PWBA Office of Regulations and Interpretations

Advisory Opinion

July 27, 2000

Hugh Janow
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2000 - 10A
ERISA SEC.
4975(c)(1)

Dear Mr. Janow:

This is in response to your request for an advisory opinion under section 4975 of the Internal Revenue Code (Code). Specifically, you ask whether allowing the owner of an IRA to direct the IRA to invest in a limited partnership, in which relatives and the IRA owner in his individual capacity are partners, will violate section 4975 of the Code.[1]

You represent that the Fetner Family Partnership is a New York general partnership that is an investment club (the Partnership), in which Mr. Adler, through a general partnership known as Esponda Associates (Esponda), and various relatives of Mr. Adler invest. Through his investment in Esponda, which is a pass-through partnership, Mr. Adler owns a 12.11 percent interest in the Partnership. Mr. Adler presently owns a 30.38 percent interest in Esponda. The only other partner in Esponda is David Geiger, who is unrelated to Mr. Adler. Esponda currently owns a 39.85 percent interest in the Partnership.

The other current partners of the Partnership are as follows: Steven Adler (Mr. Adler's son) — 5.25%; Jack Fetner (Mr. Adler's father-in-law) — 13.44%; Adam Nadel (Mr. Adler's son's brother-in-law); Fay Nadel (Mr. Adler's mother-in-law) — 25.55%; Andrea Raskin (Mr. Adler's daughter) — 5.33%; Lois Zoldon (Mr. Adler's sister-in-law) — 7.57%.

The Partnership's assets are managed by Bernard L. Madoff Investment Securities (Madoff), which is unrelated to Mr. Adler. Madoff requires entities to maintain a minimum capital account. You represent that the Partnership currently has an account with Madoff and has not received any notice that its does not meet minimum capital requirements for investment management by Madoff. The IRA's assets are not necessary for the Partnership to continue its account with Madoff.

You represent that Leonard Adler intends to open a self-directed individual retirement account (IRA) in the amount of approximately five hundred thousand ($500,000.00) dollars through Retirement Accounts, Inc. of Denver, Colorado. At the time Mr. Adler directs the IRA investment, the Partnership will become a limited Partnership. Mr. Adler will be the only general partner in the Partnership and will own 6.52%. Mr. Adler will not have any investment management functions with respect to the assets of the Partnership.

The limited partners and their percentage ownership interests will be as follows: Andrea Raskin — 1.35%; Steven Adler — 3.07%; Jack Fetner — 3.94%; Fay Nadel — 18.1%; Adam Nadel — 1.77%; Lois Zoldon — 5.55%; David Geiger — 20.31%; IRA of Leonard Adler — 39.38%. Messrs. Adler and Geiger will invest directly in the Partnership in the same percentages as they would have invested through Esponda, instead of investing through Esponda. Esponda will no longer invest in the Partnership.

You further represent that Mr. Adler believes that Madoff would effectively manage assets for the IRA, but that Mr. Adler's IRA does not meet the minimum capital requirements (currently $1 million) for investment management by Madoff. You represent, however, that Madoff will manage the IRA's assets if it invests with Madoff through the Partnership, even though the IRA by itself otherwise would not meet the minimum capital requirements. You further represent that all of the assets of the Partnership are liquid marketable securities. You also represent that none of the funds contributed by the IRA is required to be used, or will be used, to liquidate or redeem any other partner's interest in the Partnership.

Finally, you represent that Mr. Adler does not and will not receive any compensation from the Partnership. He likewise will not receive any compensation as a result of the acquisition by the IRA of its limited partnership interest.

You ask whether the investment by the IRA in the Partnership will give rise to a prohibited transaction under section 4975 of the Code. Section 4975(e)(1) of the Code, in relevant part, defines the term "plan" to include an IRA, described in section 408(a) of the Code. Section 4975(e)(2) of the Code defines "disqualified person," in relevant part, to include a fiduciary, a relative, and a partnership, of which (or in which) 50 percent or more of the capital interest or profits interest of such partnership is owned directly or indirectly, or held by a fiduciary. Section 4975(e)(3) of the Code defines the term "fiduciary," in part, to include any person who exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control regarding management or disposition of its assets. In order for a prohibited transaction to occur under section 4975 of the Code, there must be a transaction involving a disqualified person with respect to a plan. Where none of the relationships described in section 4975(e)(2) of the Code are found to exist, an entity would not be a disqualified person with respect to a plan.

