DEPARTMENT OF LABOR

Pension and Welfare Benefits Administration

29 CFR Part 2510

RIN 1210–AA53

Proposed Regulation Relating to Definition of Plan Assets; Participant Contributions

AGENCY: Pension and Welfare Benefits Administration, Department of Labor.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains a proposed regulation revising the definition of when certain monies which a participant pays to, or has withheld by, an employer for contribution to an employee benefit plan are ''plan assets'' for purposes of Title I of the Employee Retirement Income Security Act of 1974 (ERISA) and the related prohibited transaction provisions of the Internal Revenue Code (the Code). This regulation will provide guidance to employers that sponsor contributory plans, including plans complying with section 401(k) of the Internal Revenue Code, as well as fiduciaries, participants, and beneficiaries of such plans.

DATES: Written comments and requests to testify concerning the proposed regulation must be received by February 5, 1996. The Department has scheduled a public hearing on this proposal on January 24, 1995, and, if necessary, on January 25, 1995. The hearing will begin at 10:00 am on both days.

ADDRESSES: Interested persons are invited to submit written comments and requests to testify concerning this proposed regulation to: Pension and Welfare Benefits Administration, Room N–5669, U.S. Department of Labor, 200 Constitution Ave., N.W., Washington, DC 20210. Attention: Proposed Participant Contribution Regulation. All submissions will be open to public inspection at the Public Documents Room, Pension and Welfare Benefits Administration, U.S. Department of Labor, Room N–5638, 200 Constitution Ave., NW., Washington, DC 20210. Written comments may also be sent by the Internet to the following address: hinz@access.digex.net. The hearing on this proposal will be held in Room N–3437A, Constitution Ave., N.W., Washington, DC 20210.

FOR FURTHER INFORMATION CONTACT: Rudy Nuissl, Office of Regulations and Interpretations, Pension and Welfare Benefits Administration, U.S. Department of Labor, Washington, DC (202) 219–7461; or William W. Taylor, Plan Benefits Security Division, Office of the Solicitor, U.S. Department of Labor, Washington, DC (202) 219–9141. These are not toll-free numbers.

SUPPLEMENTARY INFORMATION: In 1988, the Department of Labor (the Department) published a final regulation defining when certain monies that a participant pays to, or has withheld by, an employer for contribution to a plan are ''plan assets'' for purposes of Title I of ERISA and the related prohibited transaction provisions of the Code.[1] 53 FR 17628 (May 17, 1988). The final regulation provided that the assets of the plan include amounts (other than union dues) that a participant or beneficiary pays to an employer, or amounts that a participant has withheld from his or her wages by an employer, for contribution to the plan as of the earliest date on which such contributions can reasonably be segregated from the employer's general assets, but in no event to exceed 90 days from the date on which such amounts are received by the employer (in the case of amounts that a participant or beneficiary pays to an employer) or 90 days from the date on which such amounts would otherwise have been payable to the participant in cash (in the case of amounts withheld by an employer from a participant's wages).[2] This final rule was based on a record developed with respect to a proposed regulation published in 1979. 44 FR 50363 (August 28, 1979).

Except as provided in ERISA § 403(b), plan assets are required to be held in trust by one or more trustees.[3] ERISA § 403(a), 29 U.S.C. 1103(a). In addition, ERISA's fiduciary responsibility provisions apply to the management of plan assets. Among other things, these provisions make clear that the assets of a plan may not inure to the benefit of any employer and shall be held for the exclusive purpose of providing benefits to participants in the plan and their beneficiaries, and defraying reasonable expenses of administering the plan. ERISA §§ 403–404, 29 U.S.C. 1103–1104. They also prohibit a broad array of transactions involving plan assets. ERISA §§ 406–408, 29 U.S.C. 1106–1108. Employers who fail to transmit promptly participant contributions, and plan fiduciaries who fail to collect those amounts in a timely manner, will violate the requirement that plan assets be held in trust; in addition, such employers and fiduciaries may be engaging in prohibited transactions.

