

## 26 U.S. Code § 4975 - Tax on prohibited transactions

U.S. Code    Notes

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### **(a) INITIAL TAXES ON DISQUALIFIED PERSON**

There is hereby imposed a tax on each prohibited transaction. The rate of tax shall be equal to 15 percent of the amount involved with respect to the prohibited transaction for each year (or part thereof) in the taxable period. The tax imposed by this subsection shall be paid by any disqualified person who participates in the prohibited transaction (other than a fiduciary acting only as such).

### **(b) ADDITIONAL TAXES ON DISQUALIFIED PERSON**

In any case in which an initial tax is imposed by subsection (a) on a prohibited transaction and the transaction is not corrected within the taxable period, there is hereby imposed a tax equal to 100 percent of the amount involved. The tax imposed by this subsection shall be paid by any disqualified person who participated in the prohibited transaction (other than a fiduciary acting only as such).

### **(c) PROHIBITED TRANSACTION**

**(1) GENERAL RULE** For purposes of this section, the term "prohibited transaction" means any direct or indirect—

**(A)** sale or exchange, or leasing, of any property between a plan and a disqualified person;

**(B)** lending of money or other extension of credit between a plan and a disqualified person;

**(C)** furnishing of goods, services, or facilities between a plan and a disqualified person;

**(D)** transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a plan;

**(E)** 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; or

**(F)** 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 the plan.

**(2) SPECIAL EXEMPTION** The Secretary shall establish an exemption procedure for purposes of this subsection. Pursuant to such procedure, he may grant a conditional or unconditional exemption of any disqualified person or transaction, orders of disqualified persons or transactions, from all or part of the restrictions imposed by paragraph (1) of this subsection. Action under this subparagraph may be taken only after consultation and coordination with the Secretary of Labor. The Secretary may not grant an exemption under this paragraph unless he finds that such exemption is—

**(A)** administratively feasible,

**(B)** in the interests of the plan and of its participants and beneficiaries, and

**(C)** protective of the rights of participants and beneficiaries of the plan.

Before granting an exemption under this paragraph, the Secretary shall require adequate notice to be given to interested persons and shall publish notice in the Federal Register of the pendency of such exemption and shall afford interested persons an opportunity to present views. No exemption may be granted under this paragraph with respect to a transaction described in subparagraph (E) or (F) of paragraph (1) unless the Secretary affords an opportunity for a hearing and makes a determination on the record with respect to the findings required under subparagraphs (A), (B), and (C) of this paragraph, except that in lieu of such hearing the Secretary may accept any record made by the Secretary of Labor with respect to an application for exemption under section 408(a) of title I of the Employee Retirement Income Security Act of 1974.

**(3) SPECIAL RULE FOR INDIVIDUAL RETIREMENT ACCOUNTS**

An individual for whose benefit an individual retirement account is established and his beneficiaries shall be exempt from the tax imposed by this section with respect to any transaction concerning such account (which would otherwise be taxable under this section) if, with respect to such transaction, the account ceases to be an individual retirement account by reason of the application of section 408(e)(2)(A) or if section 408(e)(4) applies to such account.

**(4) SPECIAL RULE FOR ARCHER MSAs**

An individual for whose benefit an Archer MSA (within the meaning of section 220(d)) is established shall be exempt from the tax imposed by this section with respect to any transaction concerning such account (which would otherwise be taxable under this section) if section 220(e)(2) applies to such transaction.

**(5) SPECIAL RULE FOR COVERDELL EDUCATION SAVINGS ACCOUNTS**

An individual for whose benefit a Coverdell education savings account is established and any contributor to such account shall be exempt from the tax imposed by this section with respect to any transaction concerning such account (which would otherwise be taxable under this section) if section 530(d) applies with respect to such transaction.

**(6) SPECIAL RULE FOR HEALTH SAVINGS ACCOUNTS**

An individual for whose benefit a health savings account (within the meaning of section 223(d)) is established shall be exempt from the tax imposed by this section with respect to any transaction concerning such account (which would otherwise be taxable under this section) if, with respect to such transaction, the account ceases to be a health savings account by reason of the application of section 223(e)(2) to such account.

