TRANSAMERICA CENTER
FOR RETIREMENT STUDIES℠

TCRS 2004-03: Summary of IRS Revenue Ruling 2004-10

The Transamerica Center for Retirement Studies ("TCRS") has analyzed the Revenue Ruling ("Rev. Rul.") 2004-10 that was issued by the IRS on January 29, 2004, assessed its impact, and prepared this summary.

In this Rev. Rul., the IRS continues the discussion started by the DOL's Field Assistance Bulletin ("FAB") 2003-3 released May 19, 2003. In FAB 2003-3, the DOL raised two issues with respect to the allocation of plan expenses in defined contribution plans:

- the allocation of plan expenses on a pro-rata, rather than per capita, basis, and
- the charging of plan expenses to a plan participant rather than plan participants as a whole.

In analyzing these two issues, the DOL also concluded that nothing in Title I of ERISA prevents a plan sponsor from paying only certain plan expenses or only plan expenses on behalf of certain plan participants; provided the expenses have been properly determined to be plan expenses (not settlor expenses, which must be paid by the employer) and they are reasonable as they relate to the services performed.

In this Rev. Rul., the IRS goes further and holds that the requirements of Code section 411(a)(11) are satisfied when a defined contribution plan charges the accounts of former employees a pro-rata share of the plan's reasonable administrative expenses, but the accounts of current employees are not charged those expenses.[1]

However, the IRS cautions that even though the pro-rata method of allocating plan expenses is one that is covered under FAB 2003-3[2] as a reasonable allocation method, not all allocation methods are reasonable and a method that is not reasonable could be a significant detriment[1]. For example, if a plan allocates expenses of active employees pro-rata to all accounts (both active and terminated employee accounts) and allocates expenses of terminated employees only to their accounts, this method of allocation would not be reasonable because terminated employees would bear more than an equitable portion of the expenses. This type of allocation would be a significant detriment[3].

In this Rev. Rul., the IRS also reminds employers that the allocation of plan expenses is a plan right or feature that must comply with the general nondiscrimination rules of Code section 401(a)(4). Therefore, if a plan that currently allocates QDRO expenses solely to the participant who incurred the expenses is amended in anticipation of the divorce of a highly compensated employee, so that after the amendment, those expenses would be allocated pro-rata to all participants, the timing of such an amendment would cause the plan to fail the nondiscrimination rules[4].

With the release of this Rev. Rul., service providers like Transamerica Retirement Services, would need to step back and revisit plan documents, service agreements, fee provisions and procedures to determine how best to conform to this Rev. Rul. and FAB 2003-3.

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1 Section 1.411(a)-11(c)(2)(ii) of the Income Tax Regulations provides that consent to a distribution is not valid if a significant detriment is imposed on any participant who does not consent to the distribution. The IRS held in Rev. Rul. 2004-10 that allocating reasonable plan expenses to the accounts of terminated participants is not a significant detriment under the regulations even though the employer pays for the expenses allocable to active employees.

2 The attached LTF Release 2003-3 provides examples of plan expenses and permissible allocation methods included in FAB 2003-3.

3 Because this method of allocation creates a significant detriment according to Rev. Rul. 2004-10 it would violate Code section 411(a)(11) and the regulations thereunder.

4 This type of amendment would violate the nondiscrimination rights and features requirement of Code section 401(a)(4). The test for nondiscrimination under Code section 401(a)(4) is based on facts and circumstances.