As was noted in the preamble to the final regulation published in 1988, the Department of Justice takes the position that, under 18 U.S.C. 664, the embezzlement, conversion, abstraction, or stealing of ''any of the moneys, funds, securities, premiums, credits, property, or other assets of any employee welfare benefit plan or employee pension benefit plan, or any fund connected therewith'' is a criminal offense, and that under such language, criminal prosecution may go forward in situations in which the participant contributions is not a plan asset for purposes of Title I of ERISA. The final regulation defined when participant contributions become ''plan assets'' only for the purposes of Title I of ERISA and the related prohibited transaction excise tax provisions of the Code. The Department reiterates that this regulation may not be relied upon to bar criminal prosecutions pursuant to 18 U.S.C. 664.

Similarly, the Department wishes to reemphasize its view, expressed in the preamble to the final regulation, that in circumstances in which the employer clearly converts participant contributions to its own use, such amounts are considered ''segregated,'' and thus will be ''plan assets''.

The Need for a Proposed Regulation

Although the Department believes that, in the vast majority of contributory employee benefit plans, participant contributions are handled with integrity, recent investigations conducted by the Department have revealed numerous violations related to employers' delay in transmitting or failing to transmit to employee benefit plans amounts that a participant or beneficiary pays to an employer, or

[1] The Secretary of Labor has authority to issue regulations relating to section 4975 of the Internal Revenue Code pursuant to section 102 of Reorganization Plan No. 4 of 1978. 5 U.S.C. App. 165. For the sake of clarity, the remainder of the preamble refers only to Title I of ERISA. However, these references apply to the corresponding provisions of section 4975 of the Code as well.

[2] The Department has taken the position that elective contributions to an employee benefit plan, whether made pursuant to a salary reduction agreement or otherwise, constitute amounts paid to or withheld by an employer (*i.e.*, participant contributions) within the scope of § 2510.3–102, without regard to the treatment of such contributions under the Internal Revenue Code. See 53 FR 29660 (Aug. 8, 1988).

[3] ERISA § 403(b) contains a number of exceptions to the trust requirement for certain types of assets, including assets which consist of insurance contracts, and for certain types of plans. In addition, the Secretary has issued a technical release, T.R. 92–01, which provides that, with respect to certain welfare plans (e.g., cafeteria plans), the Department will not assert a violation of the trust or certain reporting requirements in any enforcement proceeding, or assess a civil penalty for certain reporting violations, involving such plans solely because of a failure to hold participant contributions in trust. 57 FR 23272 (June 2, 1992), 58 FR 45359 (Aug. 27, 1993).

amounts that employers withhold from participants' wages, for contribution to the plans. Evidence uncovered in ongoing investigations indicates that such delays are not uncommon.[4] The above described recent enforcement activities focused on participant contribution indicate a significantly higher frequency of violations for such investigations than the Department encounters in general.[5]

In addition, the Department, responding to requests for technical assistance from employers and participants, has received information that many employers who receive participant contributions are under the misimpression that the current regulation permits a delay of up to 90 days in segregating such contributions, even if the participant contributions can reasonably be segregated much sooner. The Department has also received similar information from a variety of other sources. Such delays deprive participants of earnings on their contributions and increase the risk to participants and their beneficiaries that their contributions will be lost due to the employer's insolvency or misappropriation by the employer.

In order to better protect the security of participant contributions to employee benefit plans, the Department believes that the final regulation published in 1988 must be revised. It is important to clarify that participant contributions become plan assets as soon as they can reasonably be segregated from the employer's general assets. In addition, the Department believes that the 90-day maximum period under 1988 regulation is too long, given the abuses that have been uncovered by the Department's investigations, and improvements in cash management and payroll processing practices since the final regulation was adopted.

