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Sec. 4975. Tax on prohibited transactions

TITLE 26, Subtitle D, CHAPTER 43, Sec. 4975

STATUTE

(a)

Initial taxes on disqualified person

There is hereby imposed a tax on each prohibited transaction. The rate of tax shall be equal to 5 percent of the amount involved with respect to the prohibited transaction for each year (or part thereof) in the taxable period. The tax imposed by this subsection shall be paid by any disqualified person who participates in the prohibited transaction (other than a fiduciary acting only as such).

(b)

Additional taxes on disqualified person

In any case in which an initial tax is imposed by subsection (a) on a prohibited transaction and the transaction is not corrected within the taxable period, there is hereby imposed a tax equal to 100 percent of the amount involved. The tax imposed by this subsection shall be paid by any disqualified person who participated in the prohibited transaction (other than a fiduciary acting only as such).

(c)

Prohibited transaction

(1)

General rule

For purposes of this section, the term "prohibited transaction" means any direct or indirect -

(A)

sale or exchange, or leasing, of any property between a plan and a disqualified person;

(B)

lending of money or other extension of credit between a plan and a disqualified person;

(C)

furnishing of goods, services, or facilities between a plan and a disqualified person;

(D)

transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a plan;

(E)

act by a disqualified person who is a fiduciary whereby he deals with the income or assets of a plan in his own interests or for his own account; or

(F)

receipt of any consideration for his own personal account by any disqualified person who is a fiduciary from any party dealing with the plan in connection with a transaction involving the income or assets of the plan.

(2)

Special exemption

The Secretary shall establish an exemption procedure for purposes of this subsection. Pursuant to such procedure, he may grant a conditional or unconditional exemption of any disqualified person or transaction, orders of disqualified persons or transactions, from all or part of the restrictions imposed by paragraph (1) of this subsection. Action under this subparagraph may be taken only after consultation and coordination with the Secretary of Labor. The Secretary may not grant an exemption under this paragraph unless he finds that such exemption is -

(A)

administratively feasible,

(B)

in the interests of the plan and of its participants and beneficiaries, and

(C)

protective of the rights of participants and beneficiaries of the plan. Before granting an exemption under this paragraph, the Secretary shall require adequate notice to be given to interested persons and shall publish notice in the Federal Register of the pendency of such exemption and shall afford interested persons an opportunity to present views. No exemption may be granted under this paragraph with respect to a transaction described in subparagraph (E) or (F) of paragraph (1) unless the Secretary affords an opportunity for a hearing and makes a determination on the record with respect to the findings required under subparagraphs (A), (B), and (C) of this paragraph, except that in lieu of such hearing the Secretary may accept any record made by the Secretary of Labor with respect to an application for exemption under section 408(a) of title I of the Employee Retirement Income Security Act of 1974.

(3)

Special rule for individual retirement accounts

An individual for whose benefit an individual retirement account is established and his beneficiaries shall be exempt for the tax imposed by this section with respect to any transaction concerning such account (which would otherwise be taxable under this section) if, with respect to such transaction, the account ceases to be an individual retirement account by reason of the application of section 408(e)(2)(A) or if section 408(e)(4) applies to such account.

(d)

Exemptions

The prohibitions provided in subsection (c) shall not apply to -

(1)

any loan made by the plan to a disqualified person who is a participant or beneficiary of the plan if such loan -

(A)

is available to all such participants or beneficiaries on a reasonably equivalent basis,

(B)

is not made available to highly compensated employees (within the meaning of section 414(q)) in an amount greater than the amount made available to other employees,

(C)

is made in accordance with specific provisions regarding such loans set forth in the plan,

(D)

bears a reasonable rate of interest, and

(E)

is adequately secured;

(2)

any contract, or reasonable arrangement, made with a disqualified person for office space, or legal, accounting, or other services necessary for the establishment or operation of the plan, if no more than reasonable compensation is paid therefor;

(3)

any loan to an (FOOTNOTE 1) leveraged employee stock ownership plan (as defined in subsection (e)(7)), if - (FOOTNOTE 1) So in original. Probably should be "a".

