

## **OUTLINE OF IRC SECTIONS 4974, 4975, and 4980**

### **4974 - Excise tax on certain accumulations in qualified retirement plans**

Tax equals 50% of the excess of the minimum required distribution over the amount distributed during the tax year. Minimum required distributions are defined under 401(a)(9), 403(b)(10), 408(a)(6), 408(b)(3) and 457(d)(2).

In general, 401(a)(9)(C) requires distribution of a participant's benefit beginning at April 1 of the calendar year following the later of [the calendar year of (i) attainment of age 70 ½, or (ii) retirement] and continuing over the life of the employee. For 5% owners, the required beginning date is April 1 of the calendar year following the calendar year of attainment of age 70 ½.

The Secretary of the Treasury may waive the tax if the taxpayer can demonstrate the incorrect amount distributed was due to reasonable error, and reasonable steps are being taken to remedy the problem.

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## Section 4975 - Tax on prohibited transactions

### OVERVIEW

Section (c) enumerates prohibited transactions, and section (d) enumerates exemptions.

Prohibited transactions involve plan assets, money, credit, property, or furnishing of goods and services between a plan and a disqualified person.

Exemptions include loans that are made available to all employees, plus 14 other specific items. EGTRRA added an exception to an exception, which allows participant loans to sole proprietors, partners, and subchapter S corporation shareholders.

For purposes of this section, a disqualified person includes

- A) fiduciaries,
- B) persons providing services to the plan,
- C) the employer whose employees are covered by the plan,
- D) employee organization whose members are covered by the plan,
- E) a 50% owner,
- F) family members of persons described in (A), (B), (C) or (E)
- G) a corporation, partnership, trust or estate of which 50% of the voting stock, capital interest, profits or beneficial interest is owned by persons described in (A), (B), (C) or (E)

For purposes of this section, a fiduciary includes any person who

- A) exercises discretionary authority or control of management of the plan or disposition of its assets
- B) renders investment advice for a fee or compensation with respect to moneys or property of the plan
- C) has discretionary authority or responsibility in the administration of the plan

### NOTE:

PPA 2006 made several additions to IRC Section 4975:

Added exemptions at 4975(d)(17) through (23)

Added special rules at 4975(f)(8) through (11)

### OUTLINE

- (a) Tax equals 15% of any prohibited transaction for each year in the taxable period.
- (b) If the prohibited transaction is not corrected within the taxable period, there is an additional 100% tax
- (c) Prohibited transaction
  - (1) Defined as any of the following transactions, whether direct or indirect:
    - (A) sale or exchange, or leasing, of any property between a plan and a disqualified person

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- (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 interest or for his own account
  - (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) Treasury Secretary will establish a procedure for exemptions from the above rules
  - (3) Special rule – retirement income accounts
  - (4) Special rule – Archer MSAs
  - (5) Special rule – Coverdell education savings accounts
  - (6) Special rule – health savings accounts
- (d) Exemptions from Prohibited transaction rules
- (1) Loans from the plan to a disqualified person who is a participant or beneficiary of the plan are exempt if they meet these criteria
    - (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
    - (E) is adequately secured
  - (2) Contracts or arrangements 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
  - (3) Specified loans to a leveraged employee stock ownership plan
  - (4) Specified 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
  - (5) Specified contracts for life insurance, health insurance, or annuities with one or more insurers
  - (6) Specified provision of any ancillary service by a bank or similar financial institution
  - (7) Exercise of a privilege to convert securities, (per regulations of the Secretary) but only if the plan receives no less than adequate consideration pursuant to such conversion
  - (8) Specified transaction between a plan and a common or collective trust fund or pooled investment fund maintained by a disqualified person
  - (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 consistent with the terms of the plan

