

Part I

Section 411.--Minimum Vesting Standards

26 CFR 1.411(a)-11: Restriction and valuation of distributions.

Rev. Rul. 2004-10

ISSUE

Does a defined contribution plan under which the accounts of former employees are charged a pro rata share of the plan's reasonable administrative expenses, but the accounts of current employees are not charged those expenses, fail to satisfy the requirements of § 411(a)(11) of the Internal Revenue Code?

FACTS

Employer X maintains Plan A, a qualified defined contribution plan. Plan A provides that a participant who terminates employment will receive payment of his or her vested account balance under the plan commencing at normal retirement age or, if later, at termination of employment (subject to § 401(a)(9), in the case of a 5 percent owner). The plan permits a participant who terminates employment prior to normal retirement age to elect at any time after termination of employment to receive an immediate distribution of the vested account balance.

Plan A provides that certain administrative expenses, e.g., investment management fees, are to be allocated to the individual accounts of participants and beneficiaries based upon the ratio of each account balance to the total account balances of all participants and beneficiaries. Plan A further provides that the share of these expenses allocable to each participant's and beneficiary's account will be paid from the plan and charged against the account to the extent not paid by the employer. Employer X pays the portion of these expenses allocable to the accounts of current employees, but not those of former employees or their beneficiaries. All of the administrative expenses are proper plan expenses, within the meaning of the Employee Retirement Income Security Act of 1974 (ERISA), and are reasonable with respect to the services to which they relate.

LAW AND ANALYSIS

Section 411(a)(11)(A) sets forth requirements that must be satisfied with respect to certain distributions in order for a plan to be qualified under § 401(a). Under § 411(a)(11), if the present value of a participant's nonforfeitable benefit exceeds \$5,000, a plan meets the requirements of § 411(a)(11) only if the plan provides that the benefit may not be immediately distributable without the consent of the participant.

Section 1.411(a)-11(c)(2)(i) of the Income Tax Regulations provides that consent to a distribution is not valid if, under the plan, a significant detriment is imposed on any participant who does not consent to the distribution. That regulation further provides that whether or not a significant detriment is imposed is determined by the Commissioner by examining the particular facts and circumstances.

An allocation of administrative expenses of a defined contribution plan to the individual account of a participant who does not consent to a distribution is not a significant detriment within the meaning of § 1.411(a)-11(c)(2)(i) if that allocation is reasonable and otherwise satisfies the requirements of Title I of ERISA, such as a pro rata allocation. Such an allocation does not impose a detriment so significant as to be inconsistent with the deferral rights mandated by § 411(a)(11) because analogous fees would be imposed in the marketplace, either implicitly or explicitly, for a comparable investment outside the plan (e.g., fees charged by an investment manager for an IRA investment). Accordingly, whether or not such expenses are charged to the accounts of current employees, charging such expenses on a pro rata basis to the accounts of former employees is not a significant detriment, within the meaning of § 1.411(a)-11(c)(2)(i), that is imposed on a participant who does not consent to a distribution.

On May 19, 2003, the Employee Benefits Security Administration (the EBSA) of the Department of Labor issued Field Assistance Bulletin (FAB) 2003-3 which sets forth guidelines on the allocation of administrative expenses among plan participants in a defined contribution plan. Assuming that the expenses at issue are both proper expenses of the defined contribution plan and reasonable expenses with respect to the services to which they relate, FAB 2003-3 states that, for purposes of Title I of ERISA, certain administrative expenses may be allocated on a pro rata basis and certain administrative expenses may properly be charged to an individual participant rather than allocated among all plan participants.

However, not every method of allocating plan expenses is reasonable and a method that is not reasonable could result in a significant detriment. For example, 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 since former employees would be bearing more than an equitable portion of the plan's expenses. Accordingly, such an allocation of expenses could be a significant detriment.

Taxpayers are also reminded that the allocation of plan expenses must comply with the nondiscrimination rules of § 401(a)(4). The method of allocating plan expenses is a plan right or feature described under § 1.401(a)(4)-4(e)(3)(i). For example, if, in anticipation of the divorce of a plan participant who is a highly compensated employee, the plan's method of allocating expenses is changed so that the expense of a determination of whether an order constitutes a qualified domestic relations order under § 414(p) ceases to be allocated solely to the account of the participant for whom the expense is incurred, but instead is allocated pro rata to all accounts, the timing of such change may cause the plan to fail to satisfy the requirements of § 1.401(a)(4)-1(b)(3) and (4) with respect to the nondiscriminatory availability of benefits, rights and features and with respect to the timing of plan amendments.

HOLDING

Plan A does not fail to satisfy the requirements of § 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. Plan A also would not fail to comply with the requirements of § 411(a)(11) merely because it charged 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.

DRAFTING INFORMATION

The principal author of this revenue ruling is Michael Rubin of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this revenue ruling, please contact Employee Plans' taxpayer assistance telephone service at 1-877-829-5500 (a toll-free number) between the hours of 8:00 a.m. and 6:30 p.m. Eastern Time, Monday through Friday (a toll free call). Mr. Rubin may be reached at (202) 283-9888 (not a toll-free call).