

FEDERAL TAXATION

Prohibited Transactions—§ 7978

1. Code Sec. 503(h)(1); Regs. § 1.503(h)-1(b) and § 1.503(h)-2(b).
2. Code Sec. 503(h)(2).
3. Code Sec. 503(h)(3); Regs. § 1.503(h)-2(d).
4. Regs. § 1.503(h)-2(c).

§ 7976. Security for loans by stock brokerage employee trusts. A second exemption from the *adequate security* requirement applies only to loans by the qualified employee pension, profit sharing, or stock bonus trusts. This rule is aimed at giving relief to stock brokerage firms which are barred from pledging registered securities they own as collateral for loans from persons other than banks or brokers.

The rule exempts from the *adequate security* requirement, a loan (or renewal) by a qualified employee trust to an employer-creator who is prohibited by any U. S. law or applicable regs from directly or indirectly pledging as security for a loan from the trust, any of his assets representing more than half of the value of all his assets.

But this exemption from the adequate security requirement applies only if the following conditions are satisfied:

... The loan bears a reasonable rate of interest.

... It is approved in writing as an investment consistent with the exempt purposes of the trust by a trustee independent of the employer. If the trust has more than one independent trustee a majority of them must give the required approval.

... Immediately after the loan (or renewal) the amount loaned to the employer, without adequate security (including loans exempt from that requirement), doesn't exceed 25% of all the assets of the trust.¹

1. Code Sec. 503(j); Regs. § 1.503(j)-1.

§ 7977. Owner-employee trusts are prohibited from engaging in other transactions. A qualified employee pension, profit sharing or stock bonus trust that includes owner-employees who control the trade or business with respect to which the plan is established is barred from engaging in a second group of prohibited transactions in addition to the regular prohibited transactions described at § 7972.

Under this second group of prohibited transactions, the trust may not, directly or indirectly:

- ... lend any part of its corpus or income to;
 - ... pay any compensation for personal services to;
 - ... make any part of its services available on a preferential basis to;
 - ... acquire any property from; or
 - ... sell any property to,
- Any of the following:

... any person with whom a regular prohibited transaction would be barred (§ 7971);

... the owner-employee, his brothers, sisters, spouse, investors, and lineal descendants; or

... a corporation controlled by an owner-employee through direct or indirect ownership of 50% or more of the combined voting power or of the total value of all the stock.¹

The prohibition against acquisition of property by the trust doesn't include money. But it bars contribution of any other property to the trust by the employer.²

An owner-employee is either:

... an employee who owns the entire interest in an unincorporated trade or business, or

... is a partner who owns more than a 10% interest in either capital or profits.³

One or more owner-employees control an unincorporated trade or business if they:

... own the entire interest in the business; or

... own more than a 50% interest in either capital or profits of a partnership that owns the trade or business or of a partnership that directly or indirectly owns such a 50% interest in a partnership that owns the trade or business.⁴

1. Code Sec. 503(j).
2. Regs. § 1.503(j)-1(b).
3. Code Sec. 401(c)(3).
4. Code Sec. 401(d)(9)(B).

§ 7978. Bank deposits as prohibited loans. Savings accounts and ordinary checking accounts aren't loans for purposes of the prohibited transactions provisions. This rule applies to such deposits in national banks, state banks, savings and loan associations, and building and loan associations whose deposits are insured by the Federal Deposit Insurance Corp., the Federal Savings and Loan Insurance Corp., or their state equivalents. It applies notwithstanding that the bank reserves the right to require 30 days' notice prior to withdrawal.¹

Savings accounts in such banks aren't prohibited loans notwithstanding that they exceed the amount of deposit insurance.² But ordinary checking accounts to the extent of any excess over the insured maximum apparently may be treated as violating the prohibition against other transactions resulting in substantial diversion of income or corpus if left on deposit for longer than the period required for reasonably prompt investment.³

A time deposit, namely one made for a fixed period of time, is considered to be a loan. But the ruling so holding doesn't indicate whether such a deposit would be considered to be adequately secured to the extent insured by the Federal Deposit Insurance Corp. or the Fed-