StatonWalsh

Financial Clarity Through Transparency

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Prohibited Transactions Rules

Certain transactions between the plan and a disqualified person are prohibited.

Prohibited Transactions

- Sale, exchange or lease of property.
- Lending money or extending credit.
- Furnishing goods, services or facilities.
- The transfer of assets to, or the use of assets by, a disqualified person.

Disqualified Persons

1. A plan fiduciary.
2. Persons providing services to the plan.
3. The employer of plan participants.
4. Employee organizations with members in the plan.
5. A 50% or more owner of the plan sponsor.
6. A spouse, lineal descendant (or spouse) or ancestor of any person described above.
7. A partnership, corporation, trust or estate of which 50% or more is owned, directly or indirectly, by a person described in items one through five.
8. An officer, director, 10% or more shareholder, employee earning 10% or more of the yearly wages of the employer, or a person described in items three, four, five, and seven.
9. A 10% or more partner or joint venturer of a person described in items three, four, five, and seven (IRC Section 4975(e)(2)).

Additional Prohibitions

- A fiduciary is prohibited from dealing with plan assets for his or her own account.
- A fiduciary may not receive any payment from a party dealing with a transaction involving plan assets.

Penalties for Engaging in a Prohibited Transaction

There is a basic penalty leveled against the party engaging in the transaction equal to 15% of the value of the transaction. In the case of buying property, this would be the sale price. In the case of a loan, the value of the transaction is the interest charged for the use of the money.

Once made, the prohibited transaction is deemed to be a continuing one until corrected by: (a) undoing it; (b) a deficiency notice is delivered; or (c) the penalty tax itself is levied. If, for example, a prohibited transaction occurred in December of year one, in January of year two it is deemed to occur again.

Not only is the 15% penalty levied again in year two but also there is a pyramiding that occurs when the prohibited transaction is not corrected. In year two, there is a 15% tax levied on the prohibited transaction that occurred in year one and that continued in year two. There is also a 15% penalty assessed for the same transaction in year two. Hence, the total penalty for the two years is 15% for the initial year plus another 30% for year two for a total of 45%.

If the prohibited transaction is not reversed by the time the IRS assesses this 15% excise tax, a tax of 100% of the amount involved in the prohibited transaction will be assessed.

Exemptions

There are two types of exemptions.

- **Statutory:** IRC Section 4975(d), ERISA Secs. 407 and 408.
- **Administrative:** This type is granted by the Department of Labor (DOL) either for individual transactions or on a class basis for repetitive or identical transactions. The DOL will not grant an exemption for an act that has already occurred. DOL exemptions are prospective only.

Important Notice

This report is intended to serve as a basis for further discussion with your other professional advisors. Although great effort has been taken to provide accurate numbers and explanations, the information in this report should not be relied upon for preparing tax returns or making investment decisions.

Assumed rates of return are not in any way to be taken as guaranteed projections of actual returns from any recommended investment opportunity. The actual application of some of these concepts may be the practice of law and is the proper responsibility of your attorney.

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