The Proposed Regulation

This document contains a proposal to revise the regulation at 29 CFR 2510.3–102 by changing the maximum period during which participant contributions to an employee benefit may be treated as other than ''plan assets''. Under the current regulation, the maximum period is 90 days from the date on which the participant contributions are received by the employer (for amounts that participants or beneficiaries pay to the employer) or would otherwise have been payable to the participants in cash (for amounts that the employer withholds from the participants' wages).

Under the proposed rule, the maximum period for an employer to transmit participant contributions to the plan would be the same number of days as the period in which the employer is required to deposit withheld income taxes and employment taxes under rules promulgated by the Internal Revenue Service (IRS). The currently applicable rules are codified at 26 CFR 31.6302–1.[6] In general, these rules require employers who have reported more than $50,000 of withheld income taxes and employment taxes for a prior 12-month ''lookback'' period (defined as ''semi-weekly depositors'') to make tax deposits to a Federal Reserve Bank or authorized financial institution within a few days of withholding from wages. Employers who have reported $50,000 or less of withheld income taxes and employment taxes in the lookback period are defined as ''monthly depositors'' and must make such deposits on or before the 15th day of the month following the month in which the employees' wages are paid.

In addition, the IRS regulations reflect the statutory requirement that an employer who has accumulated on any day $100,000 in withheld income taxes and employment taxes must deposit such taxes by the next banking day. 26 U.S.C. 6302(g). If an employer accumulates less than a $500 tax liability during a calendar quarter, no deposits are required; the tax is paid with the filing of the tax return for the quarter.[7] The Department solicits comments on the appropriateness of including these two special rules to the general tax deposit rules in the IRS regulation.

The proposed rule would require employers who cannot reasonably segregate participant contributions at an earlier date to treat such amounts as plan assets within the same time frame that the employer is required to segregate and deposit withheld income taxes and employment taxes. The following table illustrates the basic time periods specified in the IRS regulations:

Type of depositor	Date withheld	Date deposit due
Semi-Weekly Depositor (more than $50,000 of Federal Income, Social Security and Medicare taxes (collectively, employment taxes) reported for 12-month period ending last June 30).	Wednesday, Thursday, and/or Friday Saturday, Sunday, Monday and/or Tuesday	Following Wednesday. Following Friday.
Monthly Depositor ($50,000 or less of employment taxes reported for 12-month period ending on the previous June 30).	In any day during a calendar month	By the 15th of the following calendar month.
Either semi-weekly or monthly depositor, if $100,000 or more in employment taxes are accumulated on any date.	Not relevant	Next banking day after the $100,000 in employment taxes was accumulated.

For example, a semi-weekly depositor that pays its employees on Wednesday, December 13, is required to deposit withheld income taxes and employment taxes by the following Wednesday (December 20). Under the proposed rule, any participant contributions withheld on December 13 would become plan assets as soon as they could reasonably be segregated from the employer's general assets, but no later than December 20. Participant contributions that are paid separately by employees or former employees to the employer would be subject to the same time frames. For example, if a semi-weekly depositor receives a participant's payment on Monday,

[4] In the Spring of 1995 PWBA began a project to investigate misuse of employee contributions to employee benefit plans and in particular in 401(k) plans. As of October 31, 1995 there were 417 employee contribution investigations open and 130 cases were closed during the year. More than $3.7 million has been recovered through voluntary compliance in situations where employee contributions were not placed in trust for participants.

[5] Of the 130 closed employee contribution cases, 44, or 33.8 percent of closed cases, resulted in findings of violations of ERISA's fiduciary provisions. This compares to a finding of fiduciary violations in 12 percent of all other closed cases in FY 95.

[6] See also IRS Publication 15 (Cat. No. 10000W) Circular E, Employer's Tax Guide (Rev. January 1995) and IRS Notice 931 (Rev. October 1995).

[7] The Department recognizes that mistakes may occur in the processing of participant contributions. It is the Department's view that ERISA does not prevent the return of any mistaken contributions nor the ability to make correcting contributions after the mistakes are discovered. *See* ERISA § 403(c), 29 U.S.C. 11103(c).

