

Internal Revenue Code Section 4975(f)(6)

Tax on prohibited transactions.

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- (f) Other definitions and special rules. For purposes of this section—
- (1) Joint and several liability. If more than one person is liable under subsection (a) or (b) with respect to any one prohibited transaction, all such persons shall be jointly and severally liable under such subsection with respect to such transaction.
 - (2) Taxable period. The term "taxable period" means, with respect to any prohibited transaction, the period beginning with the date on which the prohibited transaction occurs and ending on the earliest of—
 - (A) the date of mailing a notice of deficiency with respect to the tax imposed by subsection (a) under section 6212,
 - (B) the date on which the tax imposed by subsection (a) is assessed, or
 - (C) the date on which correction of the prohibited transaction is completed.
 - (3) Sale or exchange; encumbered property. A transfer of real or personal property by a disqualified person to a plan shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien which the plan assumes or if it is subject to a mortgage or similar lien which a disqualified person placed on the property within the 10-year period ending on the date of the transfer.
 - (4) Amount involved. The term "amount involved" means, with respect to a prohibited transaction, the greater of the amount of money and the fair market value of the other property given or the amount of money and the fair market value of the other property received; except that, in the case of services described in paragraphs (2) and (10) of subsection (d) the amount involved shall be only the excess compensation. For purposes of the preceding sentence, the fair market value—
 - (A) in the case of the tax imposed by subsection (a), shall be determined as of the date on which the prohibited transaction occurs; and
 - (B) in the case of the tax imposed by subsection (b), shall be the highest fair market value during the taxable period.
 - (5) Correction. The terms "correction" and "correct" mean, with respect to a prohibited transaction, undoing the transaction to the extent possible, but in any case placing the

plan in a financial position not worse than that in which it would be if the disqualified person were acting under the highest fiduciary standards.



(6) Exemptions not to apply to certain transactions.

(A) In general. In the case of a trust described in section 401(a) which is part of a plan providing contributions or benefits for employees some or all of whom are owner-employees (as defined in section 401(c)(3)), the exemptions provided by subsection (d) (other than paragraphs (9) and (12)) shall not apply to a transaction in which the plan directly or indirectly—

(i) lends any part of the corpus or income of the plan to,

(ii) pays any compensation for personal services rendered to the plan to, or

(iii) acquires for the plan any property from, or sells any property to,

any such owner-employee, a member of the family (as defined in section 267(c)(4)) of any such owner-employee, or any corporation in which any such owner-employee owns, directly or indirectly, 50 percent or more of the total combined voting power of all classes of stock entitled to vote or 50 percent or more of the total value of shares of all classes of stock of the corporation.

(B) Special rules for shareholder-employees, etc.

(i) In general. For purposes of subparagraph (A), the following shall be treated as owner-employees:

(I) A shareholder-employee.

(II) A participant or beneficiary of an individual retirement plan (as defined in section 7701(a)(37)).

(III) An employer or association of employees which establishes such an individual retirement plan under section 408(c).

(ii) Exception for certain transactions involving shareholder-employees.

Subparagraph (A)(iii) shall not apply to a transaction which consists of a sale of employer securities to an employee stock ownership plan (as defined in subsection (e)(7)) by a shareholder-employee, a member of the family (as defined in section 267(c)(4)) of such shareholder-employee, or a corporation in which such a shareholder-employee owns stock representing a 50 percent or greater interest described in subparagraph (A).

(iii) Loan exception. For purposes of subparagraph (A)(i), the term "owner-employee" shall only include a person described in subclause (II) or (III) of clause (i).

(C) Shareholder-employee. For purposes of subparagraph (B), the term "shareholder-employee" means an employee or officer of an S corporation who owns (or is

considered as owning within the meaning of section 318(a)(1)) more than 5 percent of the outstanding stock of the corporation on any day during the taxable year of such corporation.

(7) S corporation repayment of loans for qualifying employer securities. A plan shall not be treated as violating the requirements of section 401 or 409 or subsection (e)(7), or as engaging in a prohibited transaction for purposes of subsection (d)(3), merely by reason of any distribution (as described in section 1368(a)) with respect to S corporation stock that constitutes qualifying employer securities, which in accordance with the plan provisions is used to make payments on a loan described in subsection (d)(3) the proceeds of which were used to acquire such qualifying employer securities (whether or not allocated to participants). The preceding sentence shall not apply in the case of a distribution which is paid with respect to any employer security which is allocated to a participant unless the plan provides that employer securities with a fair market value of not less than the amount of such distribution are allocated to such participant for the year which (but for the preceding sentence) such distribution would have been allocated to such participant.

