

MEMO# 3136

September 26, 1991

IRS DISQUALIFIES PLAN FOR NOT PERMITTING PARTICIPANT- DIRECTED INVESTMENTS BY RANK AND FILE EMPLOYEES

September 26, 1991 TO: PENSION MEMBERS NO. 34-91 INVESTMENT ADVISER MEMBERS NO. 41-91 INVESTMENT ADVISER ASSOCIATE MEMBERS NO. 45-91 RE: IRS DISQUALIFIES PLAN FOR NOT PERMITTING PARTICIPANT- DIRECTED INVESTMENTS BY RANK AND FILE EMPLOYEES _____ Attached is a recent IRS technical advice memorandum in which a profit sharing plan and a money purchase pension plan were disqualified because rank and file employees could not direct the investment of their plan accounts. The plans permitted the owner/employees of the plan sponsor to direct the investment of their accounts. The owner/employees achieved significantly higher returns than the rank and file employees. The Service ruled that the plans violated the non- discrimination rule of Internal Revenue Code section 401(a)(4). The Service also stated that even if the investment activities of the owner/employees has resulted in lower returns than the rank and file employees, the opportunity for the prohibited group members to make their own investment decisions would still result in discrimination prohibited by section 401(a)(4). The Service had previously ruled in Rev. Rul. 70-370 that unless all participants have the right to direct the investment of their accounts, the prohibited group of employees could be able to select the investments which are likely to provide a higher rate of return, thus making a plan discriminatory. This ruling is particularly timely as employers add participant-direction features to their plans under ERISA section 404(c). (See Institute Memorandum to Pension Members No. 11-91, Investment Adviser Members No. 11-91 and Investment Adviser Associate Members No. 12-91, dated March 13, 1991.) We will keep you informed of related developments. W. Richard Mason Assistant Counsel - Pension Attachment

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