DEPARTMENT OF LABOR

Pension and Welfare Benefits Administration

[Prohibited Transaction Exemption 93-1;

Application Number D-4064]

Class Exemption for Certain Transactions by Individuals for Whose Benefit Individual Retirement Accounts or Retirement Plans for Self-Employed Individuals Have Been Established or Maintained

AGENCY: Pension and Welfare Benefits Administration,

U. S. Department of Labor

ACTION: Grant of Class Exemption.

SUMMARY: This document contains a final exemption from certain prohibited transaction restrictions of the Internal Revenue Code of 1986 (the Code). The class exemption permits the receipt of certain cash, premiums or other consideration paid to an individual in connection with a transaction involving an individual retirement account (IRA) or a retirement plan for a self-employed individual (Keogh Plan), provided that the conditions of the exemption are met. The exemption affects individuals with a beneficial interest in the IRAs or Keogh Plans who receive such premiums or gifts, as well as the financial institutions which provide the payments.

EFFECTIVE DATE: January 1, 1975.

FOR FURTHER INFORMATION CONTACT: Allison K. Padams, Office of Exemption Determinations, Pension and Welfare Benefits Administration, U.S. Department of Labor, (202) 523-8971 (this is not a toll-free number); or Susan E. Rees, Plan Benefits Security Division, Office of the Solicitor, U.S. Department of Labor, (202) 523-9141 (this is not a toll-free number).

SUPPLEMENTARY INFORMATION: On February 1, 1983, the Department of Labor (the Department) and the Internal Revenue Service (the Service) published a notice of proposed class exemption (48 FR 4592) from the sanctions resulting from the application of sections 4975(a) and (b), 4975(c)(3) and 408(e)(2) of the Code by reason of section 4975(c)(1) of the

Code.[1] The transactions involve the payment of cash, premiums and other consideration to individuals in connection with establishment of, or contribution to an IRA or Keogh Plan by organizations authorized to sponsor IRAs or Keogh Plans. Because of the apparent prevalence of this type of transaction, the Department and the Service proposed the class exemption on their own motion pursuant to section 4975(c)(2) of the Code, and in accordance with the procedures set forth in Rev. Proc. 75-26 (1975-1 C.B. 722) and ERISA Procedure 75-1 (40 FR 18471, April 28, 1975).

The notice of pendency invited interested persons to submit written comments or request that a public hearing be held on the proposed exemption. Over twenty public comments and requests for a public hearing with regard to the proposed class exemption were received pursuant to section 4975(c)(2) of the Code and in accordance with the procedures set forth in Rev. Proc. 75-26 and in ERISA Procedure 75-1. Notice of a public hearing was published on July 1, 1983 (48 FR 30510), and the public hearing was held on August 17, 1983. To date, the Department has not granted relief for the transactions described in the proposed exemption.

Recently, it came to the attention of the Department that many financial institutions may no longer offer premiums as incentives for their customers to establish IRAs or Keogh Plans with their particular institutions. Rather, it appeared that financial institutions were offering banking services at reduced or no cost as an inducement to customers to begin or expand banking relationships. Consequently, the Department published a notice in the Federal Register (56 FR 8368, February 28, 1990) in which it requested comments from interested persons regarding the disposition of the proposed class exemption (the Notice to Solicit Comments).[2]

The Notice to Solicit Comments gave interested persons an opportunity to submit written comments to be considered by the Department in deciding whether or not to provide exemptive relief for the receipt of cash, premiums, or other consideration by an individual in connection with the establishment of, or contribution to, an IRA or Keogh Plan. Specifically, the Department requested that interested persons provide current information on the extent of the need for exemptive relief for transactions of this type and the standards and safeguards upon which exemptive relief should be conditioned. Ten comments were received pursuant to the Notice to Solicit Comments.

Upon consideration of the entire record in this matter, including all the comments received and testimony offered at the public hearing, the

Department has determined to grant the proposed class exemption subject to certain modifications.