(8) Provision of investment advice to participant and beneficiaries.

(A) In general. The prohibitions provided in subsection (c) shall not apply to transactions described in subsection (d)(17) if the investment advice provided by a fiduciary adviser is provided under an eligible investment advice arrangement.

(B) Eligible investment advice arrangement. For purposes of this paragraph, the term "eligible investment advice arrangement" means an arrangement—

(i) which either—

(I) provides that any fees (including any commission or other compensation) received by the fiduciary adviser for investment advice or with respect to the sale, holding, or acquisition of any security or other property for purposes of investment of plan assets do not vary depending on the basis of any investment option selected, or

(II) uses a computer model under an investment advice program meeting the requirements of subparagraph (C) in connection with the provision of investment advice by a fiduciary adviser to a participant or beneficiary, and

(ii) with respect to which the requirements of subparagraphs (D), (E), (F), (G), (H), and (I) are met.

(C) Investment advice program using computer model.

(i) In general. An investment advice program meets the requirements of this subparagraph if the requirements of clauses (ii), (iii), and (iv) are met.

(ii) Computer model. The requirements of this clause are met if the investment advice provided under the investment advice program is provided pursuant to a computer model that—

- (I) applies generally accepted investment theories that take into account the historic returns of different asset classes over defined periods of time,
- (II) utilizes relevant information about the participant, which may include age, life expectancy, retirement age, risk tolerance, other assets or sources of income, and preferences as to certain types of investments,
- (III) utilizes prescribed objective criteria to provide asset allocation portfolios comprised of investment options available under the plan,
- (IV) operates in a manner that is not biased in favor of investments offered by the fiduciary adviser or a person with a material affiliation or contractual relationship with the fiduciary adviser, and
- (V) takes into account all investment options under the plan in specifying how a participant's account balance should be invested and is not inappropriately weighted with respect to any investment option.

(iii) Certification.

- (I) In general. The requirements of this clause are met with respect to any investment advice program if an eligible investment expert certifies, prior to the utilization of the computer model and in accordance with rules prescribed by the Secretary of Labor, that the computer model meets the requirements of clause (ii).
- (II) Renewal of certifications. If, as determined under regulations prescribed by the Secretary of Labor, there are material modifications to a computer model, the requirements of this clause are met only if a certification described in subclause (I) is obtained with respect to the computer model as so modified.
- (III) Eligible investment expert. The term "eligible investment expert" means any person which meets such requirements as the Secretary of Labor may provide and which does not bear any material affiliation or contractual relationship with any investment adviser or a related person thereof (or any employee, agent, or registered representative of the investment adviser or related person).

(iv) Exclusivity of recommendation. The requirements of this clause are met with respect to any investment advice program if—

- (I) the only investment advice provided under the program is the advice generated by the computer model described in clause (ii), and

(II) any transaction described in (d)(17)(A)(ii) occurs solely at the direction of the participant or beneficiary. Nothing in the preceding sentence shall preclude the participant or beneficiary from requesting investment advice other than that described in clause (i), but only if such request has not been solicited by any person connected with carrying out the arrangement.

(D) Express authorization by separate fiduciary. The requirements of this subparagraph are met with respect to an arrangement if the arrangement is expressly authorized by a plan fiduciary other than the person offering the investment advice program, any person providing investment options under the plan, or any affiliate of either.

(E) Audits.

(i) In general. The requirements of this subparagraph are met if an independent auditor, who has appropriate technical training or experience and proficiency and so represents in writing—

(I) conducts an annual audit of the arrangement for compliance with the requirements of this paragraph, and

(II) following completion of the annual audit, issues a written report to the fiduciary who authorized use of the arrangement which presents its specific findings regarding compliance of the arrangement with the requirements of this paragraph.

(ii) Special rule for individual retirement and similar plans. In the case of a plan described in subparagraphs (B) through (F) (and so much of subparagraph (G) as relates to such subparagraphs) of subsection (e)(1), in lieu of the requirements of clause (i), audits of the arrangement shall be conducted at such times and in such manner as the Secretary of Labor may prescribe.

