U.S. Department of Labor

Labor-Management Services Administration
Washington, D.C. 20216

OPINION 80-57A
407(d)(3)

OCT 1 1980

Louise A. Jackson, Esquire
Marshall, Melhorn, Cole, Hummer & Spitzer
Fourteenth Floor
National Bank Building
Toledo, Ohio 43604

Re: Kobacker Stores, Inc. Employees' Profit Sharing Plan and Trust (the Plan)
Identification Number: F-0503A

Dear Ms. Jackson:

This is in reply to your letters of January 17, 1979, February 8, 1979 and March 3, 1979 in which you request an advisory opinion as to whether the proposed sale of six retail shoe stores by Kobacker Stores, Inc. (Kobacker), the Plan sponsor, to the Plan and the subsequent leaseback of those stores by the Plan to Kobacker would be exempt from the prohibited transactions provisions of sections 406(a) and 407(a) of the Employee Retirement Income Security Act of 1974 (ERISA) by virtue of section 408(e) of ERISA.[1] We regret our delay in responding to your inquiry.

According to the information you submitted, Kobacker will construct retail shoe stores on 17 parcels of land currently owned or in the process of being acquired by Kobacker. Kobacker then proposes to sell six of these completed retail shoe stores in Dayton, Ohio; Brunswick, Ohio; Richmond, Indiana; Akron, Ohio; Toledo, Ohio; and Cleveland, Ohio to the Plan at the actual cost to Kobacker of each property, for an aggregate total price of approximately $1.0 million. The Plan would then lease these properties to Kobacker. At the time of your submission, the Plan had assets of approximately $2.3 million.

Midland Mutual Life Insurance Company (Midland), which is an entity independent of the Plan and Kobacker, has agreed to take a 20 year first mortgage, without points, at an interest rate of 10 1/8 percent, on the six properties purchased by the Plan, in an amount equal to the total purchase price. The mortgage would be secured only by the properties sold to the Plan and would be nonrecourse. The Plan and Kobacker would enter into a triple net lease for each retail shoe store at a rent which would fully amortize the mortgage over its term and generate a small amount of additional cash to the Plan. At the end of the amortization period of the mortgage, the Plan would own the six properties free and clear of any encumbrances.

It is further represented that five of the parcels of real property are located in several communities throughout Ohio, and the sixth is located in Indiana. You state that a substantial number of these parcels of property are geographically dispersed so as to avert exposure to loss arising from adverse conditions peculiar to a specific geographical area. In addition, you inform us that each of the parcels and the improvements thereon would be suitable or adaptable without excessive cost for uses other than as a retail shoe outlet. You also state that the proposed acquisition and retention of the shoe outlets by the Plan would comply with the provisions of Title I Part 4 of ERISA (other than section 404(a)(1)(B) to the extent it requires diversification, and section 404(a)(1)(C), 406, and 407(a)).

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[1] In your letter, you also request an opinion with regard to the provisions of section 4975 of the Internal Revenue Code of 1954 corresponding to the applicable provisions of Title I of ERISA. Under Reorganization Plan No.4 of 1978 (43 FR 47713, October 17, 1978) effective December 31, 1978, the authority of the Secretary of the Treasury to issue rulings and exemptions under section 4975 of the Code has been transferred, with certain exceptions not here relevant, to the Secretary of Labor.

Section 406(a) of ERISA provides, in part, as follows:

> Except as provided in section 408:
> (1) A fiduciary with respect to a plan shall not cause the plan to engage in a transaction if he knows or should know that such transaction constitutes a direct or indirect—
> (A) sale or exchange, or leasing, of any property between the plan and a party in interest; [or]
>
> * * *
>
> (D) transfer to, or use by or for the benefit of, a party in interest, of any assets of the plan …

The term "party in interest" is defined in section 3(14)(C) of ERISA to include an employer any of whose employees are covered by such plan. Kobacker is, therefore, a party in interest with respect to the Plan. In the absence of a statutory exemption under section 408(b) of ERISA or an administrative exemption under section 408(a), the proposed sale of the parcels of real property by Kobacker would contravene section 406(a)(1)(A) and (D).

Section 408(e) of ERISA, however, provides, in relevant part, as follows:

> Section 406 and 407 shall not apply to the … 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 …
> (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)) …

As noted above, you have requested an advisory opinion as to whether the exemption set forth in section 408(e) of ERISA would apply to the proposed sale of the retail shoe stores in question by Kobacker to the Plan, and their subsequent leaseback by the Plan to Kobacker.

In section 5.01 of ERISA procedure 76-1, (41 FR 36281; August 27, 1976), relating to advisory opinions, the Department stated that it would not ordinarily issue advisory opinions in areas involving problems of an inherently factual nature. In addition, section 5.02 of ERISA Procedure 76-1 lists certain specific sections of ERISA with respect to which the Department will not ordinarily issue advisory opinions. The availability of an exemption under section 408(e) of ERISA is conditioned on a number of factors that involve problems of an inherently factual nature, or that otherwise raise questions with respect to which the Department generally does not issue advisory opinions.