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- (10) Specified receipt by a disqualified person
  - (a) for the reimbursement of expenses properly and actually incurred, in the performance of his duties with the plan, or
  - (b) of any reasonable compensation for services rendered. NOTE - this part of the exemption does NOT apply if they are receiving full-time pay from an employer (or association of employers) whose employees are participants in the plan.
- (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) 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 ERISA
- (13) Any transaction which is exempt by reason of ERISA section 408(e) (acquisition or sale by a plan of qualifying employer securities or acquisition, sale or lease by a plan of qualifying employer real property) or ERISA section 408(b)(12) (sales by a plan to a party in interest of stock which does not constitute a qualifying employer security)
- (14) any transaction required or permitted under part 1 of subtitle E of title IV of ERISA or ERISA section 4223 (withdrawal liability payment fund). This exemption does not apply with respect to the application of subsection 4975(c)(1)(E) or (F)
- (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 ERISA section 4231 (mergers and transfers between multiemployer plans). This exemption does not apply with respect to the application of subsection 4975(c)(1)(E) or (F)
- (16) Specified sales of stock held by a trust which constitutes an individual retirement account under section 408(a) to the individual for whose benefit such account is established
- (17) Specified transactions in connection with the provision of investment advice described in subsection 4975(e)(3)(B) to a participant or beneficiary in a plan and that permits such participant or beneficiary to direct the investment of plan assets
- (18) Specified transactions involving the purchase or sale of securities, or other property (as determined by the Secretary of Labor), between a plan and a party in interest (other than a fiduciary described in subsection 4975(e)(3)(B)) with respect to a plan
- (19) Specified transactions involving the purchase or sale of securities, or other property (as determined by the Secretary of Labor), between a plan and a party in interest
- (20) Specified transactions described in subparagraphs (A), (B), and (D) of subsection 4975(c)(1) between a plan and a person that is a party in interest other than a fiduciary
- (21) Specified foreign exchange transactions, between a bank or broker-dealer (or any affiliate of either) and a plan
- (22) Specified transactions described in subsection 4975(c)(1)(A) involving the purchase and sale of a security between a plan and any other account managed by the same investment manager
- (23) Except as provided in subsection (f)(11), a transaction described in subparagraph (A), (B), (C), or (D) of subsection 4975(c)(1) in connection with the acquisition, holding, or disposition of any security or commodity, if the transaction is corrected before the end of the correction period

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### (e) Definitions

#### (1) Plan

#### (2) Disqualified person

- (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 employer or an employee organization described in subparagraph (C) or (D) above, which is an owner, direct or indirect, of 50 percent or more of
  - (i) combined voting power of all classes of stock entitled to vote
  - (ii) total value of shares of all classes of stock of a corporation
  - (iii) the capital interest or the profits interest of a partnership
  - (iv) the beneficial interest of a trust or unincorporated enterprise
- (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) combined voting power of all classes of stock entitled to vote
  - (ii) total value of shares of all classes of stock of a corporation
  - (iii) the capital interest or the profits interest of a partnership
  - (iv) the beneficial interest of such trust or estateis 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)
- (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)

#### (3) Fiduciary – 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
- (C) has any discretionary authority or discretionary responsibility in the administration of such plan.
- (D) Such term includes any person designated by a named fiduciary under the plan to carry out fiduciary responsibilities (other than trustee responsibilities) under the plan

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- (4) Stockholdings  
For purposes of paragraphs (2)(E)(i) and (G)(i) there shall be taken into account specified indirect stockholdings which would be taken into account under section 267(c)
  - (5) Partnerships and 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)
  - (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  
A defined contribution plan 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
  - (8) Qualifying employer security  
Any employer security within the meaning of section 409(1)
  - (9) Section made applicable to withdrawal liability payment funds
- (f) Other definitions and special rules
- (1) Joint and several liability  
If more than one person is liable under 4975(a) or 4975(b) with respect to a prohibited transaction, all persons are jointly and severally liable
  - (2) Taxable period
    - (A) Begins on date prohibited transaction occurs
    - (B) Ends on earliest of
      - (i) the date of mailing a notice of deficiency with respect to the tax imposed by subsection (a)
      - (ii) the date on which the tax imposed by subsection (a) is assessed
      - (iii) the date on which correction of the prohibited transaction is completed
  - (3) Sale or exchange; encumbered property
  - (4) Amount involved
    - (A) 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
    - (B) For services described in paragraphs (2) and (10) of subsection (d) the amount involved shall be only the excess compensation
  - (5) Correction  
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
  - (6) Exemptions not to apply to certain transactions
  - (7) S corporation repayment of loans for qualifying employer securities

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- (8) Provision of investment advice to participant and beneficiaries
  - (A) In general

The prohibitions provided in subsection (c) shall not apply to transactions described in subsection (b)(14) if the investment advice provided by a fiduciary adviser is provided under an eligible investment advice arrangement.
  - (B) Eligible investment advice arrangement
    - (i) Must either
      - (I) Provide that any fees received by the fiduciary adviser do not vary depending on the basis of any investment option selected, OR
      - (II) Uses a computer model under an investment advice program meeting the requirements of subparagraph (C)
    - (ii) Must also meet the requirements of subparagraphs (D), (E), (F), (G), (H), and (I)
  - (C) Investment advice program using computer model
    - (i) Must meet the requirements of clauses (ii), (iii) and (iv)
    - (ii) Computer model – requirements
      - (I) applies generally accepted investment theories that take into account historic returns of different asset classes over defined periods of time
      - (II) utilizes relevant participant data, such as age, life expectancy, retirement age, risk tolerance, other assets or sources of income, and preferences for certain investments
      - (III) utilizes objective criteria to provide asset allocation portfolios
      - (IV) is not biased in favor of investments offered by the fiduciary adviser or a person with a material affiliation
      - (V) takes into account all investment options under the plan in specifying how a participant's account balance should be invested and is not inappropriately weighted with respect to any investment option
    - (iii) Certification
      - (I) In general