**(7) SPECIAL RULE FOR PROVISION OF PHARMACY BENEFIT SERVICES**

Any party to an arrangement which satisfies the requirements of section 408(h) of the Employee Retirement Income Security Act of 1974 shall be exempt from the tax imposed by this section with respect to such arrangement.

**(d) EXEMPTIONS** Except as provided in subsection (f)(6), the prohibitions provided in subsection (c) shall not apply to—

- (1)** any loan made by the plan to a disqualified person who is a participant or beneficiary of the plan if such loan—
- (A)** is available to all such participants or beneficiaries on a reasonably equivalent basis,
  - (B)** is not made available to highly compensated employees (within the meaning of section 414(q)) in an amount greater than the amount made available to other employees,
  - (C)** is made in accordance with specific provisions regarding such loans set forth in the plan,
  - (D)** bears a reasonable rate of interest, and
  - (E)** is adequately secured;
- (2)** any contract, or reasonable arrangement, made with a disqualified person for office space, or legal, accounting, or other services necessary for the establishment or operation of the plan, if no more than reasonable compensation is paid therefor;
- (3)** any loan to a leveraged employee stock ownership plan (as defined in subsection (e)(7)), if—
- (A)** such loan is primarily for the benefit of participants and beneficiaries of the plan, and
  - (B)** such loan is at a reasonable rate of interest, and any collateral which is given to a disqualified person by the plan consists only of qualifying employer securities (as defined in subsection (e)(8));
- (4)** the investment of all or part of a plan's assets in deposits which bear a reasonable interest rate in a bank or similar financial institution supervised by the United States or a State, if such bank or other institution is a fiduciary of such plan and if—
- (A)** the plan covers only employees of such bank or other institution and employees of affiliates of such bank or other institution, or
  - (B)** such investment is expressly authorized by a provision of the plan or by a fiduciary (other than such bank or institution or affiliates thereof) who is expressly empowered by the plan to so instruct the trustee with respect to such investment;

**(5)** any contract for life insurance, health insurance, or annuities with one or more insurers which are qualified to do business in a State if the plan pays no more than adequate consideration, and if each such insurer or insurers is—

**(A)** the employer maintaining the plan, or

**(B)** a disqualified person which is wholly owned (directly or indirectly) by the employer establishing the plan, or by any person which is a disqualified person with respect to the plan, but only if the total premiums and annuity considerations written by such insurers for life insurance, health insurance, or annuities for all plans (and their employers) with respect to which such insurers are disqualified persons (not including premiums or annuity considerations written by the employer maintaining the plan) do not exceed 5 percent of the total premiums and annuity considerations written for all lines of insurance in that year by such insurers (not including premiums or annuity considerations written by the employer maintaining the plan);

**(6)** the provision of any ancillary service by a bank or similar financial institution supervised by the United States or a State, if such service is provided at not more than reasonable compensation, if such bank or other institution is a fiduciary of such plan, and if—

**(A)** such bank or similar financial institution has adopted adequate internal safeguards which assure that the provision of such ancillary service is consistent with sound banking and financial practice, as determined by Federal or State supervisory authority, and

**(B)** the extent to which such ancillary service is provided is subject to specific guidelines issued by such bank or similar financial institution (as determined by the Secretary after consultation with Federal and State supervisory authority), and under such guidelines the bank or similar financial institution does not provide such ancillary service—

**(i)** in an excessive or unreasonable manner, and

**(ii)** in a manner that would be inconsistent with the best interests of participants and beneficiaries of employee benefit plans;

**(7)** the exercise of a privilege to convert securities, to the extent provided in regulations of the Secretary, but only if the plan receives no less than adequate consideration pursuant to such conversion;

**(8)** any transaction between a plan and a common or collective trust fund or pooled investment fund maintained by a disqualified person which is a bank or trust company supervised by a State or Federal agency or between a plan and a pooled investment fund of an insurance company qualified to do business in a State if—

**(A)** the transaction is a sale or purchase of an interest in the fund,

**(B)** the bank, trust company, or insurance company receives not more than a reasonable compensation, and

**(C)** such transaction is expressly permitted by the instrument under which the plan is maintained, or by a fiduciary (other than the bank, trust company, or insurance company, or an affiliate thereof) who has authority to manage and control the assets of the plan;