Section 4975(c)(1)(A) of the Code prohibits any direct or indirect sale or exchange or leasing, of any property between a plan and a disqualified person. Section 4975(c)(1)(D) of the Code 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. Section 4975(c)(1)(E) of the Code prohibits a fiduciary from dealing with the income or assets of a plan in his or her own interest or for his or her own account. Section 54.4975-6(a)(5) of the Pension Excise Tax Regulations characterizes transactions described in section 4975(c)(1)(E) as involving the use of authority by fiduciaries to cause plans to enter into transactions when those fiduciaries have interests which may affect the exercise of their best judgment as fiduciaries.

As a trustee with investment discretion over the assets of his IRA, Mr. Adler is a fiduciary, and therefore, a disqualified person under section 4975(e)(2) of the Code. Mr. Adler is also a disqualified person in his capacity as the general partner of the Partnership to the extent he exercises discretionary authority over the administration or management of the IRA assets invested in the Partnership. In addition, although Mr. Adler, his son and his daughter are disqualified persons, you represent that the investment transaction is between the Partnership itself and the IRA, and not with Mr. Adler and his family, except as fellow investors in the Partnership. Mr. Adler owns only 6.5 percent of the Partnership, and therefore the Partnership itself is not a disqualified person under section 4975(e)(2)(G) of the Code which defines a disqualified person to include a corporation, partnership or trust or estate of which 50 percent or more of the capital interest is owned directly or indirectly, or held by persons described as fiduciaries.

Based solely on the facts and representations contained in your submissions, it is the opinion of the Department that the IRA's purchase of an interest in the Partnership would not constitute a transaction described in section 4975(c)(1)(A) of the Code (prohibiting any direct or indirect sale or exchange or leasing of any property between a plan and a disqualified person).

Whether the proposed transaction would violate sections 4975(c)(1)(D) and (E) of the Code raises questions of a factual nature upon which the Department will not issue an opinion. A violation of section 4975(c)(1)(D) and (E) would occur 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 any person which such fiduciary had an interest which would affect the exercise of his best judgment as a fiduciary).

In this regard, the Department notes Mr. Adler does not and will not receive any compensation from the Partnership and will not receive any compensation by virtue of the IRA's investment in the Partnership. However, the Department further notes that if an IRA fiduciary causes the IRA to enter into a transaction where, by the terms or nature of that transaction, a conflict of interest between the IRA and the fiduciary (or persons in which the fiduciary has an interest) exists or will arise in the future, that transaction would violate either 4975(c)(1)(D) or (E) of the Code. Moreover, the fiduciary must not rely upon and cannot be otherwise dependent upon the participation of the IRA in order for the fiduciary (or persons in which the fiduciary has an interest) to undertake or to continue his or her share of the investment. Furthermore, even if at its inception the transaction did not involve a violation, if a divergence of interests develops between the

IRA and the fiduciary (or persons in which the fiduciary has an interest), the fiduciary must take steps to eliminate the conflict of interest in order to avoid engaging in a prohibited transaction. Nonetheless, a violation of section 4975(c)(1)(D) or (E) will not occur merely because the fiduciary derives some incidental benefit from a transaction involving IRA assets.

Moreover, the Department notes that by virtue of the contemplated investment by the IRA in the Partnership, there will be significant investment in the Partnership by benefit plan investors. *See* 29 CFR § 2510.3-101(f). Accordingly, the Partnership will hold "plan assets" within the meaning of that term in the Department's regulations at 29 CFR § 2510.3-101. As a result, any person who exercises discretionary authority or control with respect to assets of the Partnership will be fiduciary of the IRA and subject to the restrictions of section 4975(c)(1) of the Code, except to the extent a statutory or administrative exemption applies.

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 Campagna
Chief, Division of
Fiduciary Interpretations
Office of Regulations
and Interpretations

[1] Under Presidential 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 has been transferred, with certain exceptions not here relevant, to the Secretary of Labor and the Secretary of the Treasury is bound by the interpretations of the Secretary of Labor pursuant to such authority.