Can We Plan-Related Expenses out of Plan Assets?

Facts

Like many businesses, we've been watching our cash flow carefully over the past several weeks. We're making adjustments where necessary so that we can stay on top of the invoices we receive from our service providers. Among those invoices are a few related to expenses for our 401(k) plan. I think I've heard that I can pay those invoices using plan assets. Even though the company normally covers plan expenses, it would be a big help if we could take advantage of this option at least until the economy starts to settle down. That said, I'm not completely certain we are allowed to do it and, if so, how it works.

Question

Is it really ok for us to pay plan-related expenses out of plan assets? If yes, is there anything special we need to know so that we don't accidentally do something that would throw our plan out of compliance?

Answer

The answer is "absolutely yes" for some plan expenses and "absolute no" for others.

We've explored some of the fees that can and can't be taken from plan assets or forfeitures in a previous Question of the Week, found here, but given the times thought a few more details on the subject might be useful.

Participant Accounts vs. Forfeitures

Let's start by addressing the difference between paying expenses from the plan's forfeiture account and using assets held in participant accounts. The forfeiture account is the most straightforward. In order to use forfeited dollars to pay expenses, the plan document must specifically allow for that option. If yours doesn't, a formal amendment to permit it is the first order of business. Although forfeitures are still plan assets that are subject to the same restrictions on allowable expenses, the fact that they are in a "holding account" means there is no concern about how to allocate the expenses among participants.

Keep in mind that all dollars in the forfeiture account may not currently be available to pay expenses (even once you've amended). The reason is that the plan document contains specific provisions related to when you can/must use forfeitures. For example, some say you must wait until the year after the year the forfeiture occurs to use those dollars, while other plan documents allow immediate use. The take-away is that if forfeitures are not used timely, you can lose the ability to use them to pay plan expenses.

Allocation of Expenses

Most plan documents allow for the payment of eligible expenses directly from participant accounts (other than the forfeiture account), though we still strongly recommend confirming that in your plan's document. Once confirmed, the next decision to consider is how you will allocate the expenses to participants, keeping in mind that you must do so in a manner that is consistent and does not discriminate against the non-highly compensated employees. Here are three common options:

- **Pro Rata:** This method spreads the expenses proportionately among participants based on account balances. For examples, if total plan assets are $100,000, a participant with a $20,000 balance is going to pay 20% of the expenses paid by the plan. That means if the plan pays fees totaling $1,000, this participant will pay $200. While this method avoids hitting newer/smaller participant accounts with larger fee allocations, it also means that company owners will likely bear the brunt since they often have the larger balances in the plan.

- **Per Capita:** This option simply divides the total expenses to be paid from the plan by the number of plan participants so that each one pays the exact same dollar amount. If the total plan fees are $1,000 and there are 10 participants with balances, $100 is withdrawn from each participant's account to cover the fees. While this is a totally acceptable method, you may want to consider the amount of the fees relative to average participant account balances. If you have participants who are just beginning to save, this method could result in relatively significant decreases or wipe out their balances altogether, which could result in negative participant / employee relations.

- **Transactional:** Many plans charge the fees for participant-initiated transactions – think, loans and distributions - directly against the account of the participant who requested the withdrawal. This method ensures only those participants taking advantage of a provision are paying the related fees rather than allocating them across the entire plan. If your plan is not already setup this way, it might be worth considering in light of the fact that the number of distribution and loan requests is likely to increase due to coronavirus-related distributions and CARES Act loan provisions.

Not All or Nothing

Paying expenses from plan assets does not have to be an all or nothing proposition. Consider a situation where plan expenses are comprised of a base fee, a per participant fee, and transaction-based fees. The company could choose to pay the base fee directly, charge the per head fees to participants using the per capita method, and charge transaction-based fees to those initiated the transactions. If the company wants/needs to have the plan cover the base fee as well, that could be allocated pro rata based on account balance. So long as your plan document allows, or is amended to allow, there is generally no compliance issue with shifting to having the plan pay expenses during the current period of economic uncertainty. Similarly, when the economic environment rebounds, you're able to change again. That means the company could easily resume paying these expenses out-of-pocket and claiming the tax deduction (or, in some cases, the tax credit).

If you're unsure of what your plan document allows or would like to explore how pro-rata versus per capita might affect your plan participants, please reach out to the DWC team. We'll be happy to take the time to discuss your specific plan, document, and dynamics to assist you as you explore expense alternatives.

Want to get articles just like this one delivered to your inbox weekly?

Subscribe to receive regular updates from the DWC 401(k) Q&A blog.

Helpful insights without the junk, delivered on your schedule.