Prohibited Transactions

What Are They, When Can They Occur and What To Do When One Happens

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THE
WAGNER LAW GROUP
A PROFESSIONAL CORPORATION

Agenda

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- Prohibited Transactions
  - Party in Interest Transactions
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  - Liability under ERISA and Excise Taxes under Tax Code

Agenda (cont'd)

- Prohibited Transaction Exemptions (PTEs)
  - Statutory
  - Administrative
- Voluntary Fiduciary Correction Program (VFCP)

Introduction

Prohibited Transactions – In General

- Purpose – exclusive benefit of participants
- Parallel provisions in ERISA and Tax Code
- Scope of coverage – IRAs and retirement plans
- Employee pension benefit plans
  - Titles I and II of ERISA
    - § 406 (prohibited transactions),
  - Tax Code / Title II of ERISA
    - § 4975(c) (prohibited transactions)
    - § 4975(a) (excise tax)

Prohibited Transactions – In General (cont'd)

- IRAs and Keogh Plans
  - Exempt from Title I of ERISA
  - Tax Code § 4975 (excise tax)

Party in Interest

- ERISA § 406(a) prohibits party in interest transactions
- "Party in interest" defined (ERISA § 3(14))
  - A fiduciary
  - A service provider
  - An employer with employees covered by the plan
  - An employee organization with members covered by the plan
  - A 50% or more owner of the employer or employee organization

Party in Interest
(cont’d)

- “Party in interest” defined (ERISA § 3(14)) (cont’d)
  - A spouse, ancestor, lineal descendant, or spouse of a lineal descendant of any of the persons above
  - A corporation partnership, trust or estate of which 50% is owned directly or indirectly by person above (other than relatives)
  - An employee, officer, director or 10% or more shareholder of any of the persons mentioned above except a fiduciary or relative
  - A 10% or more partner or joint venturer of nay person above except a fiduciary or relative

Party in Interest Transactions

- Prohibited Transactions in ERISA § 406(a)
  - Sale or exchange, or leasing, of any property between a plan and a party in interest
  - Loan/extension of credit by a plan to a party in interest
  - Furnishing of goods, services, or facilities by a plan to a party in interest (or vice versa)
  - Transfer to, or use by or for the benefit of a party in interest, of any assets of the plan
  - Causing the plan to acquire any employer security or employer real property in violation of ERISA § 407

Prohibited Self-Dealing and Conflicts of Interest

- Prohibited transactions in ERISA § 406(b)
  - Deal with plan assets in his own interest or for his own account (aka “self-dealing”);
  - Act in a transaction involving a plan on behalf of a person whose interests are adverse to the interests of the plan, its participants or beneficiaries (in other words, representing a party adverse to the plan in a transaction); or
  - Receive any consideration for his own personal account from any party dealing with the plan in connection with a transaction involving plan assets (aka “kickbacks”)

Disqualified Person and Prohibited Transactions in Tax Code

- Parallel prohibited transaction provisions in the Tax Code
- "Disqualified person" defined (Code § 4975(e)(2)
  - Same as "party in interest"
  - An ~~employee~~, officer, director or 10% or more shareholder, or a highly compensated employee (earning 10% or more of the yearly wages of an employer) of any of the persons mentioned above except a fiduciary or relative

Disqualified Person and Prohibited Transactions in Tax Code (cont'd)

- Prohibited transactions in Code § 4975(c)
  - First 4 prohibited transactions identical to those in "party in interest" transactions
  - Self-dealing
  - Receive kickbacks

Liability under ERISA and Excise Tax under Tax Code

- Liability – ERISA § 409
  - Personal liability for plan losses, rescission, disgorgement of profits, other equitable or remedial relief
- Excise Tax – Tax Code §§ 4975(a) and (b)
  - Imposed on “disqualified person(s)” with respect to employer-sponsored retirement plans
  - First tier excise tax – 15% of the “amount involved” for each year until correction

Liability under ERISA and Excise Tax under Tax Code

- Excise Tax – Tax Code §§ 4975(a) and (b) (cont'd)
  - Second tier excise tax – 100% of "amount involved"
    - Imposed if not corrected by the time of the IRS' assessment

Prohibited Transaction Exemptions (PTEs) – Statutory Exemptions

- Statutory exemptions – ERISA 408(b); Code 4975(d)
- Examples
  - Loans to Participants (ERISA sec. 408(b)(1); Code sec. 4975(d)(1))
  - The provision of necessary services for the operation of the plan by a party in interest (ERISA sec. 408(b)(2); Code sec. 4975(d)(2))