An eligible investment expert must certify, prior to the utilization of the computer model, that the model meets the requirements of clause (ii)
      - (II) Renewal of certification

If there are material modifications to a computer model, the revised model must be re-certified
      - (III) Eligible investment expert

Any person which meets such requirements as the Secretary of Labor may provide and which does not bear any material affiliation or contractual relationship with any investment adviser or a related person thereof

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- (iv) Exclusivity of recommendation
  - (I) The only investment advice provided under the program must be the advice generated by the computer model described in clause (ii), and
  - (II) Any transaction described in subsection (b)(14)(B)(ii) must occur solely at the direction of the participant or beneficiary
- (D) Express authorization by separate fiduciary

The arrangement must be expressly authorized by a plan fiduciary other than the person offering the investment advice program, any person providing investment options under the plan, or any affiliate of either
- (E) Audits
  - (i) General requirements
    - (I) Must use an independent auditor, who has appropriate technical training or experience and proficiency and so represents in writing
    - (II) Auditor must conduct annual audit of compliance with this paragraph
    - (III) After annual audit is done, auditor must issue written report to the fiduciary who authorized use of the arrangement which presents its specific findings
    - (IV) Any transaction described in subsection (b)(14)(B)(ii) must occur solely at the direction of the participant or beneficiary
  - (ii) Special rule for individual retirement and similar plans

In the case of a plan described in subparagraphs (B) through (F) of subsection (e)(1), in lieu of the requirements of clause (i), audits of the arrangement shall be conducted at such time / in such manner as Secretary of Labor prescribes
  - (iii) Independent auditor
    - (I) Not related to the person offering the arrangement to the plan, AND
    - (II) Not related to any person providing investment options under the plan
- (F) Disclosure
  - (i) Before the initial provision of the investment advice, the fiduciary adviser must provide, with regard to any security or other property offered as an investment option, a written notification (which may be an electronic communication):
    - (I) Role of any party that has a material affiliation or contractual relationship with the financial adviser
    - (II) Past performance and historical rates of return of the plan's investment options
    - (III) All fees or other compensation relating to the advice that the fiduciary adviser or any affiliate thereof is to receive
    - (IV) Any material affiliation or contractual relationship of the fiduciary adviser or affiliates thereof in the security or other property
    - (V) Use or disclosure of any participant or beneficiary information provided under the arrangement
    - (VI) Types of services provided by the fiduciary adviser in connection with the provision of investment advice



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- (VII) Adviser is acting as a fiduciary of the plan in connection with the provision of the advice
- (VIII) Recipient of the advice may separately arrange for the provision of advice by another adviser
- (ii) At all times during the provision of advisory services to the participant or beneficiary, the fiduciary adviser must
  - (I) Maintain the information described in clause (i) in accurate form and in the manner described in subparagraph (H)
  - (II) Provide, without charge, accurate information to the recipient of the advice
    - (a) No less frequently than annually
    - (b) Upon request of the recipient
    - (c) Concerning any material change to the information required to be provided, at a time reasonably contemporaneous to the change in information
- (G) Other conditions
  - (i) Fiduciary adviser provides appropriate disclosure, in accordance with all applicable securities laws
  - (ii) The sale, acquisition, or holding occurs solely at the direction of the recipient of the advice
  - (iii) Compensation received by the fiduciary adviser and affiliates thereof is reasonable
  - (iv) Terms of the sale, acquisition, or holding of the security or other property are at least as favorable to the plan as an arm's length transaction would be
- (H) Standards for presentation of information
  - Notification to participants and beneficiaries under subparagraph (F)(i) must be
    - (i) Written in a clear and conspicuous manner
    - (ii) Written in a manner calculated to be understood by the average plan participant
    - (iii) Sufficiently accurate and comprehensive to reasonably apprise such participants and beneficiaries of the information required to be provided in the notification
- (I) Maintenance for 6 years of evidence of compliance
  - A fiduciary adviser must maintain, for a period of not less than 6 years after the provision of the advice, any records necessary for determining whether the requirements of the preceding provisions of this paragraph and of subsection (d)(17) have been met

