Employee Benefit Plans - Parties in Interest and Prohibited Transactions

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AICPA® Employee Benefit Plan Audit Quality Center

Introduction

The AICPA Employee Benefit Plan Audit Quality Center has developed this primer to provide a general understanding of employee benefit plan *parties in interest* and *prohibited transactions* under the Employee Retirement Income Security Act of 1974 (ERISA). This primer explains how a party in interest under ERISA may differ from a *related party* as that term is defined by generally accepted accounting principles (GAAP). This primer discusses party in interest transactions that are prohibited under ERISA and administrative actions of the Department of Labor (DOL), as well as statutory and administrative class and individual exemptions. This primer also discusses how exemptions may be requested, the reporting requirements for party in interest and non-exempt transactions, applicable penalties imposed by ERISA or the Internal Revenue Code (IRC), and the Voluntary Fiduciary Correction (VFC) Program. A list of references to additional resources is included at the end of this primer.

Who is a Party in Interest?

ERISA defines a party in interest.

Employee benefit plans may engage in various types of business transactions with companies and individuals considered parties in interest under ERISA. A party in interest is defined in ERISA section 3(14) to include the following:

a. Any fiduciary (including, but not limited to, any administrator, officer, trustee, or custodian), counsel, or employee of such employee benefit plan;
b. A person providing services to such plan;
c. An employer any of whose employees are covered by such plan;
d. An employee organization any of whose members are covered by such 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 relative 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 employee, officer, director (or an individual having powers or responsibilities similar to those of officers or directors), or a 10 percent or more shareholder directly or indirectly, of a person described in subparagraph (b), (c), (d), (e), or (g), or of the employee benefit plan; or
i. A 10 percent or more (directly or indirectly in capital or profits) partner or joint venture of a person described in subparagraph (b), (c), (d), (e), or (g).

Note: The independent auditor of a plan's financial statements is a service provider to the plan and is considered a party in interest. Other common parties in interest include plan sponsors, third party administrators, plan asset custodians, plan counsel, plan trustees, fund managers, and certain owners and/or shareholders of the plan sponsor.

Party in Interest vs. Related Party

Parties in interest and related parties are not the same.

ERISA's definition of a party in interest is broader than a related party as that term is defined by GAAP. Parties in interest will include all entities and individuals that provide services to the plan; however, these entities may not necessarily be related parties. For example, the plan auditor, plan counsel and a non-affiliated third party administrator are considered parties in interest but typically are not considered related parties under GAAP.

The term related parties is defined in the glossary of the Financial Accounting Standards Board (FASB) Accounting Standards Codification™ (ASC) to include the following:

- Affiliates of the entity;
- Entities for which investments in their equity securities would be required, absent the election of the fair value option under GAAP, to be accounted for by the equity method by the investing entity;
- Trusts for the benefit of employees, such as pension and profit-sharing trusts that are managed by or under the trusteeship of management;
- Principal owners of the entity and members of their immediate families;
- Management of the entity and members of their immediate families;
- Other parties with which the entity may deal if one party controls or can significantly influence the management or operating policies of the other to the extent that one of the transacting parties might be prevented from fully pursuing its own separate interests;
- Other parties that can significantly influence the management or operating policies of the transacting parties or that has an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from pursuing its own separate interests.

Prohibited Transactions

Certain transactions between the plan and parties in interest and the plan fiduciary may be prohibited.

ERISA section 406(a) prohibits various types of transactions between a plan and parties in interest. ERISA states that a plan fiduciary shall not cause the plan to engage in a transaction if the plan fiduciary knows or should know that such transaction constitutes a direct or indirect—

- Sale or exchange, or leasing, of any property;
- Lending of money or other extension of credit;
- Furnishing of goods, services, or facilities;
- Transfer to, or use by or for the benefit of a party in interest, of any assets of the plan; or
- Acquisition, on behalf of the plan, of any employer security or employer real property in violation of ERISA section 407.

ERISA section 406(b) also prohibits certain transactions between the plan and the plan fiduciary. A plan fiduciary is prohibited from using the plan's assets in their own interest or act on both sides of a transaction involving a plan. Further, fiduciaries cannot receive money or any other consideration for their personal account from any party doing business with the plan related to that business.

Note: One of the most common prohibited transactions involving the plan fiduciary is the failure to timely remit participant deferral contributions and loan repayments to the plan in accordance with DOL regulations. (See additional discussion under Reporting and Correcting Non-Exempt Transactions).

Penalties for Prohibited Transactions

Monetary penalties can be assessed against parties in interest when they are involved in prohibited transactions with a plan.

Prohibited transactions may trigger civil monetary penalties under ERISA section 502(i) which provides the DOL authority to assess a penalty against a party in interest of up to 5 percent of the amount involved for each year or part thereof during which a prohibited transaction continues. This penalty does not apply to any plan subject to an excise tax under IRC section 4975(a).