December 18, the payment amount would become plan assets as soon as they could reasonably be segregated from the employer's general assets, but no later than the following Friday, December 22.

Because the IRS tax deposit rules are generally applicable to employers, the Department expects that employers who sponsor contributory employee benefit plans are familiar with and have systems in place to comply with the IRS requirements.[8] Thus, the Department believes that applying these same rules in determining when the maximum period beyond which participant contributions must be treated as plan assets should not result in serious inconvenience or expense for such employers. The Department believes that currently available cash management and payroll processing technology allows the segregation of participant contributions within the maximum period proposed in this document. Furthermore, the final regulation published in 1988 requires that participant contributions be treated as plan assets as soon as they can reasonably be segregated from the employer's general assets. As a result, this proposed change will not be material for many employers who have complied with the final regulation published in 1988. The Department recognizes that some employers perceive difficulties in the transfer of participant contributions to the plan that they do not have in the deposit of federal employment taxes. The Department solicits comments as to any specific burdens and associated costs of this kind. The Department also requests comments on the transition period needed for employers and service providers, especially small businesses, to make changes in practices that may be necessary to comply with the proposal if it is adopted.

Although the proposed rule would not change the requirement that participant contributions be treated as plan assets at the earliest date they can reasonably be segregated from the employer's general assets, changing the regulations to provide for an outer limit that conforms to IRS requirements will allow the Department and plan participants to more quickly and easily determine that a violation has occurred. This will assist the Department in its increased monitoring and enforcement in this area, as it reduces the room for argument as to how rapidly participant contributions must be segregated from the employer's general assets. In addition, changing the ninety-day limit for treating participant contributions as other than ''plan assets'' reduces the risk of loss that exists when employers improperly hold participant contributions in their general assets for the maximum period rather than segregating them from the employer's general assets at the earliest reasonable date.

The proposed rule does not include an alternative proposal for a maximum period based on a fixed period of days (such as 15 days), but the Department may consider adopting such a rule in place of the rule described above if adopting the IRS tax deposit rules as the maximum period for segregating participant contributions would place an undue burden on plan sponsors. Commenters may wish to address the advantages or disadvantages of using a fixed period of days or some other formulation for a maximum period when they provide comments on the proposed rule.

The Department also welcomes comments on the advisability of other measures that it might consider to address the problem of delays in transmitting participant contributions to plans, such as, for example, requirements for more frequent disclosure to participants of participant contributions and account balances by the plan.

This document also modifies the language in section 2510.3–102 to emphasize that the assets of a plan include participant contributions as of the earliest date on which such contributions can reasonably be segregated from the employer's general assets. Although this modification would not change the effect of the existing regulation, the Department expects that the proposed new language will reduce the likelihood that employers will incorrectly believe that the maximum period in the proposed rule is a safe harbor and that they may delay the segregation of participant contributions up to the maximum period.

Effective Date of Regulation

Pursuant to the requirements of the Administrative Procedure Act at 5 U.S.C. 553(b), the Department is publishing this notice of proposed rulemaking for notice and comment and will promulgate this rule in final form subsequent to such comment period. The Department expects to issue a final rule 45 days following the close of the comment period. The Department has determined to propose that the final rule will be effective 60 days after its publication, which the Department believes will allow sufficient time for an appropriate transition to the new maximum periods. The Department solicits comments regarding the appropriate effective date for the final regulation.

Regulatory Flexibility Act

The Department has determined that this regulation would not have a significant economic impact on small plans or other small entities. The regulation would describe when contributions made by a participant of a plan subject to ERISA or to the related prohibited transaction excise tax provisions of the Internal Revenue Code must be transmitted to the plan by an employer withholding the contributions. The Department solicits comments on whether the proposal is likely to have a significant economic impact on small entities. The Department also requests comments from small entities regarding what, if any, special problems they anticipate they may encounter if the proposal were to be adopted, and what changes, if any, could be made to minimize these problems.

