

U.S. Department of Labor

Pension and Welfare Benefits Administration
Washington, D.C. 20210

December 23, 1988

Mr. Joseph E. Hurst, Jr.
Friday, Eldredge & Clark
2000 First Commercial Building
Little Rock, AR 72201

Re: Thomas E. Darragh
Identification Number: F-3819A

Dear Mr. Hurst:

Your letter dated January 22, 1988, to the Internal Revenue Service (the Service) has been forwarded to this office for our consideration and response. Your letter concerns whether a loan from an Individual Retirement Account (IRA) to a corporation would violate section 4975(c)(1)(B) of the Internal Revenue Code of 1986 (the Code).

You represent that Thomas F. Darragh established an IRA described in section 408 of the Code. Mr. Darragh is the only participant in the IRA and has reserved the right to direct the IRA's investments. You further represent that Mr. Darragh is currently an employee, shareholder and member of the Board of Directors of Darragh Company (the Corporation). Your subsequent letter of April 28, 1988, indicates that the Corporation has no involvement whatsoever with the establishment or maintenance of the IRA. The Corporation has two classes of stock, Class A voting and Class B nonvoting. Mr. Darragh owns directly and indirectly (pursuant to section 4975(e)(4) and (6) of the Code) 46.04 percent of the total voting power of the Corporation and 48.14 percent of the total issued and outstanding shares of stock.

Mr. Darragh proposes to direct the IRA Custodian, One National Bank, to lend the Corporation approximately \$500,000 pursuant to a promissory note entered into by the Corporation. The Corporation will pay the IRA interest on the note based on the then current prevailing market rate of interest which lenders are currently charging to the Corporation.

You have requested an advisory opinion that the proposed loan will not constitute a prohibited transaction under section 4975(c)(1)(B) of the Code.

Pursuant to section 2510.3-2(d) of the Department of Labor's (the Department) regulations, the Department does not have jurisdiction under Title I of the Employee Retirement Income Security Act of 1974 (ERISA) over those IRAs described in section 408(a) of the Code which comply with the provisions of that section of regulation.* Under Presidential Reorganization Plan No. 4 of 1978, effective December 31, 1978, the authority of the Secretary of the Treasury to issue interpretations regarding section 4975 of the Code has

been transferred, with certain exceptions not here relevant, to the Secretary of Labor and the Secretary of the Treasury is bound by such interpretations of the Secretary of Labor pursuant to such authority.

Section 4975(c)(1)(B) of the Code prohibits any direct or indirect sale, lending of money or other extension of credit between a plan and a disqualified person. Section 4975(e)(1) of the Code, in relevant part, defines the term plan to include an IRA described in section 408(a) of the Code. Section 4975(e)(2) of the Code defines "disqualified person" to include a fiduciary, an employer any of whose employees are covered by the plan, and 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 the 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 a fiduciary. Section 4975(e)(3) of the Code defines the term fiduciary, in part, to include any person who exercises any discretionary authority or discretionary control respecting management of the plan, or exercised any authority or control respecting the management or the disposition of its assets.

Mr. Darragh is a fiduciary and, thus, a disqualified person with respect to the IRA because of the authority under the IRA to direct investments. You have stated that Mr. Darragh is employed by the Corporation. Although section 4975 does not define the term "employer", section 3(5) of ERISA provides, in part, that an "employer" is any person acting as an employer in relation to an employee benefit plan. You have stated that the Corporation has no involvement with the establishment or maintenance of the IRA. Therefore, it is the opinion of the Department that the Corporation is not a disqualified person with respect to the IRA under section 4975(e)(2)(C) of the Code. In addition, the Corporation is not a disqualified person with respect to the IRA under section 4975(e)(2)(G) of the Code by reason of Mr. Darragh's stock ownership in the Corporation.

Therefore, to the extent that the Corporation is not a disqualified person with respect to the IRA under any other provision of section 4975(e)(2) of the Code, the loan by the IRA to the Corporation would not violate section 4975(c)(1)(B) of the Code.

We note, however, that this conclusion does not preclude the existence of other prohibited transactions under section 4975 of the Code. Section 4975(c)(1)(D) of the Code prohibits any direct or indirect transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a plan. Section 4975(c)(1)(E) of the Code prohibits a fiduciary from dealing with the income or assets of a plan in his own interest or for his own account. Section 54.4975-6(a)(5) of the Pension Excise Tax Regulations characterizes transactions described in section 4975(c)(1)(E) as involving the use of authority by fiduciaries to cause plans to enter into transactions when those fiduciaries have interests which may affect the exercise of their best judgment as fiduciaries. Mr. Darragh is a fiduciary with respect to the IRA. In addition, he has a substantial interest in the Corporation. Therefore, the Corporation is a party in whom Mr. Darragh has an interest which might affect his best judgment as a fiduciary. ***Accordingly, a prohibited use of plan assets for the benefit of a disqualified person under section 4975(c)(1)(D) or an act of self-dealing under section 4975(c)(1)(E) is likely to result if Mr. Darragh directs the IRA to loan funds to the Corporation.*** [Emphasis added]

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

Sincerely,

Robert J. Doyle
Acting Associate Director for Regulations and Interpretations

- Footnote -

* Under the regulations, Title I is inapplicable only if the following conditions are met: (1) no contributions to the plan are made by the employer or employee association; (2) participation is completely voluntary for employees or members; (3) the sole involvement of the employer or employee association is to permit the sponsor to publicize the program and to collect contributions on behalf of the sponsor through payroll deductions or dues checkoffs; and (4) the employer or employee association receives no consideration in the form of cash or otherwise other than reasonable compensation for services actually rendered in connection with such

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