(iii) Independent auditor. For purposes of this subparagraph, an auditor is considered independent if it is not related to the person offering the arrangement to the plan and is not related to any person providing investment options under the plan.

(F) Disclosure. The requirements of this subparagraph are met if—

(i) the fiduciary adviser provides to a participant or a beneficiary before the initial provision of the investment advice with regard to any security or other property offered as an investment option, a written notification (which may consist of notification by means of electronic communication)—

(I) of the role of any party that has a material affiliation or contractual relationship with the fiduciary adviser, in the development of the investment advice program and in the selection of investment options available under the plan,

(II) of the past performance and historical rates of return of the investment options available under the plan,

- (III) of all fees or other compensation relating to the advice that the fiduciary adviser or any affiliate thereof is to receive (including compensation provided by any third party) in connection with the provision of the advice or in connection with the sale, acquisition, or holding of the security or other property,
 - (IV) of any material affiliation or contractual relationship of the fiduciary adviser or affiliates thereof in the security or other property,
 - (V) the manner, and under what circumstances, any participant or beneficiary information provided under the arrangement will be used or disclosed,
 - (VI) of the types of services provided by the fiduciary adviser in connection with the provision of investment advice by the fiduciary adviser,
 - (VII) that the adviser is acting as a fiduciary of the plan in connection with the provision of the advice, and
 - (VIII) that a recipient of the advice may separately arrange for the provision of advice by another adviser, that could have no material affiliation with and receive no fees or other compensation in connection with the security or other property, and
- (ii) at all times during the provision of advisory services to the participant or beneficiary, the fiduciary adviser—
- (I) maintains the information described in clause (i) in accurate form and in the manner described in subparagraph (H),
 - (II) provides, without charge, accurate information to the recipient of the advice no less frequently than annually,
 - (III) provides, without charge, accurate information to the recipient of the advice upon request of the recipient, and
 - (IV) provides, without charge, accurate information to the recipient of the advice concerning any material change to the information required to be provided to the recipient of the advice at a time reasonably contemporaneous to the change in information.
- (G) Other conditions. The requirements of this subparagraph are met if—
- (i) the fiduciary adviser provides appropriate disclosure, in connection with the sale, acquisition, or holding of the security or other property, in accordance with all applicable securities laws,
 - (ii) the sale, acquisition, or holding occurs solely at the direction of the recipient of the advice,

(iii) the compensation received by the fiduciary adviser and affiliates thereof in connection with the sale, acquisition, or holding of the security or other property is reasonable, and

(iv) the terms of the sale, acquisition, or holding of the security or other property are at least as favorable to the plan as an arm's length transaction would be.

(H) Standards for presentation of information.

(i) In general. The requirements of this subparagraph are met if the notification required to be provided to participants and beneficiaries under subparagraph (F)(i) is written in a clear and conspicuous manner and in a manner calculated to be understood by the average plan participant and is sufficiently accurate and comprehensive to reasonably apprise such participants and beneficiaries of the information required to be provided in the notification.

(ii) Model form for disclosure of fees and other compensation. The Secretary of Labor shall issue a model form for the disclosure of fees and other compensation required in subparagraph (F)(i)(III) which meets the requirements of clause (i).

(I) Maintenance for 6 years of evidence of compliance. The requirements of this subparagraph are met if a fiduciary adviser who has provided advice referred to in subparagraph (A) maintains, for a period of not less than 6 years after the provision of the advice, any records necessary for determining whether the requirements of the preceding provisions of this paragraph and of subsection (d)(17) have been met. A transaction prohibited under subsection (c) shall not be considered to have occurred solely because the records are lost or destroyed prior to the end of the 6-year period due to circumstances beyond the control of the fiduciary adviser.