Section 4975 imposes a 15 percent excise tax against disqualified persons, which are substantially similar to ERISA parties in interest, who engage in prohibited transactions with qualified pension and profit sharing plan assets. A second tier tax of 100 percent of the amount involved is imposed if the transaction is not timely corrected. A prohibited transaction may also violate the exclusive benefit rule in IRC section 401(a) potentially resulting in the plan trust losing its tax-exempt status.

Therefore, disqualified persons engaged in prohibited transactions with qualified pension or profit-sharing plans are subject to the IRC section 4975 excise tax, while parties in interest that are engaged in prohibited transactions with health and welfare plans are subject to the ERISA section 502(i) civil penalty.

Exempt Transactions

Certain party in interest transactions may be exempt from prohibited transaction rules.

Certain transactions with parties in interest are exempt from the prohibited transaction rules, either because they are permitted by a statutory exemption in ERISA, covered under a class exemption issued by the DOL, or the DOL has granted an individual exemption.

Statutory Exemptions in ERISA

ERISA section 408(a) contains specific exemptions whereby plans may engage in certain transactions with parties in interest otherwise prohibited by law. For example, the statutory exemptions include, among other exemptions, the following (with certain restrictions and limitations):

- Loans to plan participants or beneficiaries;
- The provision of services necessary for the operation of a plan for no more than reasonable compensation;
- Loans to employee stock ownership plans;
- Deposits in certain financial institutions;
- Contracts for life insurance, health insurance, or annuities with one or more insurers;
- Providing of any ancillary service by a bank or similar financial institution;
- exercise of a privilege to convert securities;
- Transaction between a plan and a common or collective trust fund or pooled investment fund, or transaction between a plan and a pooled investment fund of an insurance company;
- Distribution of the assets of the plan in accordance with the terms of the plan;
- Transfer made before January 1, 2014, of excess pension assets from a defined benefit plan to a retiree health account in a qualified transfer; and
- Providing certain investment advice to a participant or beneficiary of an individual account plan that permits such participant or beneficiary to direct the investment of assets in their individual account.

Administrative Exemptions

The DOL may grant administrative exemptions to an individual or a class of individuals allowing them to engage in a variety of transactions involving employee benefit plans. DOL administrative exemptions are referred to as Prohibited Transaction Exemptions (PTEs).

Class exemptions are administrative "blanket" exemptions that permit a person to engage in a similar transaction or a series of similar transactions with a plan in accordance with the terms and conditions of the class exemption, without requiring the person to obtain an individual exemption from the DOL. Class exemptions typically relate to transactions common in employee benefit plans that were not in practice or foreseen when the statutory exemptions in ERISA were enacted.

Class exemptions granted by the DOL are listed on the DOL Employee Benefit Security Administration’s (EBSA) website at http://www.dol.gov/ebsa/Regs/ClassExemptions/main.html.

For example, DOL class exemptions permit:

- Parties in interest to make unsecured interest-free loans to plans for plan operating expenses.
- Various transactions involving employee benefit plans whose assets are managed by in-house managers.
- Lending of securities by plans to banks and broker-dealers who are parties in interest to such plans.
- Certain transactions between multiemployer plans and parties in interest involving delinquent employer contributions, construction loans, leasing of office space, provision of services and the sales of goods by the multiemployer plan.
- Transfer of individual life insurance policies by plans to participants, relatives of participants, plan sponsors or another plan.
- Insurance company pooled separate accounts, in which plans invest in, to engage in certain transactions with parties in interest and to hold employer securities or employer real property.
- Purchases and sales of open-end mutual fund shares by a plan when a plan fiduciary is also the investment adviser for the investment company marketing the mutual fund.

Individual exemptions are administrative exemptions that apply only to the specific person named or otherwise defined in the exemption, and allow such person to engage in a variety of transactions that would be otherwise prohibited. Individual exemptions apply only to the applicant; other plans may not rely on those exemptions even if all of the conditions are met.

Individual exemptions that have been granted by the DOL are found on the DOL EBSA’s website at http://www.dol.gov/ebsa/regs/masterindex.html.

For example, individual exemptions are frequently requested in connection with the following:

- Acquisitions or mergers;
- Providing asset allocation advice or investment allocation advice;
- Extensions of credit by plans;
- Guarantees;
- Holding by plans of employer securities;
- In-kind contributions to plans;
- In-kind purchases or transfers;
- Leases by plans of real property;
- Litigation/settlements;
- Loans by plans;
- Pooled funds - investment managers/advisers and mutual funds;
- Receipt of stock warrants on employer securities;
- Purchases by plans of real property and other assets.

How Exemptions Are Obtained

Applications can be submitted for individual or class exemptions.

