

What Expenses Can We Pay from Plan Assets? A Brief Review of the Legal Principles and Some Common Questions

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ERISA plan expenses may be paid by the plan sponsor or, if certain requirements are met, reasonable plan administrative expenses may be payable from plan assets. This article provides an overview of the process for determining whether plan assets may be used to pay plan expenses, and highlights some specific concerns for plan fiduciaries related to using plan assets to pay plan expenses.

Legal Framework for Paying Plan Expenses

ERISA Section 404 is clear that plan assets are to be used for the *exclusive* purposes of providing benefits to participants and their beneficiaries, and defraying reasonable expenses of administering the plan. Any other use of plan assets can result in a breach of fiduciary duties under ERISA, a prohibited transaction under ERISA (which would trigger associated excise taxes), and a violation of the Internal Revenue Code's exclusive benefit rule (which could result in plan disqualification). Therefore, how plan expenses are paid is an important compliance issue of which plan sponsors and plan fiduciaries should be aware.

The decision to use plan assets to pay for plan administrative expenses is a fiduciary decision. There are a few threshold questions that the plan fiduciary should consider in determining whether plan expenses can be paid by the plan:

What does the plan document say about using plan assets to pay for reasonable plan administrative expenses?

The plan document may state that plan expenses may be paid out of plan assets. In addition, the Department of Labor (DOL) takes the position that plan expenses may be paid out of plan assets if the plan document is silent, as long as all other requirements are satisfied.

However, the plan document may provide that the plan sponsor is obligated to pay the costs of plan administration (or may state that the plan sponsor pays certain specified administrative costs). Some plans limit how certain plan assets (*e.g.*, forfeitures) may be used (*e.g.*, forfeitures must be used first to reduce employer contributions, before they can be used to pay reasonable plan expenses). If the plan document limits the ability to use plan assets to pay for the costs of plan administration, the plan would need to be amended to broaden the purposes for which plan assets may be used going forward.

Is the expense a "settlor" expense or a "fiduciary" expense?

Only expenses that are "fiduciary" in nature can be paid from plan assets. Fiduciary expenses are those that relate to ongoing administration of the plan according to its terms and in compliance with the law (*e.g.*, coverage and nondiscrimination testing, trustee and recordkeeping fees, costs associated with preparing and distributing mandatory participant disclosures, costs associated with preparing legally required amendments).

In contrast, "settlor" expenses are those that relate to the establishment, design and termination of a plan (*e.g.*, plan design studies, projections to determine the financial impact of a design change, legal and consulting fees in connection with the decision to terminate a plan). The DOL views settlor expenses as for the benefit of the plan

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sponsor employer; therefore, the DOL's position is that these types of expenses must be paid by the plan sponsor employer, not by the plan.

Note that it is not always clear whether an expense is "fiduciary" or "settlor" in nature, especially when an expense relates to the *implementation* of a settlor decision. For example, the decision to terminate a plan is a settlor decision, but certain expenses incurred to accomplish the plan termination are likely to be fiduciary expenses that are payable from plan assets. Plan sponsors who are faced with these types of judgment calls about whether a particular expense can be paid by the plan should consult their benefits counsel for guidance.

Is the expense prudent? Is the amount reasonable?

Expenses paid by the plan must be reasonable in light of the services performed, and relative to fees charged for the same services by other service providers in the marketplace. Before using plan assets to pay an administrative expense, the plan fiduciary should evaluate the reasonableness of the expense and document its basis for concluding that the expense is reasonable.

Common Questions Related to Paying Plan Expenses

Below are some of the common questions raised by plan sponsors that choose to pay plan administrative expenses with plan assets:

When can plan assets be used to pay for plan amendments?

The DOL distinguishes between mandatory/legally required amendments and discretionary amendments. In general, plan assets may be used to pay for the cost of preparing legally required amendments, while the plan sponsor must pay for the cost of preparing discretionary amendments. Where a plan amendment includes both discretionary and legally required changes to the plan, the DOL has stated that plan assets could be used to pay for the portion of the costs that relate to the legally required changes, but advised that plan fiduciaries would need to "obtain from the service provider a determination of the specific expense(s) attributable to the fiduciaries' implementation responsibilities" in order to do so.

Must plan administrative expenses be allocated to participant accounts on a pro rata basis?

How to allocate the cost of plan administrative expenses is a fiduciary decision - the DOL has not prescribed a single method of allocating charges for plan expenses to participant accounts in a defined contribution plan. Either pro rata allocation or per capita allocation may be an equitable method of spreading the costs of plan administration across participant accounts. In addition, expenses that are incurred by individual participants for plan administrative services (e.g., fees for reviewing hardship withdrawal requests and domestic relations orders, fees for processing plan distributions) may be charged against an individual participant's plan account, provided that the fees for such services are reasonable and proper plan administrative expenses. In addition, if participants will be charged fees for individual plan services, this needs to be disclosed to participants in the summary plan description.

Can a plan sponsor be reimbursed from the plan for paying plan administrative expenses?

Plan sponsors often pay plan administrative expenses and then seek reimbursement from the plan. Because the plan sponsor is a party-in-interest, the DOL views this type of arrangement as an interest-free loan that results in a prohibited transaction unless certain requirements are met:

1. The loan may be used only for payment of ordinary operating expenses or for a purpose incidental to the ordinary operation of the plan.
2. No interest or other fees may be charged on the loan.
3. The loan must be made from the plan sponsor to the plan (not from the plan to the plan sponsor).
4. The loan must be unsecured.
5. If the loan term is or could be 60 days or longer, there must be a written loan agreement in place that describes the material terms of the loan. Note that even if the intention is for reimbursement to be made within 60 days, it may be prudent to have a written loan agreement in case the reimbursement is not made within the 60-day period.

Plan sponsors that have a practice of being reimbursed from the plan for the cost of plan administrative expenses (e.g., a plan sponsor that pays annual recordkeeping fees and is repaid the fees as they are deducted from participant accounts over the course of the plan year) should consult with benefits counsel to ensure the reimbursement arrangement is compliant.

Is there a correction program available to address an error related to the payment of expenses from plan assets?

If a plan fiduciary determines that an expense was improperly paid from plan assets, the prohibited transaction aspect of the improper payment can be corrected through the DOL's Voluntary Fiduciary Correction Program (VFCP). Note that completing a VFCP correction protects plan fiduciaries only with respect to enforcement actions by the DOL, so there still could be potential for the IRS and/or a participant to raise complaints.

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