

**PURPOSE**

- (1) This transmits a complete reprint for IRM 4.72.1, Employee Plans Technical Guidelines, Miscellaneous Employee Plans Issues.

**NATURE OF MATERIAL**

- (1) IRM 4.72.1 provides guidelines for EP examiners on specific technical topics including pension, profit sharing, stock bonus, and other arrangements within the jurisdiction of employee plans.

**EFFECT ON OTHER DOCUMENTS**

**AUDIENCE**

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4.72.1

Miscellaneous Employee Plans Issues

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4.72.1.1

(09-12-2006)

**Overview of IRM Chapter**

- (1) This IRM chapter provides guidance on specific technical topics of particular interest relating to qualified retirement plans. These guidelines are for the use of all EP examiners in the examination of pension, profit-sharing, stock bonus, and other arrangements within the jurisdiction of employee plans.
- (2) The issues are addressed in a comprehensive manner and provide a technical discussion and suggestions for examining each issue, labeled Examination Steps. Where applicable, a topic will indicate whether it has been updated for a specific law or new legislation. Guidance on these and additional topics will be added to, updated and expanded when necessary.
- (3) The guidelines address issues for which there is an established principle of law, or where the answer is clear or reasonably certain. This applies generally where regulations or other published guidance has been issued.
- (4) The guidelines are for reference and use by EP personnel including specialists, actuaries, reviewers, and appropriate supervisory and management personnel. They may also be used as training aids for new personnel.
- (5) Because of the diversity of conditions encountered during examinations, these guidelines are not devised to be all inclusive or restrictive. They should be used as a guide and a reference by all EP examiners. Consequently, the techniques identified may be modified based on the actual examination issues encountered. It is expected that the guidelines will help the examiner decide what areas to concentrate on and what issues to raise with respect to particular plans. Given the purpose of these guidelines, they cannot be, nor are they intended to be, a precedential or comprehensive statement of the Service's legal position on the issues covered herein. They are not to be relied upon or cited as authority to taxpayers. These guidelines are being issued for the sole purpose of assisting the examiner in performing an examination of certain issues for which it was believed guidelines would be helpful. It is not expected that each issue discussed in these guidelines will be relevant in every examination.
- (6) Tax law specialists in the Employee Plans Division provide support in the preparation and updating of texts for Continuing Professional Education (CPE).
- (7) Another source for guidance on topics relating to qualified plans under IRC 401(a)(4) is found in the Alert Guidelines. Although these topics relate to qualification matters, the Explanations substantively address the pertinent issues.
  - 1. Minimum Participation Standards
  - 2. Minimum Vesting Standards - DC
  - 2A. Minimum Vesting Standards - DB
  - 3. Joint and Survivor Annuities
  - 4. Miscellaneous Provisions
  - 5. Coverage and Nondiscrimination Requirements, DC Plans
  - 5A. Coverage and Nondiscrimination Requirements, DB Plans
  - 5B. Permitted Disparity
  - 6. Limitations on Contributions and Benefits
  - 7. Top-Heavy Requirements
  - 8. Employee Leasing
  - 9. Required Plan Distributions
  - 10. Affiliated Service Groups
  - 11. Employee and Matching Contributions

- 12. Section 401(k) Requirements
- 13. Section 401(h)

(8) Discussed below are some of the miscellaneous topics covered in IRM 4.71.1.

4.72.1.2  
(09-12-2006)  
**Unrelated Business  
Activity**

- (1) IRC 511 imposes a tax on the unrelated business taxable income of certain organizations, including trust described in IRC 401(a). In the case of such trusts it means any trade or business regularly carried on by such trust. The term “trade or business” conforms to the basic definition under IRC 162.
- (2) Exceptions under IRC 513(a) do not apply to IRC 401(a) trusts. The exceptions pertain to taxation on income received from the operation of trades or businesses under certain specified circumstances of foundations and other types of exempt organizations.
  - a. Generally, the unrelated business activities in which a qualified trust engages take the form of either a trade or business or debt-financed income.

4.72.1.2.1  
(09-12-2006)  
**Examination Steps**

- (1) Techniques are provided on unrelated business income of all types and the Form 990–T filing requirements. Below also, are examples which may aid in detecting the same or similar issues during an examination.
- (2) Analyze financial statements and/or tax returns prepared by the trust for evidence of the existence of a trade or business. Receipts derived from business operations may be buried in investment income, i.e., interest or dividend and may only be revealed by examining the trusts’ books and records.
  - a. An IRC 401(a) trust may be engaged in the same business activity as the creator corporation. The management of the trust is, directly or indirectly, the same as that of the employer. Consequently, there is a tendency to apply the trade or business expertise of corporate management to the trust’s business activities.
  - b. The trust may engage in an activity which complements the employer’s business. For instance, the employer may be engaged in the manufacture of a product and permit the trust to perform all or a part of the marketing functions.
- (3) Sales of Lots. Corporations which are in the business of developing and improving real estate for sale to customers will often contribute land to their employee trusts which is adjacent to their own development projects. Or, they will contribute cash and require the trust to invest in such subdivisions. In this manner, the employer’s salespeople can promote and sell the trust’s subdivided and improved real property along with their own and escape taxation on the portion of the activity attributable to trust ownership.
  - a. If this activity is being carried on in sufficient volume on a regular and continuous basis, the trust is also engaged in the real estate business and is subject to the unrelated business income tax under IRC 511.
- (4) Vending Machines. The operation of a vending machine route (large or small) is a trade or business. Trusts find this additional activity appealing as a revenue producer because little effort is required on their part to derive financial benefits. The existence of this type of income is often hidden in the

trust's financial statements as miscellaneous income, income from sources other than investments, or some similar caption. All income accounts must be analyzed to make a determination.