(A)

such loan is primarily for the benefit of participants and beneficiaries of the plan, and

(B)

such loan is at a reasonable rate of interest, and any collateral which is given to a disqualified person by the plan consists only of qualifying employer securities (as defined in subsection (e)(8));

(4)

the investment of all or part of a plan's assets in deposits which bear a reasonable interest rate in a bank or similar financial institution supervised by the United States or a State, if such bank or other institution is a fiduciary of such plan and if

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(A)

the plan covers only employees of such bank or other institution and employees of affiliates of such bank or other institution, or

(B)

such investment is expressly authorized by a provision of the plan or by a fiduciary (other than such bank or institution or affiliates thereof) who is expressly empowered by the plan to so instruct the trustee with respect to such investment;

(5)

any contract for life insurance, health insurance, or annuities with one or more insurers which are qualified to do business in a State if the plan pays no more than adequate consideration, and if each such insurer or insurers is -

(A)

the employer maintaining the plan, or

(B)

a disqualified person which is wholly owned (directly or indirectly) by the employer establishing the plan, or by any person which is a disqualified person with respect to the plan, but only if the total premiums and annuity considerations written by such insurers for life insurance, health insurance, or annuities for all plans (and their employers) with respect to which such insurers are disqualified persons (not including premiums or annuity considerations written by the employer maintaining the plan) do not exceed 5 percent of the total premiums and annuity considerations written for all lines of insurance in that year by such insurers (not including premiums or annuity considerations written by the employer maintaining the plan);

(6)

the provision of any ancillary service by a bank or similar financial institution supervised by the United States or a State, if such service is provided at not more than reasonable compensation, if such bank or other institution is a fiduciary of such plan, and if -

(A)

such bank or similar financial institution has adopted adequate internal safeguards which assure that the provision of such ancillary service is consistent with sound banking and financial practice, as determined by Federal or State supervisory authority, and

(B)

the extent to which such ancillary service is provided is subject to specific guidelines issued by such bank or similar financial institution (as determined by the Secretary after consultation with Federal and State supervisory authority), and under such guidelines the bank or similar financial institution does not provide such ancillary service -

(i)

in an excessive or unreasonable manner, and

(ii)

in a manner that would be inconsistent with the best interests of participants and beneficiaries of employee benefit plans;

(7)

the exercise of a privilege to convert securities, to the extent provided in regulations of the Secretary but only if the plan receives no less than adequate consideration pursuant to such conversion;

(8)

any transaction between a plan and a common or collective trust fund or pooled investment fund maintained by a disqualified person which is a bank or trust company supervised by a State or Federal agency or between a plan and a pooled investment fund of an insurance company qualified to do business in a State if -

(A)

the transaction is a sale or purchase of an interest in the fund,

(B)

the bank, trust company, or insurance company receives not more than a reasonable compensation, and

(C)

such transaction is expressly permitted by the instrument under which the plan is maintained, or by a fiduciary (other than the bank, trust company, or insurance company, or an affiliate thereof) who has authority to manage and control the assets of the plan;

(9)

receipt by a disqualified person of any benefit to which he may be entitled as a participant or beneficiary in the plan, so long as the benefit is computed and paid on a basis which is consistent with the terms of the plan as applied to all other participants and beneficiaries;

(10)

receipt by a disqualified person of any reasonable compensation for services rendered, or for the reimbursement of expenses properly and actually incurred, in the performance of his duties with the plan, but no person so serving who already receives full-time pay from an employer or an association of employers, whose employees are participants in the plan or from an employee organization whose members are participants in such plan shall receive compensation from such fund, except for reimbursement of expenses properly and actually incurred;

(11)

service by a disqualified person as a fiduciary in addition to being an officer, employee, agent, or other representative of a disqualified person;

(12)

the making by a fiduciary of a distribution of the assets of the trust in accordance with the terms of the plan if such assets are distributed in the same manner as provided under section 4044 of title IV of the Employee Retirement Income Security Act of 1974 (relating to allocation of assets);

(13)

any transaction which is exempt from section 406 of such Act by reason of section 408(e) of such Act (or which would be so exempt if such section 406 applied to such transaction) or which is exempt from section 406 of such Act by reason of section 408(b) of such Act;

(14)

any transaction required or permitted under part 1 of subtitle E of title IV or section 4223 of the Employee Retirement Income Security Act of 1974, but this paragraph shall not apply with respect to the application of subsection (c)(1) (E) or (F); or

