

U.S. Department of Labor

Pension and Welfare Benefits Administration
Washington, D.C. 20330



JUL - 3 1990

ERISA OPINION 90-23A
Sec. 4975(c)(1)(A), 4975(c)(1)(b)

Jay F. Jason, Esq.
Lexow, Berbit & Jason
56 Park Avenue
P. O. Box 239
Suffern, NY 10901

Re: Identification Number: F-3759A

Dear Mr. Jason:

Your letter to the Internal Revenue Service (the Service) has been forwarded to this office for our consideration and response. Your inquiry concerns the proposed investment of the assets of two self-directed IRAs in a condominium unit.

In your letter, you state that you and Warren E. Berbit are attorneys who each own a 50% interest in the Lexow, Berbit & Jason partnership. Both of you currently maintain IRAs. In your capacity as attorneys, you and Mr. Berbit represent a builder who is developing a condominium complex. You further state that such developer has indicated that he would sell one unit to you and Mr. Berbit at a pre-construction price.

Under your proposal, you and Mr. Berbit would open two self-directed IRA accounts at a local bank. You would then create a subchapter S corporation in which the two IRAs would be the sole shareholders. The IRAs would make an initial subscription to the corporation sufficient to enable the corporation to put a down payment on the condominium. The corporation would then purchase the unit and obtain mortgage financing. You intend to rent the unit using the income therefrom to pay the mortgage. Any profit distributed by the corporation would be passed directly to the IRAs. If the corporation sold the unit, the profit realized would be similarly treated. You further indicate that you and Mr. Berbit would be the corporate officers in your capacity as trustees of your self-directed IRAs, but would hold no other interest in the corporation. Neither you nor Mr. Berbit will invest in the development in your individual capacity. You represent that the underlying assets of the subchapter S corporation will constitute "plan assets" (i.e., the condominium) for purposes of section 4975 of the Internal Revenue Code of 1986 (the Code). Finally, you have asked us to assume that the bank or other lending institution to whom the subchapter S corporation applies for a mortgage will require that Mr. Berbit and yourself sign personally as guarantors of the mortgage.

Pursuant to section 2510.3-2(d) of the Department of Labor's ("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 the regulation.¹ Such IRAs are, however, subject to section 4975 of the Code. 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 the interpretations of the Secretary of Labor pursuant to such authority.

Section 4975(c)(1) of the Code, in relevant part, prohibits any direct or indirect sale or exchange, or leasing, of any property between a plan and a disqualified person (4975(c)(1)(A)), lending of money or other extension of credit between a plan and a disqualified person (4975(c)(1)(B)), transfer to, or use by or for the benefit, of a disqualified person of the income or assets of a plan (4975(c)(1)(D)), and an 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 (4975(c)(1)(E)).

Section 4975(e)(2) of the Code defines the term "disqualified person" to include a plan fiduciary and a person providing services to the plan. 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 such plan or exercises any authority or control regarding management or disposition of its assets. In order for a prohibited transaction to occur, there must be a transaction

¹ Under the regulation, Title I is inapplicable only if: (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 organization 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 organization receives no consideration in the form of cash or otherwise, other than reasonable compensation for services actually rendered in connection with payroll deductions or dues checkoffs.

involving a disqualified person with respect to a plan. Where none of the relationships described in section 4975(e)(2) of the Code are found to exist, an entity would not be a disqualified person with respect to a plan.

As trustees with investment discretion over the assets in your respective IRAs, you and Mr. Berbit would be fiduciaries and, therefore, disqualified persons under section 4975(e)(2) of the Code. According to your representations, however, the developer of the condominium is not a disqualified person. Based solely on the facts and representations contained in your submissions, it is the opinion of the Department that the purchase of the condominium from the developer by the subchapter S corporation, which will be wholly-owned by the IRAs established by Mr. Berbit and yourself, would not involve a transaction described in section 4975(c)(1)(A) of the Code.

With respect to the issue concerning you and Mr. Berbit signing personally as guarantors of the mortgage, we note that the ERISA Conference Report states ". . . a prohibited transaction generally will occur if a loan to a plan is guaranteed by a party-in-interest [disqualified person], unless it comes within the special exemption for employee stock ownership plans." [H.R. Rep. 93-1280, 93d Cong., 2d Sess., 308(1974)] Accordingly, it is the opinion of the Department that the guarantee of the mortgage by yourself and Mr. Berbit would constitute a transaction described in section 4975(c)(1)(B) of the Code.

Whether the proposed transaction would violate sections 4975(c)(1)(D) and (E) of the Code raises questions of a factual nature upon which the Department will not issue an opinion. However, the Department notes that a violation of section 4975(c)(1)(D) and (E) would occur if the transaction was part of an agreement, arrangement or understanding in which the fiduciary caused plan assets to be used in a manner designed to benefit such fiduciary (or any person in which such fiduciary had an interest which would affect the exercise of his best judgement as a fiduciary). In this regard, see 29 CFR 2509.75-2.

We note that you have not requested and consequently the Department is not offering an opinion regarding whether the rental of the condominium unit and/or the loan from the bank or lending institution would result in a violation of section 4975 of the Code. You should be aware, however, that a violation of section 4975 would occur if the unit were rented to a disqualified person. Similarly, a violation of Code section 4975 would occur if the bank or other lending institution making the mortgage loan is a disqualified person, with respect to the IRAs.

Jay F. Jason, Esq.
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Finally, we wish to note that the views expressed in this letter relate only to the provisions of ERISA addressed above and not to any other law. In particular, we do not rule on the interpretation or application of section 408 of the Code. Accordingly, we have forwarded a copy of your submissions to the Service for a consideration of the issues you have raised under section 408 of the Code.

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,

Robert J. Doyle
Director of Regulations
and Interpretations

Enclosures