

U.S. Department of Labor

Labor-Management Services Administration
Washington, D.C. 20216



Reply to the Attention of:

OPINION NO. 82-45A
Sec. IRC §4975(c)(1)(A), IRC §4975(c)(1)(E),
IRC §4975(d)(1), ERISA §404(a)(1)(B)

AUG 27 1982

Mr. John F. Eden
10100 Santa Monica Boulevard
Suite 2500
Los Angeles, California 90067

Re: A Medical Corporation Employee Pension Plan
Identification Number: F-2350

Dear Mr. Eden:

This is in reply to your letters of March 26, 1982, May 4, 1982 and June 2, 1982 requesting an advisory opinion under the prohibited transactions provisions of the Employee Retirement Income Security Act of 1974 (ERISA).

You represent that the A Medical Corporation Employee Pension Plan (the Plan) is a defined benefit pension plan currently qualified under section 401(a) of the Internal Revenue Code of 1954 (the Code). is the sole trustee and participant of the Plan and the sole shareholder of A Medical Corporation.

The Plan permits participant loans in accordance with section 4975(d)(1) of the Code. Pursuant to that plan provision, has executed a number of promissory notes in favor of the Plan with a current principal balance due of . interest in the Plan collateralizes the loans. You represent that the value of such security is in excess of the outstanding loan amounts. proposes to reduce the aggregate balance of outstanding participant loans by 90 percent by repaying such loans through the transfer to the plan of a parcel of real property with an appraised value of . The Plan will assume an outstanding mortgage of on the property.

You request an advisory opinion that the transfer of real property to the plan in repayment of an exempt participant loan will not be a prohibited transaction under section 4975 of the Code.

Section 2510.3-3(b) of the Department's regulations provide that for purposes of Title I of ERISA, the term "employee benefit plan" shall not include any plan under which no employees

are participants covered under the plan. For purposes of this regulation, an individual shall not be deemed to be an employee of a trade or business which is wholly owned by the individual. Although the Department does not have jurisdiction under Title I of ERISA, these plans are subject to the prohibited transaction restrictions and tax sanctions of section 4975 of the Code (contained in Title II of ERISA). Under Presidential Reorganization No.4 of 1978, the authority of the Secretary of Treasury to issue interpretations regarding section 4975 of the Code has been, with certain exceptions not here relevant, transferred to the Secretary of Labor, and the Secretary of the Treasury is bound by the interpretations of the Secretary of Labor pursuant to such authority.

Section 4975(c)(1)(A) of the Code prohibits the direct or indirect sale or exchange, or leasing, of any property between a plan and a disqualified person. In addition, section 4975(c)(1)(E) of the Code prohibits a fiduciary from dealing with the assets of a plan in his own interest or for his own account. Section 4975(e)(2) defines the term "disqualified person" to include a fiduciary and an owner of 50 percent or more of the stock of a corporation which is an employer any of whose employees are covered by the plan.

Section 4975(d)(1) of the Code provides a statutory exemption for certain loans to plan participants. That exemption provides that the prohibitions contained in section 4975(c) of the Code shall not apply to any loan made by the plan to a disqualified person who is a participant or beneficiary of the plan if such loan is available to all such participants or beneficiaries on a reasonably equivalent basis, is not made available to highly compensated employees, officers, or shareholders in an amount greater than the amount made available to other employees, is made in accordance with specific plan provisions regarding such loans set forth in the plan, bears a reasonable rate of interest, and is adequately secured.

We are assuming, for purposes of your ruling request, that _____ participant loans comply with all the conditions of section 4975(d)(1) and are, therefore, exempt from the prohibitions of section 4975(c) of the Code.

A participant assumes, with respect to a promissory note evidencing a participant loan, an obligation to make payments necessary to repay outstanding loan amounts. The transfer of real property by a participant to the Plan would constitute a discharge by the participant of his or her legal obligation to repay the loans. In effect, the Plan is exchanging its legal right to payment of the loans for property other than cash. In our view, the fact that this transfer of real property would extinguish liability for a participant loan otherwise exempt under section 4975(d)(1) of the Code is not sufficient to permit treatment of this transaction in a manner different than any other sale or exchange of real property by a disqualified person to a plan. Accordingly, the transfer of real property by a disqualified person in repayment of a participant loan is a prohibited sale or exchange of property between a plan and a disqualified person under section 4975(c)(1) of the Code. In addition, if _____ causes the Plan for which he serves as trustee to accept repayment of his participant loan by the transfer of real property, he will have engaged in a prohibited transaction under section 4975(c)(1)(E) of the Code.

It should be noted that you have not requested an opinion regarding whether the participant loans described in your request satisfy the conditions contained in section 4975(d)(1) of the Code and are, therefore, exempt from the prohibitions of section 4975(c)(1) of the Code. By way of general information, the Department views the requirement that participant loans bear a reasonable rate of interest as encompassing a flexible standard based on the composite of what persons and institutions in the business of lending money would obtain as compensation for the use of the money which they lend under similar circumstances. This prevailing rate standard permits a fiduciary to consider those factors pertaining to the opportunity for gain and the risk of loss that professional lenders would consider, in setting the rate of interest on a similar arm's length loan.

In addition, qualified retirement plans under the Internal Revenue Code must be maintained for the exclusive benefit of the employees and their beneficiaries. In this regard, the ERISA Conference Report (H.R. Rep. 93-1280, 93rd Cong., 2d Sess. 1974 at p. 302) states that the "conferees intend that to the extent that a fiduciary meets the prudent man rule of the labor provisions, he will be deemed to meet these aspects of the exclusive benefit rule under the Internal Revenue Code." Under the prudence standard of section 404(a)(1)(B) of ERISA, it is the Department's view that any participant loan or participant loan program is considered a plan investment and would not be prudent if the investment provided the plan with less return, in comparison to the risk involved, than comparable investments available to the plan or, alternatively, involved a greater risk to the security of plan assets than such other investment offering a similar return.

This letter constitutes an advisory opinion under ERISA Procedure 76-1 and is issued subject to the provisions of the procedure, including section 10, relating to the effect of advisory opinions.

Sincerely,

Alan D. Lebowitz
Assistant Administrator for Fiduciary Standards
Pension and Welfare Benefit Programs