U.S. Department of Labor Office of Pension and Welfare Benefit Programs
Washington, D.C. 20210

OPINION NO. 84-44A
Sec. 408(d), 408(b)(1)

NOV 9 1984

Charles S. Dunetz, Esquire
Gern, Stieber, Dunetz, Davison & Weinstein
769 Northfield Avenue
West Orange, N.J. 07052

Re: Diagnostic Pathology, P.A. Employees' Pension and Profit Sharing Plans
(the Pension Plan and Profit Sharing Plan)
Identification Number: F-2836

Dear Mr. Dunetz:

This is in response to your letter of February 7, 1984 in which you requested an advisory opinion concerning the impact of a proposed corporate election pursuant to section 1362 of the Internal Revenue Code (the Code) on certain loans made in accordance with the provisions of section 408(b)(1) of the Employee Retirement Income Security Act of 1974 (ERISA) and section 4975(d)(1) of the Code.

You represent that Diagnostic Pathology, P.A. (the Employer) is a professional service corporation incorporated in New Jersey in 1973. Dr. Robert Hutter and Dr. Robert Rickert each own 50% of the outstanding shares of the Employer. The Employer adopted the Profit Sharing Plan and Pension Plan on December 31, 1973 and December 23, 1975, respectively. The Profit Sharing Plan and Pension Plan each contain provisions pursuant to which participants may make application to the trustees to borrow funds. On May 18, 1983, Dr. Rickert borrowed $25,000 from the Pension Plan and $25,000 from the Profit Sharing Plan. On November 2, 1983, Dr. Hutter borrowed $25,000 from the Pension Plan and $25,000 from the Profit Sharing Plan (collectively, the loans to Drs. Rickert and Hutter will be referred to as the Loans). Each Loan represented less than 80% of the account balances of Dr. Hutter and Dr. Rickert in the Profit Sharing Plan and Pension Plan as of December 31, 1982.[1] You represent that the Loans comply with the provisions of section 408(b)(1) of ERISA and 4975(d)(1) of the Code. The Employer proposes to make an election to become a small business corporation within the meaning of and pursuant to the provisions of section 1362 of the Code.

You specifically request an advisory opinion as to whether the election by the Employer to become a small business corporation under section 1362 of the Code would cause the Loans

[1] The Department notes that the Tax Equity and Fiscal Responsibility Act (TEFRA) (P.L. 97-248) places a number of restrictions on participant loans for certain tax purposes. Specifically, section 236 of TEFRA amends section 72 of the Code to state, in part, that a participant loan will be treated as a taxable distribution unless such loan does not exceed the lesser of (i) $50,000, or (ii) one-half of the present value of the nonforfeitable accrued benefit of the employee under the plan (but not less than $10,000).

to become prohibited transactions under section 406 of ERISA and 4975(c) of the Code by virtue of section 408(d) of ERISA and the last paragraph of 4975(d) of the Code. It appears that your request also concerns the matter of what constitutes the "taxable period" for a prohibited transaction under section 4975(f)(2) of the Code. Under Reorganization Plan No. 4 of 1978 (43 FR 47713, October 17, 1978) the authority to issue rulings under section 4975 of the Code has been transferred, with certain exceptions, to the Secretary of Labor. Therefore, the references in this letter to specific sections of ERISA refer also to corresponding sections of the Code. However, the Internal Revenue Service has retained sole jurisdiction with respect to questions involving section 4975(f)(2) of the Code. Accordingly, this advisory opinion will not address questions involving 4975(f)(2) of the Code.

Except as provided in section 408 of ERISA, section 406(a)(1)(B) of ERISA prohibits a fiduciary with respect to a plan from causing the plan to engage in a transaction if the fiduciary knows or should know that such transaction constitutes a direct or indirect lending of money or other extension of credit between a plan and a party in interest with respect to the plan. Section 3(14) of ERISA defines the term "party in interest" with respect to a plan to include an officer, director or 10 percent or more shareholder of an employer any whose employees are covered by the plan.

Section 408(b)(1) of ERISA provides that the prohibitions of section 406 shall not apply to any loans made by a plan to a party in interest who is a participant or beneficiary of the plan if the loans (1) are available to all participants and beneficiaries on a reasonably equivalent basis, (2) are not available to highly compensated employees, officers or stockholders in an amount greater than the amount made available to other employees, (3) are made in accordance with specific provisions regarding such loans set forth in the plan, (4) bear a reasonable rate of interest and (5) are adequately secured.

Section 408(d) of ERISA provides, in pertinent part, that the statutory exemption contained in section 408(b)(1) does not apply to any transaction in which a plan directly or indirectly lends any part of the corpus or income of the plan to any person who with respect to the plan is an owner-employee as defined in section 401(c)(3) of the Code. For purposes of the preceding sentence, a shareholder-employee (as defined in section 1379 of the Code) shall be deemed to be an owner-employee. Section 1379(d) of the Code defines a shareholder-employee, in pertinent part, to mean an employee or officer of an electing small business corporation who owns more than 5 percent of the outstanding stock of the corporation involved. Thus, if an election is made by the Employer under section 1362 of the Code, you represent that Drs. Hutter and Rickert would be deemed to be owner-employees by reason of their status as shareholder-employees under section 1379(d) of the Code.

It is the opinion of the Department that a transaction, subject to a statutory exemption when entered into, nevertheless, may become prohibited under section 406 of ERISA while the transaction is continuing. Certain transactions such as loans are continuing transactions and, therefore, the debtor-creditor relationship continues throughout the existence of the extension of credit.[2] Thus, although a loan between a plan and a party in interest may have been entitled to the relief provided by the statutory exemption under section 408(b)(1) of ERISA when entered into, if the party in interest later becomes an owner-employee for

[2] The Department has expressed a similar view in the preamble to a class exemption for relief for transactions involving bank collective investment funds (45 FR 49709, 49713, July 25, 1980).

purposes of section 408(d), it is consistent with the purpose of section 408(d) to then treat the loan as a prohibited transaction, for which no relief is available under section 408(b)(1). Accordingly, under the facts you have described, if the Employer elects to become a small business corporation under section 1362 of the Code, at such time the Loans would become prohibited transactions under section 406 of ERISA for which relief under section 408(b)(1) would not be available.

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

Sincerely,

Elliot I. Daniel
Acting Assistant Administrator for Regulations and Interpretations