Description of the Proposal

The 1983 Proposal provided retroactive and prospective relief from the sanctions resulting from the application of 4975 of the Code, including the loss of exemption of an IRA pursuant to section 408(e)(2)(A) of the Code, by reason of section 4975(c)(1) of the Code, for the payment of cash, property or other consideration by an organization authorized to sponsor IRAs or Keogh Plans, to an individual establishing or contributing to an IRA or Keogh Plan or to members of his or her family as defined by section 4975(e)(6) of the Code.

The proposal contained specific conditions designed to insure that the transactions did not conflict with the basic purpose of such plans which is to provide retirement savings for participants and their beneficiaries. Thus, the IRA or Keogh Plan must be established solely to benefit the person receiving the cash, property or other consideration, his or her spouse, and their beneficiaries. The fair market value of the property or other consideration which may be measured by its cost to the financial institution, or the cash received, must not exceed $10 for a deposit of less than $5,000 and $20 for a deposit of $5,000 or more. The conditions of the proposed exemption did not specifically limit the form the premium or other consideration may take.

The Department also noted in the preamble to the proposal that the exemption would not be available for transactions involving IRAs or Keogh Plans which are subject to Title I of ERISA.[3] Nor would the exemption be available to exempt the receipt of cash, property or other consideration by third persons other than those described in the exemption.

The Department proposed the class exemption based upon its understanding that it was common practice for financial institutions to offer premiums in connection with the establishment of, or the additional contribution to, an IRA or Keogh Plan. The Department also recognized that the apparent prevalence of this type of transaction could result in adverse consequences to a large number of individuals establishing IRAs and Keogh Plans.

DISCUSSION OF THE COMMENTS

I. Major Issues Raised in Response to the 1983 Notice of Proposed Exemption and Public Hearing

Several commenters suggested that no exemption was necessary because the transactions described in the proposed exemption are not prohibited transactions under section 4975(c)(1) of the Code. In this regard, section 4975(c)(1) of the Code prohibits, in relevant part, the transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a plan (4975(c)(1)(D)); an act by a disqualified person who is a fiduciary whereby he deals with the income or assets of a plan in his own interest or for his own account (4975(c)(1)((E)); and the receipt of any consideration for his own personal account by any disqualified person who is a fiduciary from any party dealing with the plan in connection with a transaction involving the income or assets of plan (4975(c)(1)(F)). The Department disagrees with these comments. The term "disqualified person", as defined in Code section 4975(e)(2), includes a fiduciary and a person providing services to the plan. Persons who exercise discretionary authority or control over the assets of a plan, including IRAs and Keogh Plans, are fiduciaries subject to the restrictions imposed by section 4975(c)(1) of the Code.[4] Thus the receipt of cash, premiums or other consideration by such individuals in connection with the investment of his or her IRA or Keogh Plan assets is a transaction prohibited under section 4975(c)(1) of the Code. [5] In the absence of an exemption, the individual who receives such cash, premiums or other consideration and the plan involved may be subject to the sanctions applied under section 408(e)(2) and 4975(c)(1) of the Code. To clarify the Department's position, the final exemption now specifies the subsections of section 4975(c)(1) from which relief is provided.

A number of commenters expressed concern that the exemption would discourage financial institutions from providing IRA and Keogh Plan participants with customary financial services, such as free checking accounts and free check-cashing privileges which have traditionally been based on account balances maintained by a customer at the financial institution. It was represented that these services, unlike such premiums as toasters and radios, cannot readily be valued because their cost varies greatly among institutions and recipients. In this regard, the Department notes that a separate exemption for the receipt of certain services by individuals covered under individual retirement accounts or retirement plans for self-employed individuals is published in today's Federal Register. Consequently, the Department has determined not to revise the subject exemption in this regard.

