

# Why Changing Payroll Providers Is a 401(k) Event

By Ary Rosenbaum, Esq.

Plan sponsors treat changing payroll providers the way homeowners treat replacing a dishwasher. Unplug the old one, slide in the new model, and suddenly everything runs better. In the retirement-plan world, it's nothing like that. Switching payroll is closer to rewiring your house while the lights are still on and the kids are microwaving popcorn. Payroll is not an accessory to the 401(k) plan—it is the nervous system. Every deferral, match calculation, eligibility date, and compensation definition flows through that system first. When payroll changes, the plan changes, whether anyone intended it to or not.

## Who Really Runs the 401(k)

Most employers think the recordkeeper runs the plan. That's one of the great urban legends of ERISA. The recordkeeper records what payroll tells it. If payroll sends bad data, the recordkeeper preserves that bad data with impressive efficiency. Payroll decides who is eligible, when they enter, what pay counts, and how much is deferred. The recordkeeper is just the historian writing down the story. If chapter one is wrong, the whole book is fiction.

## When Languages Collide

Payroll providers and 401(k) plans speak different languages. Payroll thinks in terms of gross pay, net pay, taxes, PTO, and garnishments. Retirement plans think in terms of safe-harbor compensation, hours

of service, true-up formulas, and entry dates. Those vocabularies are about as compatible as my Brooklyn English and a Parisian sommelier describing a Bordeaux. I had a client whose new payroll company decided, without asking anyone, that compensation meant W-2 wages only. The plan document included com-

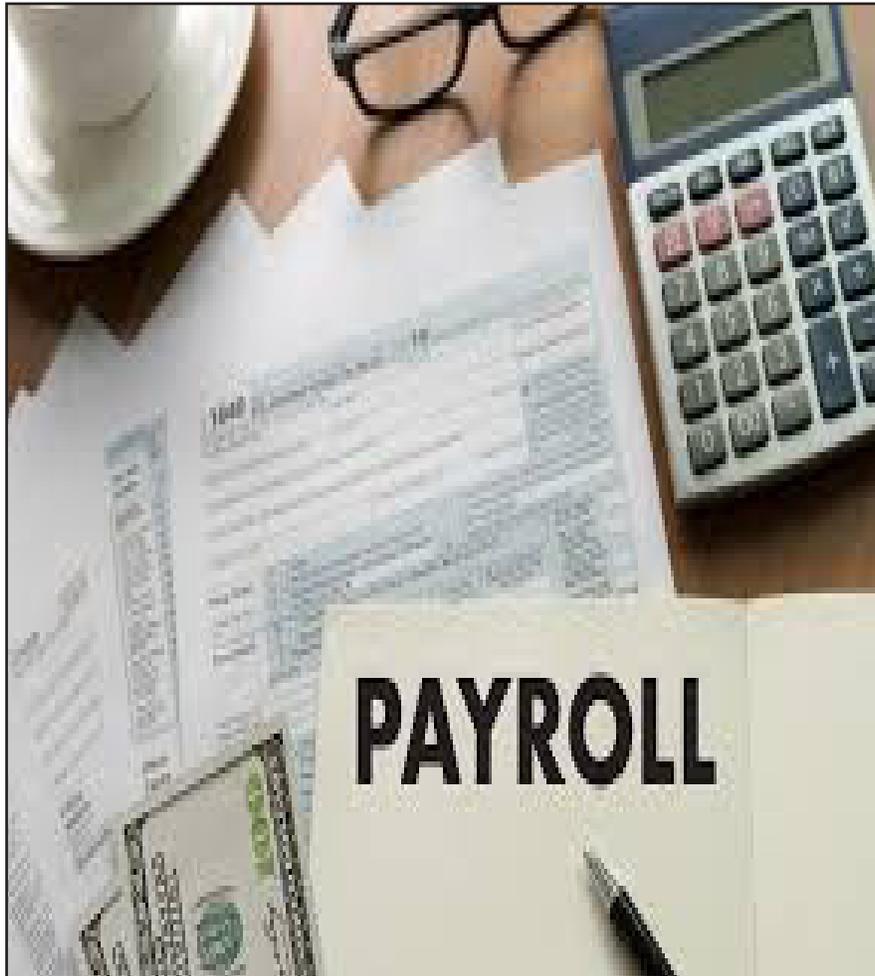
patibility for some employees, one year with 1,000 hours for others, different rules for match versus deferrals, special treatment for rehires. Payroll systems are built for simplicity, not philosophy. I've seen new hires allowed in too early, veterans locked out too long, and part-timers misclassified in ways that would make an IRS agent grin like he found a \$20 bill on the sidewalk. Each error eventually produces corrective contributions and letters that begin with the word "unfortunately." No happy ending ever follows that word.

