MEMO# 17053

February 3, 2004

IRS REVENUE RULING ON ALLOCATION OF PLAN EXPENSES IN DEFINED CONTRIBUTION PLANS

[17053] February 3, 2004 TO: PENSION MEMBERS No. 6-04 PENSION OPERATIONS ADVISORY COMMITTEE No. 8-04 RE: IRS REVENUE RULING ON ALLOCATION OF PLAN EXPENSES IN DEFINED CONTRIBUTION PLANS The Internal Revenue Service recently issued Revenue Ruling 2004-10,1 which addresses whether a defined contribution plan may charge the accounts of former employees a pro rata share of the plan's reasonable administrative expenses without charging those expenses to the accounts of current employees. Specifically, the Revenue Ruling clarifies the issues raised by the Department of Labor's Field Assistance Bulletin (FAB) 2003-32 under section 411(a)(11) of the Internal Revenue Code. FAB 2003-3 generally sets forth guidelines under Title I of ERISA on the allocation of administrative expenses among participants in defined contribution plans. In particular, the FAB provides that because nothing in Title I of ERISA limits the ability of a plan sponsor to pay only certain plan expenses or expenses on behalf of only certain plan participants, a plan may charge a vested separated participant account its share (on either a pro rata or per capita basis) of reasonable plan expenses, notwithstanding (1) whether active participants are charged such expenses or (2) whether the vested separated participant was provided the option of withdrawing the funds from his or her account or the option to roll the funds to another plan or IRA. Under Code section 411(a)(11), however, a qualified plan must provide that the benefit may not be immediately distributable without the consent of the participant (where the present value of a participant's nonforfeitable benefit exceeds $5,000). The regulations under section 411(a)(11) provide that consent to a distribution is "not valid if a significant detriment is imposed under the plan on any participant who does not consent to a distribution."3 1 Revenue Ruling 2004-10 is currently available at http://www.irs.gov/pub/irs-drop/rr-04-10.pdf. 2 See Institute Memorandum to Pension Members No. 25-03 and Pension Operations Advisory Committee No. 30-03 (16105), dated May 22, 2003. 3 26 C.F.R. 1.411(a)-11(c)(2)(i). 2 The Revenue Ruling holds that a plan does not fail to satisfy the requirements of Code section 411(a)(11) merely because it charges reasonable plan administrative expenses to the accounts of former employees and their beneficiaries on a pro rata basis, but does not charge the accounts of current employees. A plan also would not fail section 411(a)(11) merely because it charges reasonable plan administrative expenses to the accounts of former employees and their beneficiaries, but not the accounts of current employees, on another reasonable basis that complies with the requirements of Title I of ERISA. The Revenue Ruling cautions, however, that not every method of allocating plan expenses is reasonable, and an unreasonable method could result in a significant detriment. For instance, allocating the expenses of active employees pro rata to all accounts, including the accounts of both active and former

employees, while allocating the expenses of former employees only to their accounts would not be reasonable, given that former employees would be bearing more than an equitable portion of the plan's expenses. In addition, the Revenue Ruling reminds taxpayers that an allocation method must comply with the nondiscrimination rules of Code section 401(a)(4), as the allocation of plan expenses is a plan "right or feature" under that provision. The Revenue Ruling provides an example of a possible violation of this requirement where a change in the allocation method benefits a highly compensated employee and increases expenses for all other plan accounts. Thomas T. Kim Associate Counsel

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