- (5) Commissions and Fees. An employee trust may earn commissions or fees for services rendered. Income from these sources commonly stems from sales commissions (real estate as well as personal property) and finder's or agency fees of various sorts. The income from such activities are subject to the unrelated business income tax under IRC 511.
- (6) Factors. Factoring is a trade or business. The profits derived from this operation do not constitute interest on investments as may be shown on the financial statements.
- (7) Fruit Orchards and Citrus Groves. Some trusts own property and may operate the activity rather than lease the property.
- (8) Timber. In a raw material industry, IRC 482 may apply as well as IRC 513(b). **Example:** If the creator corporation is a paper company, ascertain that the price the employer pays the trust for the timber is reasonable.
- (9) Rental of Personal Property. The income derived from the lease or rental of personal property (other than that leased with real property) constitutes income from operation of a trade or business. Some examples are: tank cars, boats, automobiles, fishing and skiing equipment, signs and vending machines.
- (10) Option Income. Revenue received from unexercised stock options (puts and calls) regularly issued on stocks held in the trust's portfolio constitutes unrelated trade or business income under IRC 513. See Rev. Rul. 66-47. Since this income is commonly shown on the financial statements as "capital gain", carefully review the broker's confirmation documents which will reveal the existence of such stock option sales.
- (11) Partnerships. If a partnership of which the trust is a member is engaged in a trade or business, the trust has unrelated business income with respect to its portion of distributable income. Verify this by reviewing the information return for an entry reported as investment income.
- (12) Miscellaneous Business Enterprises. Other ventures in the trade or business category which have been uncovered are retail stores, cafeterias, parking lots, and mineral interests, etc.
- (13) Common Trust Funds: An Individual Retirement Account (IRA) that participates in a common trust fund (defined in IRC 584) is treated as if it directly earned its proportionate share of the unrelated business income earned by the common trust fund (including unrelated business income earned from an investment in a limited partnership), and will therefore be subject to taxation under IRC 511(a). The IRA, however, will not lose its status as an IRA under IRC 408(a). Thus, any amount of income or loss of the common trust fund which is included in computing the participant's taxable income for the taxable year will be treated as income or loss from an unrelated trade or business to the extent that such amount would have been income or loss from an unrelated trade or business if such participant had made directly the investments of the common trust fund. See Regs. 1.584-2 and 1.512(a)-1(a).

4.72.1.3  
(09-12-2006)  
**Unrelated Debt-Financed  
Income**

- (1) In general, the income received from all income producing property on which an acquisition indebtedness exists is taxable in proportion to the amount of unpaid indebtedness. See IRC 514(a). This does not apply to indebtedness incurred in acquiring or improving any real property, with certain exceptions. See IRC 514(c)(9)(B).

4.72.1.3.1  
(09-12-2006)  
**Examination Steps**

- (1) Ascertain the reason for the incurrences of all existing liabilities to determine if they were in any way connected with the acquisition of income-producing property. If funds were borrowed before or after the purchase, acquisition indebtedness occurs if it can be shown that the liabilities would not have been incurred but for the purchase of the income-producing property.
- (2) If any of the following situations apply, identify the leveraged investments.

If	Then
Common stock is purchased on margin,	a portion of the dividends received is taxable
Bonds are purchased on margin,	a portion of the interest received is taxable
Real property is debt-financed,	a portion of the rental or lease income is taxable (other than that provided in IRC 514(c)(9)(B).)
A trust is a member of a partnership,	the trust's distributable portion of interest, dividends, rents, etc. (items never before taxed) which were earned on all of the partnership's debt-financed property is taxable.

4.72.1.4  
(09-12-2006)  
**Form 990-T**

- (1) Form 990-T, Exempt Organization Business Income Tax Return, is a taxable return. Since IRC 401(a) trusts are not corporations, they are taxed at individual rates with respect to their unrelated business activities.

4.72.1.4.1  
(09-12-2006)  
**Only One \$1,000  
Specific Deduction**

- (1) Some trusts file a separate Form 990-T for each trade or business and in doing so automatically avail themselves of multiple \$1,000 specific deductions. If this is discovered, disallow all but one of such \$1,000 deductions.

4.72.1.4.2  
(09-12-2006)  
**Statute of Limitations**

- (1) In most cases, the statute of limitations begins to run for the Form 990-T with either:
- a. The later of the date the Form 990-T is filed or due.
  - b. If Form 990-T is not filed, the statute of limitations starts to run based on the Form 5500 if Form 5500 discloses sufficient information to reveal the existence of unrelated business income (UBI).
- (2) If the trust statement is not filed, the statute of limitations will not begin to run for the trust.



- (3) To extend the statute, it is necessary to secure a separate Form 872 from the Form 5500.
  - a. The filing of the Form 5500 does not commence the running the statute of limitations on the 990-T unless sufficient information was disclosed to reveal the existence of an unrelated business activity. See Rev. Rul. 69-247.
  - b. The timely filing of a Form 5500 does not excuse the taxpayer from the delinquency penalty on a delinquent 990-T secured during an examination. See IRM 4.71.3 and IRM 4.71.9

4.72.1.4.3  
(09-12-2006)  
**Failure to File  
Information Returns**

- (1) A penalty of \$25 per day (up to \$15,000) is imposed on employers that fail to file timely information returns. See IRC 6652(e).
- (2) This penalty is automatically asserted on delinquent returns filed by plan sponsors/administrators.
- (3) This penalty applies provided reasonable cause cannot be established. See IRM 4.71.3.