DOL regulation 29 CFR 2570, *Prohibited Transaction Exemption Procedures, Employee Benefit Plans,* describes the procedures for filing and processing applications for exemptions from the prohibited transaction provisions. A plan, party in interest, or an association or organization representing parties in interest can apply for an individual or a class prohibited transaction exemption through the DOL's Office of Exemption Determination.

To help expedite the authorization process, the DOL issued Prohibited Transaction Exemption 96-62 (PTE 96-62), *Class Exemption to Permit Certain Authorized Transactions Between Plans and Parties in Interest,* more commonly known as EXPRO, which provides an exemption for certain prospective transactions between employee benefit plans and parties in interest where such transactions are specifically authorized by the DOL and are subject to terms, conditions and representations that are substantially similar to exemptions previously granted by the Department. Instructions on applying for an EXPRO exemption and all previously approved EXPRO exemptions can be found at the DOL EBSA website at http://www.dol.gov/ebsa/Regs/expro_exemptions.html.

Reporting and Correcting Non-Exempt Transactions

Non-exempt transactions must be reported on the Form 5500.

ERISA and DOL regulations require transactions with parties in interest (excluding any transactions exempted from prohibited transaction rules) to be reported on schedules to the Form 5500 *Annual Return/Report of Employee Benefit Plan.* The failure to timely remit participant contributions must be reported on Form 5500, Schedule H and the Supplemental Schedule of Delinquent Participant Contributions. Other prohibited transactions must be disclosed on Form 5500; Schedule G. Additional disclosures may also be required in accordance with the Form 5500 instructions.

Under ERISA section 502(c)(2), the DOL may assess a daily penalty against a plan administrator who fails or refuses to comply with the annual reporting requirements.

The DOL has developed a list of frequently asked questions about reporting delinquent participant contributions on the Form 5500 at the DOL EBSA's web site at www.dol.gov/ebsa/faqs/faq_compliance_5500.html.

DOL Voluntary Fiduciary Correction Program

The DOL Voluntary Fiduciary Correction Program offers plan administrators a means of self-correcting prohibited transactions.

The DOL established the Voluntary Fiduciary Correction (VFC) Program to aid plan administrators in self-correcting violations of ERISA, including prohibited transactions. The VFC Program is a voluntary enforcement program that allows plan officials to identify and fully correct certain transactions such as prohibited purchases, sales and exchanges; improper loans; delinquent participant contributions; and improper plan expenses. The program includes specific transactions and their acceptable means of correction, eligibility requirements, and application procedures. Covered transactions in the VFC Program include, among other transactions, fair market and below market interest rate loans with parties in interest; purchase and sale of assets by plans from parties in interest; and late payments of contributions to the plan.

The VFC program may provide relief from payment of excise taxes under a class exemption granted through PTE 2002-51, *Class Exemption to Permit Certain Transactions Identified in the Voluntary Fiduciary Correction Program.*

Other Resources

Employee Retirement Income Security Act – Title 29, Chapter 18, *Employee Retirement Income Security Program,* of the U.S. Code, found at the DOL EBSA's website at www.dol.gov/ebsa/regs/main.html.

- Definition of Party in Interest – ERISA section 3(14) defines the term party in interest.
- Prohibited Transactions – ERISA section 406 includes the definition of a prohibited transaction.
- Exemptions from Prohibited Transactions – ERISA section 408(a) establishes a procedure to grant an exemption for a transaction.

The DOL EBSA website (www.dol.gov/ebsa/) provides resources for obtaining authorization for non-exempt transactions:

- 29 CFR 2570 Prohibited Transaction Procedures - Contains the final regulation that describes the procedures for filing and processing applications for exemptions from the prohibited transaction provisions of the Employee Retirement Income Security Act of 1974 (ERISA), the Internal Revenue Code of 1986 (the Code), and the Federal Employees' Retirement System Act of 1986 (FERSA).
- Class Exemptions Website – Lists the class exemptions granted.
- EXPRO Exemptions Under PTE 96-62 Website – Lists the EXPRO exemptions granted.
- Index of Granted Individual Exemptions Website – Lists the individual exemptions granted.
- DOL's Frequently Asked Questions on Reporting Delinquent Contributions on the Form 5500 - Provides guidance to plan administrators and accountants on complying with the requirements of the Form 5500 *Annual Return/Report of Employee Benefit Plan* for reporting delinquent participant contributions.
- DOL's Voluntary Fiduciary Correction Program Website – Includes information such as forms, tools, checklists and FAQs to help the plan sponsor in self-correcting ERISA violations.

IRS Retirement Plan FAQs – These FAQs contain guidance on prohibited transactions, disqualified persons and related IRS excise taxes. Find these FAQs at http://www.irs.gov/Retirement-Plans/Retirement-Plans-FAQs-regarding-Plan-Investments.

The AICPA Audit and Accounting Guide, *Employee Benefit Plans*, provides audit guidance related to party in interest transactions and prohibited transactions.

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