Several commenters recommended that institutions be permitted to pay premiums with respect to an IRA or Keogh Plan on an annual or more frequent basis without regard to whether additional contributions have been

made. The Department is not persuaded by the commenters that such an expansion would be appropriate. Another commenter urged the Department to permit the payment of premiums with respect to each contribution made to an IRA or Keogh Plan. The commenters suggested that failure to allow such payments may result in IRA and Keogh Plan assets being transferred to another financial institution solely to obtain additional premiums. The Department generally believes that most plan participants are more concerned with their future retirement income and the terms and conditions of the various investment options offered at particular financial institutions than with the de minimis premiums permitted by this exemption. Nevertheless, the Department recognizes that some IRA and Keogh funds may be transferred from institution to institution in order to receive a premium. Accordingly, the Department has determined to modify the final exemption to permit the payment of cash, premiums or other consideration in connection with the making of additional contributions to an established IRA or Keogh Plan, including the transfer of assets from another plan.

A number of commenters urged the Department to delete or modify the $10 and $20 limits under the proposed exemption. Several commenters suggested that the exemption permit market forces to establish the dollar limitations. Another commenter suggested a "rule of reasonableness" or a maximum limit set as a percentage of the total IRA (or Keogh Plan) investment. The Department believes that deleting or increasing the dollar limits, or substituting a maximum limit set as a percentage of total plan investment, could have an adverse impact on IRAs and Keogh Plans by creating an incentive for individuals to make IRA or Keogh Plan investments at a particular financial institution for reasons unrelated to the purposes for which such plans are established, i.e. to provide retirement income. Regarding the other suggested modifications to the dollar limits, the Department does not believe it would be appropriate to revise these limits in this regard since adoption of these suggestions would necessitate a subjective determination of the appropriate limit.

A number of commenters suggested that the relief provided by the class exemption should be given retroactive application without any dollar limitation on the amount of the premiums and that the dollar limitations should only apply prospectively. The Department is not persuaded by the commenters' arguments regarding additional retroactive relief. In this regard, the Department notes that financial institutions were aware of the dollar limitations found in the Notice of Proposed Exemption,[6] and had the opportunity to alter their banking programs accordingly. Additionally, the Department wishes to

note that on January 8, 1990, the Service issued an IRA nonenforcement policy (the IRA Nonenforcement Policy),[7] which provides that the Service will not raise issues concerning the tax effects resulting from possible prohibited transactions arising from certain cash, property or services offered by financial institutions described in section 408(n) of the Code to individuals for whom the financial institution maintains certain IRAs and Keogh Plans. The IRA Nonenforcement Policy applies to the cash, property or other consideration described in the 1983 Proposal.

Several commenters urged the Department to clarify that the exemption provides relief for the provision by a credit union of life insurance coverage to members who maintain or establish IRAs and Keogh Plans at such credit union. [8] According to the commenters, it is a long established and customary practice for a credit union to provide life insurance, in an amount equal to the balance of the savings of its members, including IRA and Keogh Plan accounts. Each credit union determines the maximum level of insurance coverage that it will furnish its members. One commenter stated that 99% of all credit unions currently limit life insurance coverage to $5,000 per member. The insurance is provided by credit unions through the purchase of group term life insurance policies with coverages in an amount equal to each member's total account balance up to the maximum amount established by the particular credit union.

According to the commenters, in calculating the dollar amount of insurance coverage, a credit union generally considers the relevant accounts maintained by an individual in the order in which they are established. Since the value of the insurance attributable to the IRA or Keogh Plan balance may differ from member to member depending upon the number of other accounts maintained by the member, the maximum level of coverage selected by the credit union, and the order in which each account is opened, the commenter argued that it would be difficult for the financial institutions to comply with the dollar limitations with regard to these insurance programs. Additionally, because the nature of life insurance contemplates that coverage be maintained from year to year, it would raise administrative problems for the financial institutions, and prove disadvantageous to members, if additional contributions were required in order to maintain insurance coverage from year to year. On the basis of these comments, the Department has determined that it would be appropriate to modify the final exemption to permit the provision of group term life insurance by a financial institution.

Accordingly, we have revised the exemption to provide additional relief for the provision of life insurance subject to a requirement limiting the amount of

coverage that may be provided. Thus, under the final exemption, where a financial institution takes into account an IRA or Keogh Plan balance in determining eligibility for life insurance, the amount of insurance that is attributable on a dollar for dollar basis to the IRA or Keogh Plan deposit balance may not exceed $5,000.