**(9)** receipt by a disqualified person of any benefit to which he may be entitled as a participant or beneficiary in the plan, so long as the benefit is computed and paid on a basis which is consistent with the terms of the plan as applied to all other participants and beneficiaries;

**(10)** receipt by a disqualified person of any reasonable compensation for services rendered, or for the reimbursement of expenses properly and actually incurred, in the performance of his duties with the plan, but no person so serving who already receives full-time pay from an employer or an association of employers, whose employees are participants in the plan or from an employee organization whose members are participants in such plan shall receive compensation from such fund, except for reimbursement of expenses properly and actually incurred;

**(11)** service by a disqualified person as a fiduciary in addition to being an officer, employee, agent, or other representative of a disqualified person;

**(12)** the making by a fiduciary of a distribution of the assets of the trust in accordance with the terms of the plan if such assets are distributed in the same manner as provided under section 4044 of title IV of the Employee Retirement Income Security Act of 1974 (relating to allocation of assets);

**(13)** any transaction which is exempt from section 406 of such Act by reason of section 408(e) of such Act (or which would be so exempt if such section 406 applied to such transaction) or which is exempt from section 406 of such Act by reason of section 408(b)(12) of such Act;

**(14)** any transaction required or permitted under part 1 of subtitle E of title IV or section 4223 of the Employee Retirement Income Security Act of 1974, but this paragraph shall not apply with respect to the application of subsection (c)(1) (E) or (F);

**(15)** a merger of multiemployer plans, or the transfer of assets or liabilities between multiemployer plans, determined by the Pension Benefit Guaranty Corporation to meet the requirements of section 4231 of such Act, but this paragraph shall not apply with respect to the application of subsection (c)(1)(E) or (F);

**(16)** a sale of stock held by a trust which constitutes an individual retirement account under section 408(a) to the individual for whose benefit such account is established if—

**(A)** such stock is in a bank (as defined in section 581) or a depository institution holding company (as defined in section 3(w)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1813(w)(1))),

**(B)** such stock is held by such trust as of the date of the enactment of this paragraph,

**(C)** such sale is pursuant to an election under section 1362(a) by such bank or company,

**(D)** such sale is for fair market value at the time of sale (as established by an independent appraiser) and the terms of the sale are otherwise at least as favorable to such trust as the terms that would apply on a sale to an unrelated party,

**(E)** such trust does not pay any commissions, costs, or other expenses in connection with the sale, and

**(F)** the stock is sold in a single transaction for cash not later than 120 days after the S corporation election is made;

**(17)** any transaction in connection with the provision of investment advice described in subsection (e)(3)(B) to a participant or beneficiary in a plan that permits such participant or beneficiary to direct the investment of plan assets in an individual account, if—

**(A)** the transaction is—

**(i)** the provision of the investment advice to the participant or beneficiary of the plan with respect to a security or other property available as an investment under the plan,

**(ii)** the acquisition, holding, or sale of a security or other property available as an investment under the plan pursuant to the investment advice, or

**(iii)** the direct or indirect receipt of fees or other compensation by the fiduciary adviser or an affiliate thereof (or any employee, agent, or registered representative of the fiduciary adviser or affiliate) in connection with the provision of the advice or in connection with an acquisition, holding, or sale of a security or other property available as an investment under the plan pursuant to the investment advice; and

**(B)** the requirements of subsection (f)(8) are met,<sup>[1]</sup>

**(18)** any transaction involving the purchase or sale of securities, or other property (as determined by the Secretary of Labor), between a plan and a disqualified person (other than a fiduciary described in subsection (e)(3)) with respect to a plan if—

**(A)** the transaction involves a block trade,

**(B)** at the time of the transaction, the interest of the plan (together with the interests of any other plans maintained by the same plan sponsor), does not exceed 10 percent of the aggregate size of the block trade,

**(C)** the terms of the transaction, including the price, are at least as favorable to the plan as an arm's length<sup>[2]</sup> transaction, and

**(D)** the compensation associated with the purchase and sale is not greater than the compensation associated with an arm's length<sup>2</sup> transaction with an unrelated party,<sup>1</sup>