PTEs – Administrative Exemptions

- Class exemptions (e.g., Best Interest Contract Exemption)

PTEs – Administrative Exemptions (cont'd)

- Individual exemptions
  - Relief for a specific transaction
  - Factors
    - Percentage of plan assets
    - Return compared to other investment with similar risk
    - Value of property involved
    - Independent fiduciary review

PTEs – Administrative Exemptions (cont'd)

- Individual exemptions (cont'd)
  - Retroactive exemption possible where safeguards existed and resulted in a beneficial transaction carried out in good faith
  - PTE 96-62 – EXPRO expedited consideration

Voluntary Fiduciary Compliance Program (VFCP)

VFCP

- Purpose – correct violations of Part 4 of Title I of ERISA
- Relief – No action letter
  - No investigation will be initiated
  - ERISA §§ 502(l) or 502(i) civil penalties will not apply
  - EBSA reserves the right to verify correction

VFCP (cont'd)

- Limits to Relief
  - Limited to transactions and applicants in application
  - Conditioned on accuracy of application. Material misrepresentation will void the no-action letter.
  - Does not preclude criminal investigation
  - Does not preclude removal of any person from position of responsibility
  - Does not preclude referral to IRS
  - Not binding on other agencies

VFCP (cont'd)

- Eligibility
  - Available to plan sponsors, fiduciaries, parties in interest or others
  - Not under investigation
  - No evidence of criminal violations
  - No notification of referral to the IRS

VFCP (cont'd)

- Correcting Under VFCP
  - Full and accurate correction
  - Restoration of plan, participants and beneficiaries
  - Incomplete/inaccurate applicants rejected
  - Amend Forms 5500 for affected years, if applicable
  - A correction under VFCP of a P/T under § 4975 generally is a correction for purposes of § 4975

VFCP (cont'd)

- Correcting Under VFCP (cont'd)
  - Correction costs may not be paid from plan assets
  - $20 de minimus exception for corrective distributions

VFCP (cont'd)

- Application Procedures
  - Prepared by "Plan Official"
  - Detailed narrative
  - Supporting materials
    - Relevant portions of plan document
    - Documents supporting transactions
    - Documentation of lost earnings
    - Documentation of restored profits, if applicable
    - Proof of payment of required amounts

VFCP (cont’d)

- Application Procedures (cont’d)
  - Signed Checklist
  - Penalty of perjury statement
  - DOL provides a model application form

VFCP (cont'd)

- 19 Covered Transactions; 6 categories
  - Delinquent Remittance of Participant Funds
    - Delinquent Participant Contributions and Participant Loan Repayments to Pension Plans 406(a)(1)(B) or (D)
    - Delinquent Participant Contributions to Insured Welfare Plans 406(a)(1)(B) or (D)
    - Delinquent Participant Contributions to Welfare Plan Trusts 406(a)(1)(B) or (D)

VFCP (cont’d)

- 19 Covered Transactions; 6 categories (cont’d)
  - Loans
    - Fair Market Interest Rate Loans to Parties in Interest 406(a)(1)(B)
    - Below Market Interest Rate Loans to Parties in Interest 406(a)(1)(B)
    - Below Market Interest Rate Loans to Non-Parties in Interest
    - Below Market Interest Rate Loans Due to Delay in Perfecting Security Interest
  - Participant Loans
    - Failing to Comply with Plan Provisions for Amount, Duration, or Level Amortization (violation of exemption)
    - Defaulted Participant Loans

VFCP

- 19 Covered Transactions; 5 categories
  - Purchases, Sales and Exchanges
    - Purchase of Assets by Plans from Parties in Interest
    - Sale of Assets by Plans to Parties in Interest
    - Sale and Leaseback of Property to Sponsoring Employers
    - Purchase of Assets from Non-Parties in Interest at More Than Fair Market Value
    - Sale of Assets to Non-Parties in Interest at Less Than Fair Market Value
    - Holding of an Illiquid Asset Previously Purchased by Plan

VFCP

- 19 Covered Transactions; 5 categories
  - Benefits
    - Benefit Payments Based on Improper Valuation of Plan Assets
  - Plan Expenses
    - Payment of Duplicate, Excessive, or Unnecessary Compensation
    - Improper Payment of Expenses by Plan
    - Payment of Dual Compensation to Plan Fiduciaries

Important Information

This presentation is intended for general informational purposes only, and it does not constitute legal, tax or investment advice from The Wagner Law Group. Financial advisors and other plan service providers should consult with their own legal counsel to understand the nature and scope of their responsibilities under ERISA and other applicable law.

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