U.S. Department of Labor **Employee Benefits Security Administration**
Washington, D.C. 20210

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2011-04A
IRC SEC.
4975(c)(1)

Dear Mr. Adams:

This is in response to your request for an advisory opinion from the U.S. Department of Labor (Department) concerning the application of the prohibited transaction provisions under section 4975(c) of the Internal Revenue Code of 1986, as amended (Code),[1] to a proposed transaction involving an individual retirement account (IRA). Specifically, you ask whether it would be a prohibited transaction in violation of Code section 4975 for an IRA to purchase a promissory note and deed of trust held by a bank where the IRA owner and his spouse are obligors on the note and title to the real property encumbered by the deed of trust is held by a family trust of which the IRA owner and his spouse are trustees.

The IRA is an individual retirement account as described in section 408(a) of the Code, as amended. The IRA was established by Donald H. Warfield (Mr. Warfield) over twenty years ago. Mr. Warfield is the sole participant in the IRA and his wife, Betty L. Warfield (Ms. Warfield), is the sole beneficiary of the IRA. Mr. Warfield has sole discretion over the assets of the IRA.

In 1993, Mr. and Ms. Warfield (together, the Warfields) purchased an interest in certain improved real property (i.e., an eight unit apartment building) located in San Diego, California (the Property) for $200,000. They financed the purchase with a loan from Chase Bank (the Bank), secured by a first mortgage on the Property. The loan from the Bank is evidenced by a promissory note (the Note). Currently, title to the Property is held by the D&B Family Trust, a revocable trust (the Family Trust). The Warfields are trustees and sole beneficiaries of the Family Trust. Title to the Property, as held by the Family Trust, is encumbered by a deed of trust used to secure the Note held by the Bank.

Mr. Warfield proposes that his IRA purchase the Note and deed of trust held by the Bank. Upon payment, the Bank would assign the Note and deed of trust directly to the IRA. The IRA would become the holder of the Note and, as such, entitled to payments made thereon. The Warfields would make all payments on the Note to the IRA. The Bank has agreed to engage in the proposed transaction with the IRA. A third-party commercial

[1] Under 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 was transferred, with certain exceptions not here relevant, to the Secretary of Labor. The Secretary of the Treasury is bound by the interpretation of the Secretary of Labor pursuant to such authority.

bank, acting as a custodian for the IRA, would be used to receive monthly loan payments from the Warfields and enforce provisions of the Note and deed of trust. Thus, you state that the transaction has been structured to avoid any new loan or other extension of credit between the IRA and the Warfields, as would occur if they refinanced the loan under different terms using the IRA as a new lender.

Code section 4975 sets forth a series of "prohibited transactions" involving a plan and a "disqualified person." Section 4975(e)(1), in pertinent part, defines the term "plan" to include an IRA, described in section 408(a) of the Code. Section 4975(e)(2) defines "disqualified person," in pertinent part, to include a fiduciary (sec. 4975(e)(2)(A)), a member of the family of such fiduciary (sec. 4975(e)(2)(F)), and a trust of which (or in which) 50 percent or more of the beneficial interest of such trust is owned directly or indirectly, or held by a fiduciary (sec. 4975(e)(2)(G)).

Section 4975(e)(3) defines the term "fiduciary," in part, to include any person who exercises discretionary authority or control respecting management of such plan or exercises any authority or control regarding management or disposition of plan assets. Section 4975(e)(6) states that a "member of the family," for purposes of "disqualified persons" described in section 4975(e)(2), includes a spouse of a fiduciary.

Thus, Mr. Warfield, as the IRA owner who has sole discretion to direct the investments made by his IRA, would be a fiduciary and a disqualified person with respect to the IRA under Code section 4975(e)(2) and would be subject to the restrictions imposed by section 4975(c)(1).[2] Ms. Warfield, as Mr. Warfield's wife, would be a disqualified person with respect to the IRA as a "member of the family" of the IRA fiduciary. The Family Trust would also be considered a disqualified person under section 4975(e)(2), since Mr. Warfield is its trustee and the Warfields are its sole beneficiaries.

Section 4975(c)(1)(B) prohibits the direct or indirect lending of money or other extension of credit between a plan and a disqualified person. In the present case, while the IRA would acquire the Note and related deed of trust directly from the Bank, an otherwise unrelated party, the IRA would hold the Note and receive payments on the Note from the Warfields, who are disqualified persons with respect to the IRA, as described above.

In the Department's view, a loan is a transaction that continues from the time it is made until all amounts due are paid. Thus, a debtor-creditor relationship continues throughout the duration of the extension of credit. As a result, the relationship of the parties must be examined throughout the course of the loan to determine whether a disqualified person relationship exists.[3] Based upon the facts you describe, it is the opinion of the Department that a prohibited extension of credit, in violation of Code section 4975(c)(1)(B), will exist between the IRA and the Warfields, disqualified persons with respect to the IRA, once the

[2] *See*, *e.g.*, Advisory Opinions 2009-03A (Oct. 27, 2009) and 2006-09A (Dec. 19, 2006).
[3] *See*, *e.g.*, Advisory Opinion 85-30A (Aug. 22, 1985).

IRA acquires the Note from the Bank. In addition, the holding of the Note by the IRA will continue to be a prohibited transaction under Code section 4975(c)(1)(B) as long as payments on the Note are made by the Warfields or any other disqualified person.

The Department notes that section 4975(c)(1) also 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 (see section 4975(c)(1)(D)), and a fiduciary from dealing with the income or assets of a plan in his own interest or for his own account (see section 4975(c)(1)(E)). In this regard, the acquisition and holding of the Note by the IRA would violate Code section 4975(c)(1)(D) and (E) 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 persons in which such fiduciary had an interest that would affect the exercise of his best judgment as a fiduciary).[4] A person in which an IRA fiduciary would have an interest that may affect the exercise of such fiduciary's best judgment would include, among others, a person that is a "disqualified person" by reason of a relationship to such fiduciary as defined in Code section 4975(e)(2)(F) or (G).[5]

Whether the proposed transaction is being made by the IRA as part of an agreement, arrangement or understanding by Mr. Warfield, as the IRA's fiduciary, to benefit himself or persons in whom he has an interest that affects his best judgment as a fiduciary (e.g., the Family Trust) is generally an inherently factual question. In the situation you describe, the IRA would be making an investment (i.e., the purchase of the Note from an unrelated party) where the IRA owner, Mr. Warfield, would have an understanding, as a fiduciary, that the assets of the IRA are being used to create a prohibited transaction (i.e., an ongoing debtor-creditor relationship between the IRA and disqualified persons) once the IRA acquires the Note. Under these circumstances, it is the Department's view that the purchase of the Note itself would be a separate prohibited transaction under Code section 4975(c)(1)(D) and (E).

This letter constitutes an advisory opinion under ERISA Procedure 76-1, 41 Fed. Reg. 36281 (1976). Accordingly, this letter is issued subject to the provisions of that procedure, including section 10 thereof, relating to the effect of advisory opinions.

Sincerely,

Louis J. Campagna
Chief, Division of Fiduciary Interpretations
Office of Regulations and Interpretations

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[4] *See* Advisory Opinion 2006-01A (Jan. 6, 2006).
[5] Treas. Reg. § 54.4975-6(a)(5).