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- (J) Definitions
  - (i) Fiduciary adviser
    - (I) Person who is a fiduciary of the plan due to provision of investment advice
    - (II) Person is one of the following
      - (a) Registered investment adviser
      - (b) Bank or savings association, but only if advice is given through a trust department which is subject to examination by Federal or State banking authorities
      - (c) Insurance company qualified under State law
      - (d) Broker / dealer registered under SEC
      - (e) Affiliate of person described in subclauses (a) – (d)
      - (f) Employee, agent, or registered representative of a person described in subclauses (a) through (e) who satisfies the requirements of applicable insurance, banking, and securities laws relating to the provision of the advice
  - (ii) Affiliate
    - “Affiliate” of another entity means an affiliated person of the entity (as defined in section 2(a)(3) of the Investment Company Act of 1940)
  - (iii) Registered representative
    - “Registered representative” of another entity means a person described in section 3(a)(18) of the Securities Exchange Act of 1934
- (9) Block trade
  - Any trade of at least 10,000 shares or with a market value of at least \$200,000 which will be allocated across two or more unrelated client accounts of a fiduciary
- (10) Adequate consideration means:
  - (A) For a security where there is a recognized market
    - (i) If the security is traded on a national securities exchange, the price of the security, taking into account factors such as the size of the transaction and marketability of the security
    - (ii) if the security is not traded on such a national securities exchange, a price not less favorable to the plan than the offering price for the security as established by the current bid and asked prices quoted by persons independent of the issuer and of the party in interest, taking into account factors such as the size of the transaction and marketability of the security,
  - (B) For an asset (other than a security) where there is a recognized market, the fair market value, determined in good faith
- (11) Correction period
  - (A) In general
    - 14-day period beginning on the date on which the disqualified person discovers, or reasonably should have discovered, that the transaction would constitute a prohibited transaction

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### (B) Exceptions

- (i) Employer securities - Subsection (d)(23) does not apply to
  - (I) Transactions between plan and a plan sponsor (or its affiliates)
  - (II) Which involve acquisition or sale of an employer security, or
  - (III) Which involve acquisition, sale or lease of employer real property
- (ii) Knowing prohibited transaction  
Subsection (d)(23) does not apply to a transaction if, at the time of the transaction, the disqualified person knew (or reasonably should have known) that the transaction would constitute a prohibited transaction

### (C) Abatement of tax where there is a correction

If a transaction is not treated as a prohibited transaction by reason of subsection (d)(23), then no tax shall be assessed. If a tax was assessed, the assessment shall be abated, and if collected shall be credited or refunded as an overpayment

### (D) Definitions

- (i) Security – defined under 475(c)(2)
- (ii) Commodity – defined under 475(e)(2)
- (iii) Correct a transaction:
  - (I) Undo the transaction to the extent possible and in any case to make good to the plan or affected account any losses resulting from the transaction, and
  - (II) Restore to the plan or affected account any profits made through the use of assets of the plan

### (g) Application of section – Does NOT apply to

- (1) In case of a plan which is issued a guaranteed benefit policy, does not apply to assets of insurance company,
- (2) Governmental plan under 414(d)
- (3) Church plan where election under 410(d) has not been made

### (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

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### **4980 - Tax on reversion of qualified plan assets to employer**

Tax equals 50% of any employer reversion. If the employer provides a qualified replacement plan, or if certain benefit increases are provided, then the tax is reduced to 20% of the employer reversion. The tax is due the last day of the month following the month the reversion occurs.

Employer reversion includes cash or fair market value of property received. It excludes amounts under 401(a)(2) such as (i) contributions returned to employer due to mistake of fact, or (ii) contributions conditioned on (ii) qualification of plan, or (iii) contributions conditioned on deductibility.

There is a limited exception for transfers to an ESOP, but it only applies to transfers that occur before 01/01/89 or to plan terminations that occur before 01/01/89.

#### Benefit Increases

Plan can provide benefit increases for all participants to reduce the tax to 20%. The value of the benefit increases must be at least 20% of the employer reversion prior to the benefit increase. The increase in benefits is applied uniformly to all participants, except that the increase in the PVAB for retirees can't exceed 8% of the employer reversion prior to the benefit increase.

#### Qualified Replacement Plan

At least 95% of participants in terminated plan who remain employed must be participants in the replacement plan. Employer must transfer an amount equal to at least 25% of the employer reversion, less any increase in PVAB due to amendment adopted within 60 days prior to termination date. If the replacement plan is a DC plan, the asset transfer may be allocated to accounts of participants, or it can be placed in a suspense account and allocated to accounts of participants over next 7 years.

#### NOTE:

IRC Section 4980 refers to transfer of an amount equal to 25% of the reversion. Revenue Ruling 2003-85 clarified that the transfer can be an amount equal to at least 25% of the reversion. This is another example where a more recent regulation / revenue ruling overrides language in the IRC. In other words, "the code lies."