Executive Order 12866

Under Executive Order 12866 (58 FR 51735, Oct. 4, 1993), the Department must determine whether the regulatory action is ''significant'' and therefore subject to review by the Office of Management and Budget (OMB) and the requirements of the Executive Order. Under section 3(f), the order defines a ''significant regulatory action'' as an action that is likely to result in, among other things, a rule raising novel policy issues arising out of the President's priorities.

Pursuant to the terms of the Executive Order, the Department has determined that this regulatory action is a ''significant regulatory action'' as that term is used in Executive Order 12866 because the action would raise novel policy issues arising out of the President's priorities. Thus, the Department believes this notice is ''significant,'' and subject to OMB review on that basis. The Department also solicits comments on potential economic effects of this proposed rule in the context of Executive Order 12866, and any evidence with respect to whether or not this proposed rule may be ''economically significant''.

Paperwork Reduction Act

The regulation being issued here is not subject to the requirements of the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 et seq.) because it does not

[8] The Department understands that most employers who sponsor section 401(k) plans are ''semi-weekly depositors'' under the IRS rules.

contain an ''information collection request'' as defined in 44 U.S.C. 3502(11).

Statutory Authority

The proposed regulation would be adopted pursuant to the authority contained in section 505 of ERISA (Pub. L. 93–406, 88 Stat. 894; 29 U.S.C. 1135) and section 102 of Reorganization Plan No. 4 of 1978 (43 FR 47713, October 17, 1978), effective December 31, 1978 (44 FR 1065, January 3, 1979), 3 CFR 1978 Comp. 332, and under Secretary of Labor's Order No. 1–87, 52 FR 13139 (Apr. 21, 1987).

List of Subjects in 29 CFR Part 2510

Employee benefit plans, Employee Retirement Income Security Act, Pensions, Plan assets.

PART 2510—[AMENDED]

1. The authority for Part 2510 is revised to read:

Authority: Secs. 3(2), 111(c), 505, Pub. L. 93–406, 88 Stat. 852, 894 (29 U.S.C. 1002(2), 1031, 1135); Secretary of Labor's Order No. 27–74, 1–86 (51 FR 3521, January 28, 1986), 1–87 (52 FR 13139, April 21, 1987), and Labor Management Services Administration Order No. 2–6.

Section 2510.3–40 is also issued under sec. 3(40), Pub. L. 97–473, 96 Stat. 2611, 2612 (29 U.S.C. 1002(40)).

Section 2510.3–101 is also issued under sec. 102 of Reorganization Plan No. 4 of 1978 (43 FR 47713, October 17, 1978), effective December 31, 1978 (44 FR 1065, January 3, 1978), 3 CFR 1978 Comp. 332 and sec. 11018(d) of Pub. L. 99–272, 100 Stat. 82.

Section 2510.3–102 is also issued under sec. 102 of Reorganization Plan No. 4 of 1978 (43 FR 47713, October 17, 1978), effective December 31, 1978 (44 FR 1065, January 3, 1978), 3 CFR 1978 Comp. 332.

2. Section 2510.3–102 is revised to read as follows:

2510.3–102 Definition of ''plan assets''—participant contributions.

(a) *General rule.* For purposes of Subtitle A and Parts 1 and 4 of Subtitle B of Title I of ERISA and section 4975 of the Internal Revenue Code only (but without any implication for and may not be relied upon to bar criminal prosecutions under 18 U.S.C. 664), the assets of the plan include amounts (other than union dues) that a participant or beneficiary pays to an employer, or amounts that a participant has withheld from his wages by an employer, for contribution to the plan as of the earliest date on which such contributions can reasonably be segregated from the employer's general assets.