II. Major Issues Raised in Response to the 1991 Notice to Solicit Comments

Nine commenters urged the Department to finalize the proposed exemption. These commenters indicated that financial institutions may still offer premiums to attract customers. One commenter requested that the Department withdraw the proposed exemption.

Several of these commenters requested that the Department increase the dollar limitations on the value of the cash, premiums or other consideration to account for inflation. The Department is not persuaded by the comments submitted in favor of this modification. The Department continues to believe that the value of the cash, premiums or other consideration allowed under the exemption must be de minimis to assure that such transactions do not conflict with the basic purpose of IRAs and Keogh Plans which is to provide retirement savings for participants and their beneficiaries.

III. Miscellaneous

For purposes of clarification, the Department has defined the terms "IRA" and "Keogh Plan" under the final exemption. In addition, the definition of "members of his or her family" has been modified to make it consistent with the definition contained in the class exemption for the receipt of certain services at reduced or no cost by an individual for whose benefit an IRA or a Keogh is established and maintained from a bank which is published in this issue of the FEDERAL REGISTER.

GENERAL INFORMATION

The attention of interested persons is directed to the following:

(1) The fact that a transaction is the subject of an exemption under section 4975(c)(2) of the Code does not relieve a fiduciary or other disqualified person from certain other provisions of the Code. These provisions include any prohibited transaction provisions in section 4975(c)(1) to which the exemption does not expressly apply; nor does the exemption affect the requirement of

section 408(a) of the Code that an IRA must operate for the exclusive benefit of the individual for whose benefit the IRA is maintained and his or her beneficiaries, or the requirement of section 401(a) of the Code that a plan must operate for the exclusive benefit of the employees of the employer maintaining the plan and their beneficiaries.

(2) This exemption is supplemental to, and not in derogation of, any other provisions of the Code, including statutory or administrative exemptions and transitional rules. Furthermore, the fact that a transaction is subject to an administrative or statutory exemption is not dispositive of whether the transaction is in fact a prohibited transaction.

(3) The class exemption is applicable to a particular transaction only if the transaction satisfies the conditions specified in the class exemption.

(4) In accordance with section 4975(c)(2) of the Code and the procedures set forth in ERISA Procedure 75-1 (40 FR 18471, April 28, 1975), and based upon the entire record, the Department has made the following determinations:

(i) the exemption is administratively feasible;

(ii) it is in the interest of the individuals for whose benefit the IRA and Keogh Plans are maintained; and

(iii) it is protective of the rights of those individuals and their beneficiaries.

Exemption

Accordingly, the following exemption is granted under the authority of section 4975(c)(2) of the Code, and in accordance with the procedures set forth in ERISA Procedure 75-1.

I. Effective January 1, 1975, the sanctions resulting from the application of section 4975 of the Code, including the loss of exemption of an IRA pursuant to section 408(e)(2)(A) of the Code, by reason of section 4975(c)(1)(D), (E) and (F) of the Code, shall not apply to the payment of cash, property, or other consideration by an organization authorized to sponsor IRAs or Keogh Plans, to an individual for whose benefit an IRA or Keogh Plan is established or maintained, or to members of his or her family provided that:

(a) The IRA or Keogh Plan in connection with which cash, property or other consideration is given, is established solely to benefit the participant, his or her spouse and their beneficiaries;

(b) The cash, property or other consideration is given only in connection with the establishment of the IRA or Keogh Plan or the making of an additional contribution, including the transfer of assets from another plan, to an existing IRA or Keogh Plan.

(c) During any taxable year, the total of the fair market value of the property or other consideration to the sponsor of the IRA or Keogh Plan, and the cash received is not more than:

(1) $10 for deposits to the IRA or Keogh Plan of less than $5,000; and

(2) $20 for deposits to the IRA or Keogh Plan of $5,000 or more.