(J) Definitions. For purposes of this paragraph and subsection (d)(17)—

(i) Fiduciary adviser. The term "fiduciary adviser" means, with respect to a plan, a person who is a fiduciary of the plan by reason of the provision of investment advice referred to in subsection (e)(3)(B) by the person to a participant or beneficiary of the plan and who is—

(I) registered as an investment adviser under the Investment Advisers Act of 1940 (15 U.S.C. 80b-1 et seq.) or under the laws of the State in which the fiduciary maintains its principal office and place of business,

(II) a bank or similar financial institution referred to in subsection (d)(4) or a savings association (as defined in section 3(b)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b)(1))), but only if the advice is provided through a trust department of the bank or similar financial institution or savings association which is subject to periodic examination and review by Federal or State banking authorities,

(III) an insurance company qualified to do business under the laws of a State,

(IV) a person registered as a broker or dealer under the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.),

(V) an affiliate of a person described in any of subclauses (I) through (IV), or

(VI) an employee, agent, or registered representative of a person described in subclauses (I) through (V) who satisfies the requirements of applicable insurance, banking, and securities laws relating to the provision of the advice. For purposes of this title, a person who develops the computer model described in subparagraph (C)(ii) or markets the investment advice program or computer model shall be treated as a person who is a fiduciary of the plan by reason of the provision of investment advice referred to in subsection (e)(3)(B) to a participant or beneficiary and shall be treated as a fiduciary adviser for purposes of this paragraph and subsection (d)(17), except that the Secretary of Labor may prescribe rules under which only 1 fiduciary adviser may elect to be treated as a fiduciary with respect to the plan.

(ii) Affiliate. The term "affiliate" of another entity means an affiliated person of the entity (as defined in section 2(a)(3) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a)(3))).

(iii) Registered representative. The term "registered representative" of another entity means a person described in section 3(a)(18) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(18)) (substituting the entity for the broker or dealer referred to in such section) or a person described in section 202(a)(17) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a)(17)) (substituting the entity for the investment adviser referred to in such section).

(9) Block trade. The term "block trade" means any trade of at least 10,000 shares or with a market value of at least \$ 200,000 which will be allocated across two or more unrelated client accounts of a fiduciary.

(10) Adequate consideration. The term "adequate consideration" means—

(A) in the case of a security for which there is a generally recognized market—

(i) the price of the security prevailing on a national securities exchange which is registered under section 6 of the Securities Exchange Act of 1934, taking into account factors such as the size of the transaction and marketability of the security, or

(ii) if the security is not traded on such a national securities exchange, a price not less favorable to the plan than the offering price for the security as established by the current bid and asked prices quoted by persons independent of the issuer and of the party in interest, taking into account factors such as the size of the transaction and marketability of the security, and

(B) in the case of an asset other than a security for which there is a generally recognized market, the fair market value of the asset as determined in good faith by a fiduciary or fiduciaries in accordance with regulations prescribed by the Secretary of Labor.

(11) Correction period.

(A) In general. For purposes of subsection (d)(23), the term "correction period" means the 14-day period beginning on the date on which the disqualified person discovers, or reasonably should have discovered, that the transaction would (without regard to this paragraph and subsection (d)(23)) constitute a prohibited transaction.

(B) Exceptions.

(i) Employer securities. Subsection (d)(23) does not apply to any transaction between a plan and a plan sponsor or its affiliates that involves the acquisition or sale of an employer security (as defined in section 407(d)(1) of the Employee Retirement Income Security Act of 1974) or the acquisition, sale, or lease of employer real property (as defined in section 407(d)(2) of such Act).

(ii) Knowing prohibited transaction. In the case of any disqualified person, subsection (d)(23) does not apply to a transaction if, at the time the transaction is entered into, the disqualified person knew (or reasonably should have known) that the transaction would (without regard to this paragraph) constitute a prohibited transaction.

(C) Abatement of tax where there is a correction. If a transaction is not treated as a prohibited transaction by reason of subsection (d)(23), then no tax under subsections (a) and (b) shall be assessed with respect to such transaction, and if assessed the assessment shall be abated, and if collected shall be credited or refunded as an overpayment.

(D) Definitions. For purposes of this paragraph and subsection (d)(23)—

(i) Security. The term "security" has the meaning given such term by section 475(c)(2) (without regard to subparagraph (F)(iii) and the last sentence thereof).

(ii) Commodity. The term "commodity" has the meaning given such term by section 475(e)(2) (without regard to subparagraph (D)(iii) thereof).

(iii) Correct. The term "correct" means, with respect to a transaction—

(I) to undo the transaction to the extent possible and in any case to make good to the plan or affected account any losses resulting from the transaction, and

(II) to restore to the plan or affected account any profits made through the use of assets of the plan.

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