First, section 408(e) applies to an acquisition, sale or lease by a plan of real property only if such real property is "qualifying employer real property." The term "employer real property" is defined in section 407(d)(2) of ERISA to mean real property (and related personal property) which is leased to an employer of employees covered by the plan or to an affiliate of such employer.[2] The term "qualifying employer real property" is defined in section 407(d)(4) of ERISA to mean parcels of employer real property, provided that the following conditions, set forth in section 407(d)(4)(A), (B), and (D) are met:[3]

> (A) if a substantial number of the parcels are dispersed geographically;
> (B) if each parcel of real property and the improvements thereon are suitable (or adaptable without excessive cost) for more than one use; … and
> (D) if the acquisition and retention of such property comply with the provisions of [Part 4 of Title I of ERISA] (other than section 404(a)(1)(B) to the extent it requires diversification, and sections 404(a)(1)(C), 406, and subsection (a) of [section 407]).

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[2] On the basis of the information provided in your letters, it appears that the retail stores in question, if purchased by the Plan and leased back to Kobacker, would become "employer real property" within the meaning of section 407(d)(2).

[3] Section 407(d)(4)(C), which recognizes that all of such real property may be leased to one lessee (which may be employer or an affiliate of an employer), is permissive, rather than restrictive, in character, unlike section 407(d)(4)(A), (B), and (D).

The questions of whether a number of parcels of employer real property are geographically dispersed so as to provide protection for the Plan in the event of adverse economic conditions in any one area,[4] and whether such parcels are each suitable or adaptable without excessive costs for more than one use, are both questions which are inherently factual in nature. For this reason, in accordance with section 5.01 of ERISA Procedure 76-1, the Department will not normally issue an advisory opinion that is based on determinations concerning these questions.[5]

In this regard, we note that your letter contains the following assertions: that a "substantial number of the parcels in question are dispersed geographically thereby averting exposure to loss arising from adverse economic conditions peculiar to a geographical area which could significantly affect the economic status of the plan as a whole;" that the parcels of real property in question are "suitable or adaptable without excessive costs for other uses" than as retail shoe outlets; that the acquisition and retention of the property by the Plan "complies with Part 4 of ERISA;" that the cost to the Plan of acquiring the parcels of property will be "lower than fair market value;" and that "the lease amount will be the fair rental value of the property." It is true that if these assertions are accurate, the applicable conditions of sections 407(d)(4) and 408(e) will be met. For the reasons set forth above, however, the Department will issue no opinion on these matters. Instead, it is the duty of the appropriate plan fiduciaries to determine in good faith whether the conditions will be met before causing the plan to enter into the proposed transactions.

Your letter also indicates that it is your opinion that the Plan is an "eligible individual account plan" within the meaning of section 407(d)(3) of ERISA, and that you contemplate relying on section 408(e)(3)(A). Under section 408(e)(3)(A), transactions involving an eligible individual account plan are not required to meet certain restrictions applicable, under section 408(e)(3)(B), to transactions involving plans other than eligible individual account plans, in order to qualify for the exemption set forth in section 408(e).

The term "eligible individual account plan" is defined in section 407(d)(3) of ERISA to include an individual account plan which is a profit sharing plan, provided that such plan explicitly provides for acquisition and holding of qualifying employer real property. The Plan in question appears to be an individual account plan which has the characteristics of a profit sharing plan.[6] The Plan document, however, provides, in relevant part, that in managing the funds of the Plan, the Trustee may invest up to fifty percent of all Plan assets in "the securities of [Kobacker] and/or real property (and related personal property) which is leased to [Kobacker]." You should be aware that, in the Department's view, the plan does not explicitly provide for the acquisition and holding of "qualifying employer real property" (as that term is defined in section in section 407(d)(4)). Assuming that a change is made in the Plan document so that it would explicitly provide for the acquisition and holding of "qualifying employer real property", the Plan, in our view, would be an "eligible individual account plan" within the meaning of section 407(d)(3).

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[4] With regard to the "geographic dispersion" requirement, the Conference Report accompanying ERISA, H. Rep. No. 93-1280, 93d Cong., 2d Sess. (1974), at page 318, indicates that Congress intended the geographic dispersion of qualifying employer real property to be sufficient so that adverse economic conditions peculiar to one area would not significantly affect the economic status of the plan as a whole.

[5] The Department has, on occasion, issued an advisory opinion (see, for example, ERISA Opinion 75-111) in which it concluded on the basis of factual representations submitted by a private party that certain parcels of real property met the requirements of section 407(d)(4)(A) and (B). In the absence of highly unusual circumstances, however, the Department will not issue advisory opinions covering these issues.

[6] The Plan document submitted with your letters provides that individual accounts are required to be maintained for each individual participant and that the benefits distributed to the individual participant and his beneficiaries by reason of his death, retirement or disability are equal to the full value of that participant's individual account. Further, the Plan provides, in Article II, that Kobacker is required to contribute, out of its current or accumulated earnings and profits, an amount based upon a percentage of Kobacker's aggregate net operating income. At the close of the fiscal year the total amount contributed by Kobacker for all employees is apportioned so that the amount distributed to an individual employee bears the same ratio to the total amount of Kobacker's contribution as that employee's annual salary bears to the aggregate annual compensation of all participants.

This letter constitutes an advisory opinion under ERISA Procedure 75-1. Accordingly, this letter is issued subject to the Procedure, including section 10, relating to the effect of advisory opinions.

The Department has recently issued final regulations under section 408(e) of ERISA, 29 CFR 2550.408e (45 FR 1194; August 1, 1980). We are enclosing herewith a copy of those regulations for your information.

Sincerely,

Alan D. Lebowitz
Assistant Administrator for Fiduciary Standards

Enclosure