**(19)** any transaction involving the purchase or sale of securities, or other property (as determined by the Secretary of Labor), between a plan and a disqualified person if—

**(A)** the transaction is executed through an electronic communication network, alternative trading system, or similar



execution system or trading venue subject to regulation and oversight by—

**(i)** the applicable Federal regulating entity, or

**(ii)** such foreign regulatory entity as the Secretary of Labor may determine by regulation,

**(B)** either—

**(i)** the transaction is effected pursuant to rules designed to match purchases and sales at the best price available through the execution system in accordance with applicable rules of the Securities and Exchange Commission or other relevant governmental authority, or

**(ii)** neither the execution system nor the parties to the transaction take into account the identity of the parties in the execution of trades,

**(C)** the price and compensation associated with the purchase and sale are not greater than the price and compensation associated with an arm's length<sup>2</sup> transaction with an unrelated party,

**(D)** if<sup>[3]</sup> the disqualified person has an ownership interest in the system or venue described in subparagraph (A), the system or venue has been authorized by the plan sponsor or other independent fiduciary for transactions described in this paragraph, and

**(E)** not less than 30 days prior to the initial transaction described in this paragraph executed through any system or venue described in subparagraph (A), a plan fiduciary is provided written or electronic notice of the execution of such transaction through such system or venue,<sup>1</sup>

**(20)** transactions described in subparagraphs (A), (B), and (D) of subsection (c)(1) between a plan and a person that is a disqualified person other than a fiduciary (or an affiliate) who has or exercises any discretionary authority or control with respect to the investment of the plan assets involved in the transaction or renders investment advice (within the meaning of subsection (e)(3)(B)) with respect to those assets, solely by reason of providing services to the plan or solely by reason of a relationship to such a service provider described in

subparagraph (F), (G), (H), or (I) of subsection (e)(2), or both, but only if in connection with such transaction the plan receives no less, nor pays no more, than adequate consideration,<sup>1</sup>

**(21)** any foreign exchange transactions, between a bank or broker-dealer (or any affiliate of either) and a plan (as defined in this section) with respect to which such bank or broker-dealer (or affiliate) is a trustee, custodian, fiduciary, or other disqualified person, if—

**(A)** the transaction is in connection with the purchase, holding, or sale of securities or other investment assets (other than a foreign exchange transaction unrelated to any other investment in securities or other investment assets),

**(B)** at the time the foreign exchange transaction is entered into, the terms of the transaction are not less favorable to the plan than the terms generally available in comparable arm's length<sup>2</sup> foreign exchange transactions between unrelated parties, or the terms afforded by the bank or broker-dealer (or any affiliate of either) in comparable arm's-length foreign exchange transactions involving unrelated parties,

**(C)** the exchange rate used by such bank or broker-dealer (or affiliate) for a particular foreign exchange transaction does not deviate by more than 3 percent from the interbank bid and asked rates for transactions of comparable size and maturity at the time of the transaction as displayed on an independent service that reports rates of exchange in the foreign currency market for such currency, and

**(D)** the bank or broker-dealer (or any affiliate of either) does not have investment discretion, or provide investment advice, with respect to the transaction,<sup>1</sup>

**(22)** any transaction described in subsection (c)(1)(A) involving the purchase and sale of a security between a plan and any other account managed by the same investment manager, if—

**(A)** the transaction is a purchase or sale, for no consideration other than cash payment against prompt delivery of a security for which market quotations are readily available,

**(B)** the transaction is effected at the independent current market price of the security (within the meaning of section 270.17a-7(b)) of

title 17, Code of Federal Regulations),

**(C)** no brokerage commission, fee (except for customary transfer fees, the fact of which is disclosed pursuant to subparagraph (D)), or other remuneration is paid in connection with the transaction,

**(D)** a fiduciary (other than the investment manager engaging in the cross-trades or any affiliate) for each plan participating in the transaction authorizes in advance of any cross-trades (in a document that is separate from any other written agreement of the parties) the investment manager to engage in cross trades at the investment manager's discretion, after such fiduciary has received disclosure regarding the conditions under which cross trades may take place (but only if such disclosure is separate from any other agreement or disclosure involving the asset management relationship), including the written policies and procedures of the investment manager described in subparagraph (H),

