

MEMO# 2384

December 17, 1990

PAYMENT OF ADVISER FEES FROM 403(B) ACCOUNTS

December 17, 1990 TO: PENSION MEMBERS NO. 41-90 INVESTMENT ADVISER MEMBERS NO. 56-90 INVESTMENT ADVISER ASSOCIATE MEMBERS NO. 52-90 RE: PAYMENT OF ADVISER FEES FROM 403(b) ACCOUNTS

As we previously informed you, the Internal Revenue Service has provided letter rulings regarding the income tax consequences of payment of market timing and other advisory fees from IRAs. (See Institute Memorandum to Pension Members No. 38-90, Investment Adviser Members No. 49-90 and Investment Adviser Associate Members No. 44-90, dated October 3, 1990.) In this regard, the Service recently released the attached ruling regarding payment of advisory fees from annuity contracts under section 403(b) of the Code or custodial accounts under section 403(b)(7) of the Code. The ruling concerned a situation in which a state statute amended the state's annuity program to permit payment of investment advisory fees from the participant's custodial account or annuity. The statute required the fees to be limited to 2 percent annually, paid directly to a registered investment adviser and subject to a written contract for services between the participant and the investment adviser. Such contract would provide that the custodial account or annuity is solely liable for the payment of the investment advisory fees and that the participant will not pay this fee at any time. The Service ruled that the advisory fee arrangement was analogous to the payment of expenses under an IRA. Therefore, as long as the respective annuity contracts or custodial accounts were solely liable for payment of the investment expenses, the payment of such fees would not disqualify the 403(b) arrangement and would not be treated as a distribution from the account. As such, the payment would not be included in the participant's gross income. The Service noted that the ruling would not apply if the annuity or custodial account were not solely liable for investment advisory fees or if the accounts did not actually pay the fees. We will keep you informed of further developments. W. Richard Mason Assistant General Counsel Attachment