P/OPINION 77-06

407

March 29, 1977

Dear :

This is in reply to your letter requesting an advisory opinion under the Employee Retirement Income Security Act of 1974 (ERISA) on behalf of the (named) Corporation Employees Profit Sharing Plan and Trust (the Plan). I regret that our heavy workload has resulted in a delay in responding to your letter.

Specifically, you request an advisory opinion that the common stock of (X), Inc. and the common stock of (Y), Inc. owned by the Plan constitute qualifying employer securities under section 407(d)(5) of ERISA so that a sale by the Plan to (named) Corporation of such common stock will be exempt from the provisions of section 406 of ERISA if made in compliance with the provisions of section 408(e). However, you explain that, in view of the provisions of section 5.02(a) of ERISA Procedure 76-1 (Advisory Opinion Procedure), the Plan is not requesting an advisory opinion as to what constitutes adequate consideration.

You state the following facts. The Plan is a profit-sharing plan qualified under section 401(a) of the Internal Revenue Code of 1954. On December 11, 1973, (named) permanently discontinued all contributions to the Plan. A favorable determination letter from the Internal Revenue Service was issued with respect to such termination on August 27, 1974. However, the Plan's trust fund has not been liquidated and distributions will be made to employees from the Plan only upon their retirement, death, or termination of employment. The Plan is currently the sole shareholder of (X) and (Y). Thirty-three and a half percent of the Plan's assets as of December 31, 1975, were invested in the shares of (X) and (Y). An additional 10.6 percent consisted of approximately 10 shares of unimproved

land near the City of . The balance of the Plan's assets are in certificates of deposit or other liquid assets. The trustees of the Plan believe that disposition of both the unimproved land and the shares of (X) and (Y) is necessary to permit distribution to participants in accordance with the provisions of the Plan inasmuch as a substantial amount of the funds in the Plan are attributable to participants who are within 10 years of the Plan's normal retirement date and distributions are also anticipated to be made to terminated employees.

(Named) is the only participating employer in the Plan, which was not adopted by (X) or any of the (named) subsidiaries or affiliates. (Named) and its subsidiary corporations are engaged in the freight forwarding (surface and air) business. (X) and (Y) are shipper's agents located in the City area at Pier and in the (Home State) area, respectively. (X) and (Y) are essentially service companies whose earnings are produced by the personal efforts principally of two key employees, Mr. (A) and Mr. (B), who are also employed by (#1) Consolidators and (#2) Consolidators, both divisions of (named). Some of the Plan trustees fear that in light of the long relationship with (named), Messrs. (A) and (B) would continue to work solely for the (named) companies, thus dampening the Plan's ability to sell the stock of (X) and (Y) to an unrelated party on a basis favorable to the Plan. These trustees have determined that there is no active market for the sale of such stock and believe that (named) may present the only buyer available for it.

In 1956, Mr. (Blank) sold to the Plan all of the issued and outstanding stock of (X). Mr. (Blank) and his two adult children currently own all of the stock of (named). He is also one of the trustees of the Plan. (Y) was organized in 1975 as a wholly owned subsidiary of the Plan by means of a cash dividend paid to the Plan by (X).

Although no documents have been submitted to this Office pertaining to the proposed sale by the Plan to (named) of the shares of (X) and (Y), you state that the following procedures have been proposed with respect to the negotiation. The (X) stock will be appraised by an independent and unrelated firm with experience in the shipping business. Members of the (Blank) family will not participate in the decision as to the selection of the

appraiser. The other Plan trustees will then endeavor to negotiate a sale of the (X) stock to (named) for an all-cash price equal to the amount of the appraisal. If (named) agrees to this price, the trustees will advise all Plan participants of the terms of the proposed sale. The trustees will request each participant's views on the desirability of the proposed sale but will not be bound to act in accordance with such views.

You believe that the above-mentioned stock is the stock of an affiliate of (named) for purposes of section 407(d)(1), (5), and (7) of ERISA for each of the following reasons:

1. Simultaneously with the consummation of the transaction, (X) and (Y) are affiliates of (named) since (named) will own 100 percent of the of stock said corporation.

2. At the time that the stock of (X) was first issued by (named) to Mr. (Blank) prior to the sale of (X) stock to the Plan, (X) was an affiliate of (named). Since (Y) was created "out of" (X), its status should be the same as (X) in this regard.