**(E)** each plan participating in the transaction has assets of at least \$100,000,000, except that if the assets of a plan are invested in a master trust containing the assets of plans maintained by employers in the same controlled group (as defined in section 407(d)(7) of the Employee Retirement Income Security Act of 1974), the master trust has assets of at least \$100,000,000,

**(F)** the investment manager provides to the plan fiduciary who authorized cross trading under subparagraph (D) a quarterly report detailing all cross trades executed by the investment manager in which the plan participated during such quarter, including the following information, as applicable: (i) the identity of each security bought or sold; (ii) the number of shares or units traded; (iii) the parties involved in the cross-trade; and (iv) trade price and the method used to establish the trade price,

**(G)** the investment manager does not base its fee schedule on the plan's consent to cross trading, and no other service (other than the investment opportunities and cost savings available through a cross trade) is conditioned on the plan's consent to cross trading,

**(H)** the investment manager has adopted, and cross-trades are effected in accordance with, written cross-trading policies and procedures that are fair and equitable to all accounts participating in the cross-trading program, and that include a description of the manager's pricing policies and procedures, and the manager's

policies and procedures for allocating cross trades in an objective manner among accounts participating in the cross-trading program, and

**(I)** the investment manager has designated an individual responsible for periodically reviewing such purchases and sales to ensure compliance with the written policies and procedures described in subparagraph (H), and following such review, the individual shall issue an annual written report no later than 90 days following the period to which it relates signed under penalty of perjury to the plan fiduciary who authorized cross trading under subparagraph (D) describing the steps performed during the course of the review, the level of compliance, and any specific instances of non-compliance.

The written report shall also notify the plan fiduciary of the plan's right to terminate participation in the investment manager's cross-trading program at any time,<sup>1</sup> or

**(23)** except as provided in subsection (f)(11), a transaction described in subparagraph (A), (B), (C), or (D) of subsection (c)(1) in connection with the acquisition, holding, or disposition of any security or commodity, if the transaction is corrected before the end of the correction period.

## **(e) DEFINITIONS**

**(1) PLAN** For purposes of this section, the term "plan" means—

**(A)** a trust described in section 401(a) which forms a part of a plan, or a plan described in section 403(a), which trust or plan is exempt from tax under section 501(a),

**(B)** an individual retirement account described in section 408(a),

**(C)** an individual retirement annuity described in section 408(b),

**(D)** an Archer MSA described in section 220(d),

**(E)** a health savings account described in section 223(d),

**(F)** a Coverdell education savings account described in section 530, or

**(G)** a trust, plan, account, or annuity which, at any time, has been determined by the Secretary to be described in any preceding

subparagraph of this paragraph.

**(2) DISQUALIFIED PERSON** For purposes of this section, the term "disqualified person" means a person who is—

- (A)** a fiduciary;
- (B)** a person providing services to the plan;
- (C)** an employer any of whose employees are covered by the plan;
- (D)** an employee organization any of whose members are covered by the plan;
- (E)** an owner, direct or indirect, of 50 percent or more of—
  - (i)** the combined voting power of all classes of stock entitled to vote or the total value of shares of all classes of stock of a corporation,
  - (ii)** the capital interest or the profits interest of a partnership, or
  - (iii)** the beneficial interest of a trust or unincorporated enterprise,  
  
which is an employer or an employee organization described in subparagraph (C) or (D);
- (F)** a member of the family (as defined in paragraph (6)) of any individual described in subparagraph (A), (B), (C), or (E);
- (G)** a corporation, partnership, or trust or estate of which (or in which) 50 percent or more of—
  - (i)** the combined voting power of all classes of stock entitled to vote or the total value of shares of all classes of stock of such corporation,
  - (ii)** the capital interest or profits interest of such partnership, or
  - (iii)** the beneficial interest of such trust or estate,  
  
is owned directly or indirectly, or held by persons described in subparagraph (A), (B), (C), (D), or (E);
- (H)** an officer, director (or an individual having powers or responsibilities similar to those of officers or directors), a 10 percent or more shareholder, or a highly compensated employee (earning 10

percent or more of the yearly wages of an employer) of a person described in subparagraph (C), (D), (E), or (G); or

**(I)** a 10 percent or more (in capital or profits) partner or joint venturer of a person described in subparagraph (C), (D), (E), or (G).