(b) *Maximum time period.* In no event shall the date determined pursuant to paragraph (a) of this section occur later than the end of period of time during which the employer is required to make federal tax deposits for withheld income taxes and taxes under the Federal Insurance Contributions Act under regulations issued at 26 CFR 31.6302–1, measured from the date on which such amounts are received by the employer (in the case of amounts that a participant or beneficiary pays to an employer) or the date on which such amounts would otherwise have been payable to the participant in cash (in the case of amounts withheld by an employer from a participant's wages).

(c) *Examples.* The requirements of this section are illustrated by the following examples:

(1) Employer W is a small company with a small number of employees at a single payroll location. W maintains a plan under section 401(k) of the Internal Revenue Code in which all of its employees participate. W's practice is to issue a single check to the trust that is maintained under the plan in the amount of the total withheld employee contributions within two days of the date on which the employees are paid. Under applicable Internal Revenue Service federal tax deposit rules, W is a ''monthly depositor'' as defined at 26 CFR 31.6302–1(c)(1). Under these rules W must deposit withheld federal income taxes and employment taxes no later than the 15th of the month following the month in which the relevant wages are paid. In view of the relatively small number of employees and the fact that they are paid from a single location, W could reasonably be expected to transmit participant contributions to a trust within two days after the employee's wages are paid. Therefore, the assets of W's 401(k) plan include the participant contributions attributable to any pay period as of the date two days from the close of such period, even though IRS federal tax deposit rules allow W substantially more time in which to make tax deposits.

(2) Employer X is a large national corporation which sponsors a section 401(k) plan. X has several payroll centers and uses an outside payroll processing service to pay employee wages and process deductions. Each payroll center has a different pay period. Each center maintains separate accounts on its books for purposes of accounting for that center's payroll deductions and provides the outside payroll processor the data necessary to prepare employee paychecks and process deductions. The payroll processing service has adopted a procedure under which it issues the employees' paychecks when due and deducts all payroll taxes and elective employee deductions. It deposits withheld income and employment payroll taxes within the time frame specified by 26 CFR 31.6302–1 and forwards a computer data tape representing the total payroll deductions for each employee, for a month's worth of pay periods, to a centralized location in X, where the data tape is checked for accuracy. A single check representing the aggregate participant contributions for the month is issued to the plan by the employer. X believes that this procedure, which takes 7 days after receipt of the date tape to complete, permits segregation of participant contributions at the earliest practicable time and avoids mistakes in the allocation of contribution amounts for each participant. X, however, is a ''semi-weekly depositor'' under the Internal Revenue Service's Federal Deposit Rules and makes Federal tax deposits within the time frames, set forth in those IRS rules. Under paragraphs (a) and (b) of this section, the assets of the plan include the participant contributions as soon as X could reasonably be expected to segregate the contributions from its general assets, but in no event later than the date on which the employer would be required to deposit withheld income taxes and employment taxes under 26 CFR 31.6302–1. The participant contributions become plan assets no later than end of the time period within which X is required to deposit withheld income taxes and employment taxes.

(3) Employer Y is medium-sized company which maintains a self-insured contributory group health plan. Several former employees have elected, pursuant to the provisions of ERISA § 602, 29 U.S.C. 1162, to pay Y for continuation of their coverage under the plan. Y is a semi-weekly depositor of withheld Federal income taxes and employment taxes. Under paragraphs (a) and (b) of this section, the assets of the plan include the former employees' payments as soon as Y could reasonably be expected to segregate the payments from its general assets, but in no event later than the date on which Y would be required to deposit the payment amounts if the payments were withheld from Federal income taxes or employment taxes. A former employee's payment received on a Monday would have become plan assets no later than the following Friday.

(d) *Effective date.* This section is effective 60 days after date of publication of final regulation.

Signed at Washington, DC, this 14th day of December 1995.

Alan D. Lebowitz,

Deputy Assistant Secretary for Program Operations, Pension and Welfare Benefits Administration, U.S. Department of Labor.

[FR Doc. 95–30782 Filed 12–19–95; 8:45 am]

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