



## The Ferenczy Flash

FROM THE LAW OFFICES OF Ilene H. Ferenczy, LLC

### *The Latest Word in Employee Benefits . . .*

#### **"BUT THE PENSION FUND WAS JUST SITTING THERE!"**

The other day, an old Doonesbury comic came to mind. The character, Duke (modeled after the late Rolling Stone writer, Hunter S. Thompson) was the head of the Washington Redskins, and he made a questionable investment with the pension assets of the team. When asked about it, his response was – you guessed it – "But the Pension Fund was just sitting there!"

In today's economy, it is easy to have a similar attitude toward one's retirement plan assets. In fact, we have been asked to represent several small plan sponsors who have authorized the investment of plan assets into real estate transactions. Inevitably, these investments contain one or more of the following characteristics:

- The plan sponsor is in the real estate investment business, and the investment of plan assets was made because the plan trust was a ready source of funds for some really good deal.
- The owner of the real estate investment was supposed to be the plan, but was listed as the plan sponsor (or the plan sponsor's owner) by accident.
- The real estate investment has not thrown off any income in several years, and has been kept on the plan books at the original purchase value.
- The real estate investment is in a joint venture or partnership with the plan sponsor, the owner of the plan sponsor, or a relative or friend of the plan sponsor.
- Someone other than the plan is making money off this deal, and it is likely the plan sponsor or someone who does business with the plan sponsor.
- The real estate investment is now in trouble because of the down real estate market.

**And, the final characteristic that these clients have in common: they are being audited by the IRS or the Department of Labor (DOL).** We have seen a significant increase in audit activity in relation to these transactions, as well as harsher treatment by the government of individuals engaging in these types of transactions.

People ask all the time if they "can do" a given investment out of the plan. The answer may be "yes," but that does not mean that the transaction is advisable. These types of transactions fit that bill.

You need to know the following about significant plan investments:

- The plan cannot enter into a transaction with the company, the shareholders, the officers, or the plan participants unless a specific provision exists in the law permitting this. Intent to benefit the plan is not a legal justification for this type of transaction. If you do it, you're liable for taxes and penalties, and the transaction may need to be reversed (with any profits made by the non-plan party to the transaction disgorged to the plan).
- The plan trustee is required to diversify assets among many investments so as to reduce the potential of large plan losses.
- All plan assets must be valued at fair market value each year, meaning that assets not traded on a ready exchange must be appraised by an independent appraiser each year.
- If you are entering into a transaction that would not be something you would do with a stranger, then the IRS or DOL will look upon the transaction as self-dealing and prohibited by law. Again, the

ability to benefit the plan in the transaction is not a defense.

Just to clarify the potential risk: a company that came to us for assistance made a \$900,000 investment in a real estate partnership. The IRS has threatened to assess \$2.5 million in taxes and penalties for this transaction. The plan participants include the business owner and his wife – no employees.

We advise that:

- 1. You think very carefully about using plan assets for these types of investments. Real estate people are used to wheeling and dealing, but doing this with plan assets can be very risky.
- 2. Be sure that these are arms length transactions, not with your family or friends.
- 3. No family, friends, or employees may make use of the asset. Even for a weekend or a few days.
- 4. Arrange to have the asset valued before the transaction takes place and each year by a third party professional appraiser.
- 5. Remember: this money is for your retirement. Use your other assets for the riskier ventures.

Call us if you have questions or if you are involved in one of these transactions and need assistance in assessing its risk and future action that may be needed.

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**The Law Offices of Ilene H. Ferenczy, LLC**  
404.320.1100

Ilene Ferenczy • x 102 • [Ilene@ihflaw.com](mailto:Ilene@ihflaw.com) | Gina Farmer • x 101 • [gfarmer@ihflaw.com](mailto:gfarmer@ihflaw.com)  
Barbara Murphy • x 104 • [bmurphy@ihflaw.com](mailto:bmurphy@ihflaw.com) | Matt Cristy • x 110 • [mcristy@ihflaw.com](mailto:mcristy@ihflaw.com)

2200 Century Parkway, Suite 560 • Atlanta, GA 30345 • T-404.320.1100 • F-404.320.1105 • [www.ihflaw.com](http://www.ihflaw.com)