The Secretary, after consultation and coordination with the Secretary of Labor or his delegate, may by regulation prescribe a percentage lower than 50 percent for subparagraphs (E) and (G) and lower than 10 percent for subparagraphs (H) and (I).

**(3) FIDUCIARY** For purposes of this section, the term “fiduciary” means any person who—

**(A)** exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets,

**(B)** renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or

**(C)** has any discretionary authority or discretionary responsibility in the administration of such plan.

Such term includes any person designated under section 405(c)(1)(B) of the Employee Retirement Income Security Act of 1974.

#### **(4) STOCKHOLDINGS**

For purposes of paragraphs (2)(E)(i) and (G)(i) there shall be taken into account indirect stockholdings which would be taken into account under section 267(c), except that, for purposes of this paragraph, section 267(c)(4) shall be treated as providing that the members of the family of an individual are the members within the meaning of paragraph (6).

#### **(5) PARTNERSHIPS; TRUSTS**

For purposes of paragraphs (2)(E)(ii) and (iii), (G)(ii) and (iii), and (I) the ownership of profits or beneficial interests shall be determined in accordance with the rules for constructive ownership of stock provided in section 267(c) (other than paragraph (3) thereof), except that section 267(c)(4) shall be treated as providing that the members of the family of an individual are the members within the meaning of paragraph (6).

**(6) MEMBER OF FAMILY**

For purposes of paragraph (2)(F), the family of any individual shall include his spouse, ancestor, lineal descendant, and any spouse of a lineal descendant.

**(7) EMPLOYEE STOCK OWNERSHIP PLAN** The term “employee stock ownership plan” means a defined contribution plan—

**(A)** which is a stock bonus plan which is qualified, or a stock bonus and a money purchase plan both of which are qualified under section 401(a), and which are designed to invest primarily in qualifying employer securities; and

**(B)** which is otherwise defined in regulations prescribed by the Secretary.

A plan shall not be treated as an employee stock ownership plan unless it meets the requirements of section 409(h), section 409(o), and, if applicable, section 409(n), section 409(p), and section 664(g) and, if the employer has a registration-type class of securities (as defined in section 409(e)(4)), it meets the requirements of section 409(e).

**(8) QUALIFYING EMPLOYER SECURITY**

The term “qualifying employer security” means any employer security within the meaning of section 409(l). If any moneys or other property of a plan are invested in shares of an investment company registered under the Investment Company Act of 1940, the investment shall not cause that investment company or that investment company’s investment adviser or principal underwriter to be treated as a fiduciary or a disqualified person for purposes of this section, except when an investment company or its investment adviser or principal underwriter acts in connection with a plan covering employees of the investment company, its investment adviser, or its principal underwriter.

**(9) SECTION MADE APPLICABLE TO WITHDRAWAL LIABILITY PAYMENT FUNDS** For purposes of this section—

**(A) In general**

The term “plan” includes a trust described in section 501(c)(22).

**(B) Disqualified person**

In the case of any trust to which this section applies by reason of subparagraph (A), the term “disqualified person” includes any person who is a disqualified person with respect to any plan to which such trust is permitted to make payments under section 4223 of the Employee Retirement Income Security Act of 1974.

**(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 subsection (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)** of 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<sup>2</sup> 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.

**(g) APPLICATION OF SECTION** This section shall not apply—

**(1)** in the case of a plan to which a guaranteed benefit policy (as defined in section 401(b)(2)(B) of the Employee Retirement Income Security Act of 1974) is issued, to any assets of the insurance company, insurance service, or insurance organization merely because of its issuance of such policy;

**(2)** to a governmental plan (within the meaning of section 414(d)); or

**(3)** to a church plan (within the meaning of section 414(e)) with respect to which the election provided by section 410(d) has not been made.

In the case of a plan which invests in any security issued by an investment company registered under the Investment Company Act of 1940, the assets of such plan shall be deemed to include such security but shall not, by reason of such investment, be deemed to include any assets of such company.