(d) In any case where the consideration provided by a financial institution to an individual for whose benefit an IRA or Keogh Plan is established or maintained, is group term life insurance, the limitations set forth in conditions (b) and (c) shall not apply to the provision of such insurance if, during any taxable year, no more than $5,000 of the face value of the insurance is attributable on a dollar for dollar basis to the assets of the IRA or Keogh Plan.

II. Definitions

(a) The term "taxable year" means the taxable year of the individual. In determining the taxable year for payments in connection with transfers of assets from previously established plans, the calendar year in which the transfer is received by the organization is deemed to be the taxable year of the individual.

(b) The "fair market value of the cash, property or other consideration" given may be measured by the cost to the financial institution.

(c) The term "members of his or her family" refers to beneficiaries of the individual for whose benefit the IRA or Keogh Plan is established or maintained, who would be members of the family as that term is defined in Code section 4975(e)(6), or a brother, a sister, or spouse of a brother or a sister.

(d) The term "IRA" means an individual retirement account described in Code section 408(a). For purposes of this exemption, the term IRA shall not include an IRA which is an employee benefit plan covered by title I of ERISA.

(e) The term "Keogh Plan" means a pension, profit sharing or stock bonus plan qualified under Code section 401(a) and exemption from taxation under Code section 501(a) under which some or all of the participants are employees described in section 401(c) of the Code. For purposes of this exemption the term Keogh Plan shall not include a Keogh Plan which is an employee benefit plan covered by title I of ERISA.

Signed at Washington, D.C., this 5th day of

January 1992.

ALAN D. LEBOWITZ

Deputy Assistant Secretary for

Program Operations

Pension and Welfare Benefits

Administration

U.S. Department of Labor

[1]Section 102 of Reorganization Plan No. 4 of 1978 (43 FR 47713, October 17, 1978) generally transferred the authority of the Secretary of the Treasury to issue administrative exemptions under section 4975(c)(2) of the Code to the Secretary of Labor.

[2]By notice appearing elsewhere in this issue of the FEDERAL REGISTER, the Department has granted a conditional class exemption which permits the receipt of certain services at reduced or no cost by an individual, for whose benefit an IRA or Keogh Plan is established or maintained, from a bank.

[3]29 CFR 2510.3-2(d) explains that IRAs described in section 408(a) of the Code will not be considered pension plans subject to title I of ERISA, provided that: (1) no contributions to the plan are made by the employer or employee association; (2) participation is completely voluntary for employees or members; (3) the sole involvement of the employer or employee organization

is without endorsement to permit the sponsor to publicize the program, to collect contributions on behalf of the sponsor through payroll deductions or dues checkoffs and to remit them to

the sponsor; and (4) the employer or employee organization receives no consideration in the form of cash or otherwise other than reasonable compensation for services actually rendered in connection with payroll deductions or dues checkoffs.

29 CFR 2510.3-3(b) explains that for purposes of title I of ERISA, "employee benefit plan" shall not include a Keogh Plan under which no employees are covered under the plan. In this regard, 29 CFR 2510.3-3(c) states that for purposes of the above referenced section: (1) an individual and his or her spouse shall not be deemed to be employees with respect to a trade or business, whether incorporated or unincorporated, which is wholly owned by the individual and his or her spouse; and (2) a partner in a partnership and his or her spouse shall not be deemed to be employees with respect to the partnership.

[4] See section 4975(e)(3) of the Code.

[5] See Advisory Opinion 89-12A (July 14, 1989)

[6]See 48 FR 4592, at 4593.

[7]Announcement 90-1, 1990-2 I.R.B. 31 (January 8, 1990).

[8]The Credit Union National Association Inc., (CUNA) was among the commenters who raised this issue. Additionally, CUNA provided comments on the proposed exemption for the receipt of certain services by individuals establishing or maintaining Individual Retirement Accounts or Retirement Plans for Self- Employed Individuals (56 FR 8365, February 28, 1991), and filed an individual exemption request to permit credit unions to provide members with such life insurance coverage.