(15)

a merger of multiemployer plans, or the transfer of assets or liabilities between multiemployer plans, determined by the Pension Benefit Guaranty Corporation to meet the requirements of section 4231 of such Act, but this paragraph shall not apply with respect to the application of subsection (c)(1) (E) or (F). The

exemptions provided by this subsection (other than paragraphs (9) and (12)) shall not apply to any transaction with respect to a trust described in section 401(a) which is part of a plan providing contributions or benefits for employees some or all of whom are owner-employees (as defined in section 401(c)(3)) in which a plan directly or indirectly lends any part of the corpus or income of the plan to, pays any compensation for personal services rendered to the plan to, or acquires for the plan any property from or sells any property to, any such owner-employee, a member of the family (as defined in section 267(c)(4)) of any such owner-employee, or a corporation controlled by any such owner-employee through the ownership, directly or indirectly, of 50 percent or more of the total combined voting power of all classes of stock entitled to vote or 50 percent or more of the total value of shares of all classes of stock of the corporation. For purposes of the preceding sentence, a shareholder-employee (as defined in section 1379, as in effect on the day before the date of the enactment of the Subchapter S Revision Act of 1982), a participant or beneficiary of an individual retirement account or an individual retirement annuity (as defined in section 408), and an employer or association of employees which establishes such an account or annuity under section 408(c) shall be deemed to be an owner-employee.

(e)

Definitions

(1)

Plan

For purposes of this section, the term "plan" means a trust described in section 401(a) which forms a part of a plan, or a plan described in section 403(a), which trust or plan is exempt from tax under section 501(a), an individual retirement account described in section 408(a) or an individual retirement annuity described in section 408(b) (or a trust, plan, account, or annuity which, at any time, has been determined by the Secretary to be such a trust, plan, or account).

(2)

Disqualified person

For purposes of this section, the term "disqualified person" means a person who is -

(A)

a fiduciary;

(B)

a person providing services to the plan;

(C)

an employer any of whose employees are covered by the plan;

(D)

an employee organization any of whose members are covered by the plan;

(E)

an owner, direct or indirect, of 50 percent or more of -

(i)

the combined voting power of all classes of stock entitled to vote or the total value of shares of all classes of stock of a corporation,

(ii)

the capital interest or the profits interest of a partnership, or

(iii)

the beneficial interest of a trust or unincorporated enterprise, which is an employer or an employee organization described in subparagraph (C) or (D);

(F)

a member of the family (as defined in paragraph (6)) of any individual described in subparagraph (A), (B), (C), or (E);

(G)

a corporation, partnership, or trust or estate of which (or in which) 50 percent or more of -

(i)

the combined voting power of all classes of stock entitled to vote or the total value of shares of all classes of stock of such corporation,

(ii)

the capital interest or profits interest of such partnership, or

(iii)

the beneficial interest of such trust or estate, is owned directly or indirectly, or held by persons described in subparagraph (A), (B), (C), (D), or (E);

(H)

an officer, director (or an individual having powers or responsibilities similar to those of officers or directors), a 10 percent or more shareholder, or a highly compensated employee (earning 10 percent or more of the yearly wages of an employer) of a person described in subparagraph (C), (D), (E), or (G); or

(I)

a 10 percent or more (in capital or profits) partner or joint venturer of a person described in subparagraph (C), (D), (E), or (G). The Secretary, after consultation and coordination with the Secretary of Labor or his delegate, may by regulation prescribe a percentage lower than 50 percent for subparagraphs (E) and (G) and lower than 10 percent for subparagraphs (H) and (I).

(3)

Fiduciary

For purposes of this section, the term "fiduciary" means any person who -

(A)

exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets,

(B)

renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or

(C)

has any discretionary authority or discretionary responsibility in the administration of such plan. Such term includes any person designated under section 405(c)(1)(B) of the Employee Retirement Income Security Act of 1974.

(4)

Stockholdings

For purposes of paragraphs (2)(E)(i) and (G)(i) there shall be taken into account indirect stockholdings which would be taken into account under section 267(c), except that, for purposes of this paragraph, section 267(c)(4) shall be treated as providing that the members of the family of an individual are the members within the meaning of paragraph (6).

(5)

Partnerships; trusts

For purposes of paragraphs (2)(E)(ii) and (iii), (G)(ii) and (iii), and (I) the ownership of profits or beneficial interests shall be determined in accordance with the rules for constructive ownership of stock provided in section 267(c) (other than paragraph (3) thereof), except that section 267(c)(4) shall be treated as providing that the members of the family of an individual are the members within the meaning of paragraph (6).

(6)

Member of family

For purposes of paragraph (2)(F), the family of any individual shall include his spouse, ancestor, lineal descendant, and any spouse of a lineal descendant.

