvania businessman, who had been criminally charged with theft from his company's employee benefit plan, was sentenced to seventeen months in federal prison. This article will provide an overview of why the charges occurred and discuss compliance strategies that plan sponsors can employ to ensure the appropriate treatment of employee deferrals.

The individual charged was the plan fiduciary for an employee benefits plan sponsored by a company facing bankruptcy. During the three months prior to the bankruptcy filing, no employee contributions were deposited into the plan's trust, resulting in over $16,000 in missing employee contributions. The company also failed to make timely deposits of the employee deferrals, sometimes withholding the employee deferrals for up to six months.

DOL Penalties & Federal Criminal Charges

The DOL filed a complaint against the company and the plan fiduciary, personally, for ERISA violations. The company was required to repay the missing employee contributions and an additional restitution of over $4,000. The plan fiduciary was required to pay $4,100 in fines and was permanently enjoined from ever serving as a trustee, fiduciary, advisor, or administrator to any employee benefit plan. The plan fiduciary was additionally charged with the federal crime of theft from an employee benefit plan, to which he plead guilty. He was sentenced to seventeen months in federal prison, with a two-year supervised probationary period to follow.

Delinquent Contributions as Plan Assets

The criminal charges stem from the fact that the $16,000 in missing employee deferrals was considered plan assets. Employee deferrals are considered plan assets at the time that they *should* have been deposited to the plan's trust, which is on the "earliest date" that the deferrals can be reasonably segregated from the employer's general assets. According to DOL guidance, a reasonable amount of time for segregation ranges from two to seven business days, depending on the size of the plan.

Key Point: Deeming the deferrals as plan assets is significant because, as a plan asset, the continued use of the funds for personal or business reasons, or even merely allowing the funds to remain part of the employer's general assets, is a prohibited transaction under ERISA and may also be considered theft (*see* 18 U.S.C. § 664). This is because, as plan assets, the employee deferrals belong to the plan, and, as such, the failure to deposit them constitutes an unlawful taking.

Correction Options

The recent charges demonstrate how important it is to ensure that all employee deferrals are timely deposited and never misappropriated, but if a delinquent contribution or misappropriation should occur, correction options are available. The DOL's Voluntary Fiduciary Compliance Program (VFCP) allows plan sponsors to file an explanation of the error and make a corrective contribution. If any of the employee deferrals were actually used, subject to certain exemptions, the employer may also have to file a report with the IRS and pay an excise tax.

Employers can also take certain proactive actions to prevent the misuse or delinquent deposit of employee deferrals, including:

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