Section 406(a)(1)(A) of ERISA prohibits a fiduciary with respect to a plan from causing the plan to engage in a transaction, if he knows or should know that such transaction constitutes a direct or indirect sale or exchange, or leasing, of any property between the plan and a party in interest. Under section 3(14)(C), the term "party in interest" includes an employer any of whose employees are covered by such plan.

Notwithstanding these provisions, however, section 408(e) of ERISA permits the acquisition or sale by a plan of qualifying employer securities (as defined in section 407(d)(5)) or acquisition, sale or lease by a plan of qualifying employer real property (as defined in section 407(d)(4))—(1) if such acquisition, sale, or lease is for adequate consideration (with a special rule in the case of a marketable obligation), (2) if no commission is charged with respect thereto, and (3) if (A) the plan is an eligible individual account plan (as defined in section 407(d)(3)), or (B) additional specified requirements are met if the plan is not an eligible individual account plan.

Section 407(d)(5) of ERISA defines the term "qualifying employer security" as an employer security which is stock or a marketable obligation (as defined in section 407(e)).

In this regard, section 407(d)(1) defines the term "employer security" as a security issued by an employer of employees covered by the plan, or by an affiliate of such employer. Under section 407(d)(7), a corporation is an affiliate of an employer if it is a member of any controlled group of corporations (as defined in section 1563(a) of the Code, except that "applicable percentage" shall be substituted for "80 percent" wherever the latter percentage appears in such section) of which the employer who maintains the plan is a member. In this regard, the term "applicable percentage" means 50 percent, or such lower percentage as the Secretary of Labor may prescribe by regulation.

Since (named) is an employer some of whose employees are covered by the Plan, (named) is a party in interest with respect to the Plan, pursuant to section 3(14)(C) of ERISA. Therefore, section 406(a)(1)(A) would apply to any sale by the Plan of its assets to (named). For the exemption provided by section 408(e) to apply to any such sale, the property being sold must be either qualifying employer securities or qualifying employer real property. Thus, if the shares of (X) and (B) are qualifying employer securities at the time they are owned by the Plan, section 408(e) would apply to the sale of those shares by the Plan to (named), provided the other requirements of that section are met. However, if the shares do not constitute employer securities within the meaning of section 407(d)(1) at the time they are owned by the Plan, they cannot be deemed to be qualifying employer securities under section 407(d)(5) at such time. Since the shares in question are not securities of (named), they must, at the time they are owned by the Plan, be securities issued by an affiliate of (named) in order to constitute employer securities within the meaning of section 407(d)(1) at such time.

(X) and (Y) will become affiliates of (named) when they become members of a controlled group of corporations, to the extent provided by section 407(d)(7), to which (named) belongs. The information submitted indicates that (X) and (Y) are not presently and will not be members of such a controlled group of corporations prior to the consummation of the proposed sale. Thus, (X) and (Y) will not become affiliates, within the meaning of section 407(d)(7), of (named) prior to the consummation of the proposed sale, and

the shares of (X) and (Y) will not become securities of an affiliate of (named) prior to such consummation.

Based on the foregoing, therefore, we conclude that prior to the consummation of the proposed sale, the shares of (X) and (Y) will be neither employer securities within the meaning of section 407(d)(l) of ERISA nor qualifying employer securities within the meaning of section 407(d)(5), so that the proposed sale will not fall within the purview of the exemption provided by section 408(e).

Section 8 of ERISA Procedure 76-1 (41 FR 36281, August 27, 1976) states that if a conference has been requested with respect to a request for an advisory opinion and the Department of Labor (the Department) determines that a conference is necessary or appropriate, the individual or organization or the authorized representative will be notified of the time and place of the conference; a conference will normally he scheduled only when the Department in its sole discretion deems it will be necessary or appropriate in deciding the case. Our analysis of the information submitted leads us to believe that a conference is not necessary or appropriate in deciding this case.

Section 408(a) of ERISA permits the Department to grant exemptions from the prohibited transaction restrictions of sections 406 and 407(a) if the Department finds that such exemptions are administratively feasible, in the interests of the plan and of its participants and beneficiaries, and protective of the rights of participants and beneficiaries of such plan. The Department would consider an application for such an exemption regarding the proposed sale described above if you choose to submit one. In this regard, please see the enclosed copy of ERISA Procedure 75-1 (exemption procedure).

Because your letter also raises questions under section 4975(d)(13) of the Internal Revenue Code of 1954, we have conferred with representatives of the Internal Revenue Service and they concur in the views set forth above as they apply to that section.

Sincerely,