(7)

Employee stock ownership plan

The term "employee stock ownership plan" means a defined contribution plan -

(A)

which is a stock bonus plan which is qualified, or a stock bonus and a money purchase plan both of which are qualified under section 401(a), and which are designed to invest primarily in qualifying employer securities; and

(B)

which is otherwise defined in regulations prescribed by the Secretary. A plan shall not be treated as an employee stock ownership plan unless it meets the requirements of section 409(h), section 409(o), and, if applicable, section 409(n) and, if the employer has a registration-type class of securities (as defined in section 409(e)(4)), it meets the requirements of section 409(e).

(8)

Qualifying employer security

The term "qualifying employer security" means any employer security within the meaning of section 409(l). If any moneys or other property of a plan are invested in shares of an investment company registered under the Investment Company Act of 1940, the investment shall not cause that investment company or that investment company's investment adviser or principal underwriter to be treated as a fiduciary or a disqualified person for purposes of this section, except when an investment company or its investment adviser or principal underwriter acts in connection with a plan covering employees of the investment company, its investment adviser, or its principal underwriter.

(9)

Section made applicable to withdrawal liability payment funds

For purposes of this section -

(A)

In general

The term "plan" includes a trust described in section 501(c)(22).

(B)

Disqualified person

In the case of any trust to which this section applies by reason of subparagraph (A), the term "disqualified person" includes any person who is a disqualified person with respect to any plan to which such trust is permitted to make payments under section 4223 of the Employee Retirement Income Security Act of 1974.

(f)

Other definitions and special rules

For purposes of this section -

(1)

Joint and several liability

If more than one person is liable under subsection (a) or (b) with respect to any one prohibited transaction, all such persons shall be jointly and severally liable under such subsection with respect to such transaction.

(2)

Taxable period

The term "taxable period" means, with respect to any prohibited transaction, the period beginning with the date on which the prohibited transaction occurs and ending on the earliest of -

(A)

the date of mailing a notice of deficiency with respect to the tax imposed by subsection (a) under section 6212,

(B)

the date on which the tax imposed by subsection (a) is assessed, or

(C)

the date on which correction of the prohibited transaction is completed.

(3)

Sale or exchange; encumbered property

A transfer of real or personal property by a disqualified person to a plan shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien which the plan assumes or if it is subject to a mortgage or similar lien which a disqualified person placed on the property within the 10-year period ending on the date of the transfer.

(4)

Amount involved

The term "amount involved" means, with respect to a prohibited transaction, the greater of the amount of money and the fair market value of the other property given or the amount of money and the fair market value of the other property received; except that, in the case of services described in paragraphs (2) and (10) of subsection (d) the amount involved shall be only the excess compensation. For purposes of the preceding sentence, the fair market value -

(A)

in the case of the tax imposed by subsection (a), shall be determined as of the date on which the prohibited transaction occurs; and

(B)

in the case of the tax imposed by subsection (b), shall be the highest fair market value during the taxable period.

(5)

Correction

The terms "correction" and "correct" mean, with respect to a prohibited transaction, undoing the transaction to the extent possible, but in any case placing the plan in a financial position not worse than that in which it would be if the disqualified person were acting under the highest fiduciary standards.

(g)

Application of section

This section shall not apply -

(1)

in the case of a plan to which a guaranteed benefit policy (as defined in section 401(b)(2)(B) of the Employee Retirement Income Security Act of 1974) is issued, to any assets of the insurance company, insurance service, or insurance organization merely because of its issuance of such policy;

(2)

to a governmental plan (within the meaning of section 414(d)); or

(3)

to a church plan (within the meaning of section 414(e)) with respect to which the election provided by section 410(d) has not been made. In the case of a plan which invests in any security issued by an investment company registered under the Investment Company Act of 1940, the assets of such plan shall be deemed to include such security but shall not, by reason of such investment, be deemed to include any assets of such company.

(h)

Notification of Secretary of Labor

Before sending a notice of deficiency with respect to the tax imposed by subsection (a) or (b), the Secretary shall notify the Secretary of Labor and provide him a reasonable opportunity to obtain a correction of the prohibited transaction or to comment on the imposition of such tax.

(i)

Cross reference

For provisions concerning coordination procedures between Secretary of Labor and Secretary of Treasury with respect to application of tax imposed by this section and for authority to waive imposition of the tax imposed by subsection (b), see section 3003 of the Employee Retirement Income Security Act of 1974.