**(h) NOTIFICATION OF SECRETARY OF LABOR**

Before sending a notice of deficiency with respect to the tax imposed by subsection (a) or (b), the Secretary shall notify the Secretary of Labor and provide him a reasonable opportunity to obtain a correction of the prohibited transaction or to comment on the imposition of such tax.

**(i) CROSS REFERENCE**

For provisions concerning coordination procedures between Secretary of Labor and Secretary of the Treasury with respect to application of tax imposed by this section and for authority to waive imposition of the tax imposed by subsection (b), see section 3003 of the Employee Retirement Income Security Act of 1974.

(Added Pub. L. 93-406, title II, § 2003(a), Sept. 2, 1974, 88 Stat. 971; amended Pub. L. 94-455, title XIX, § 1906(b)(13)(A), Oct. 4, 1976, 90 Stat. 1834; Pub. L. 95-600, title I, § 141(f)(5), (6), Nov. 6, 1978, 92 Stat. 2795; Pub. L. 96-222, title I, § 101(a)(7)(C), (K), (L)(iv)(III), (v)(XI), Apr. 1, 1980, 94 Stat. 198-201; Pub. L. 96-364, title II, §§ 208(b), 209(b), Sept. 26, 1980, 94 Stat. 1289, 1290; Pub. L. 96-596, § 2(a)(1)(K),(L), (2)(I), (3)(F), Dec. 24, 1980, 94 Stat. 3469, 3471; Pub. L. 97-448, title III, § 305(d)(5), Jan. 12, 1983, 96 Stat. 2400; Pub. L. 98-369, div. A, title IV, § 491(d)(45), (46), (e)(7), (8), July 18, 1984, 98 Stat. 851-853; Pub. L. 99-514, title XI, § 1114(b)(15)(A), title XVIII, §§ 1854(f)(3)(A), 1899A(51), Oct. 22, 1986, 100 Stat. 2452, 2882, 2961; Pub. L. 101-508, title XI, § 11701(m), Nov. 5, 1990, 104 Stat. 1388-513; Pub. L. 104-188, title I, §§ 1453(a), 1702(g)(3), Aug. 20, 1996, 110 Stat. 1817, 1873; Pub. L. 104-191, title III, § 301(f), Aug. 21, 1996, 110 Stat. 2051; Pub. L. 105-34, title II, § 213(b), title X, § 1074(a), title XV, §§ 1506(b)(1), 1530(c)(10), title XVI, § 1602(a)(5), Aug. 5, 1997, 111 Stat. 816, 949, 1065, 1079, 1094; Pub. L. 105-206, title VI, § 6023(19), July 22, 1998, 112 Stat. 825; Pub. L. 106-554, § 1(a)(7) [title II, § 202(a)(7), (b)(7), (10)], Dec. 21, 2000, 114 Stat. 2763, 2763A-628, 2763A-629; Pub. L. 107-16, title VI, §§ 612(a), 656(b), June 7, 2001, 115 Stat. 100, 134; Pub. L. 107-22, § 1(b)(1)(D), (3)(D), July 26, 2001, 115 Stat. 197; Pub. L. 108-173, title XII, § 1201(f), Dec. 8, 2003, 117 Stat. 2479; Pub. L. 108-357, title II, §§ 233(c), 240(a), Oct. 22, 2004, 118 Stat. 1434, 1437; Pub. L. 109-135, title IV, § 413(a)(2), Dec. 21, 2005, 119 Stat. 2641; Pub. L. 109-280, title VI, §§ 601(b)(1), (2), 611(a)(2), (c)(2), (d)(2), (e)(2), (g)(2), 612(b), Aug. 17, 2006, 120 Stat. 958, 959, 967, 969-971, 974, 976; Pub. L. 110-458, title I, § 106(a)(2), (b)(2), (c), Dec. 23, 2008, 122 Stat. 5106; Pub. L. 115-141, div. U, title IV, § 401(a)(190), (229)-(234), Mar. 23, 2018, 132 Stat. 1193, 1195; Pub. L. 116-94, div. P, title XIII, § 1302(b), Dec. 20, 2019, 133 Stat. 3205.)

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