## The Deposit Myth

The Department of Labor has a simple rule for employee deferrals: deposit them as soon as they can be segregated from the employer's assets. Not when the new system gets comfortable. Not after a few test cycles. I once heard a payroll rep tell a client that ten business days was "industry standard." Maybe in an industry that enjoys excise taxes and DOL audits. Late deposits lead to lost earnings calculations and filings that feel like a root canal without anesthesia. The DOL does not accept "the vendor was new" as a Hallmark card excuse.

## The Match Formula Comedy Show

Matching contributions are where conversions become stand-up routines. Plans have per-payroll matches with annual true-ups, tiered formulas, safe harbor require-



missions and bonuses. An entire year of matches was wrong because someone translated ERISA into payroll Esperanto.

## Eligibility: The Bermuda Triangle

Eligibility rules are where payroll conversions disappear without a trace. Plans have nuanced requirements: immediate eli-



ments, and limits tied to definitions buried deep in the document. Payroll systems love straight lines; 401(k) plans resemble modern art. I watched a conversion turn a true-up formula into a flat per-payroll match. Employees who front-loaded deferrals were shortchanged for almost two years. Fixing it required recalculating every participant as if we were counting cards in Vegas.

#### **Controlled Groups: Payroll's Blind Spot**

If your company has related entities or an ownership chart that looks like a family tree from a soap opera, payroll will struggle. Retirement plans must treat certain related businesses as one employer. Payroll systems treat them as separate islands. I've seen subsidiaries excluded, shared employees counted twice, and owners treated like brand-new interns. It's like using a bicycle GPS to navigate a tractor-trailer through Manhattan.

#### **The Triangle of Confusion**

Every payroll switch creates a triangle: payroll provider, recordkeeper, and TPA. Payroll points at the recordkeeper. The

recordkeeper points at payroll. The TPA asks who approved this circus. The plan sponsor stands in the middle wondering why something that sounded simple now requires aspirin and possibly a lawyer. Without a quarterback—usually the TPA or a seasoned advisor—the mistakes become permanent residents.

#### **Testing Is Cheaper Than Apologies**

The smartest dollar a sponsor spends during a payroll conversion is on testing. Running one parallel payroll cycle costs time; fixing a year of mistakes costs dignity. Sample employees should be walked through the new system like crash-test dummies before anyone goes live. Compensation definitions should be compared line by line with the plan document, not with the salesperson's memory. A conversion without testing is like performing surgery without an X-ray—you might get lucky, but hope is not a fiduciary strategy.

#### **Easy Versus Accurate**

Payroll companies sell easy. Retirement plans require accurate. Those two concepts

rarely share dessert. Switching payroll isn't wrong, but assuming the 401(k) will obediently follow is fantasy. The plan is less like a toaster and more like a temperamental classic car. Change one part without understanding the whole machine and you'll be stranded with a repair bill that could fund a small wedding.

#### **The Only Sensible Order**

If you're changing payroll providers, call your TPA first, your recordkeeper second, and the salesperson who promised "seamless integration" last. In the 401(k) world, payroll isn't just payroll. It's the engine, the steering wheel, and occasionally the airbag. And you don't swap those out while driving unless you enjoy surprises that begin with the word "unfortunately."

Sponsors who respect that reality survive conversions with nothing more than mild indigestion. Those who don't get an education that tuition can't refund.

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**The Rosenbaum Law Firm P.C.**  
**734 Franklin Avenue, Suite 302**  
**Garden City, New York 11530**  
**(516) 594-1557**

<http://www.therosenbaumlawfirm.com>