

**Office of Chief Counsel  
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memorandum**

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to: David Conrad, CC:TEGEDC

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subject: Application of rule prohibiting loans to the employer from a § 403(b)(9) retirement income account

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

ISSUE

You have asked whether the rule prohibiting loans from a § 403(b)(9) retirement income account of a participant to the participant's employer under the exclusive benefit requirement of § 1.403(b)-9(a)(2)(i)(C) applies only to loans that are made directly from the retirement income account assets to the employer, or to all loans of retirement income account assets to the employer, including indirect loans.

FACTS

In order to address your question, we will analyze the following situations.

For both situations, assume the employer (Church) is a church under § 3121(w)(3)(A). Church maintains a § 403(b)(9) retirement income account plan (the Plan) for its employees. The Plan satisfies the separate accounting requirement of § 1.403(b)-9(a)(2)(i)(A), the investment performance requirement of § 1.403(b)-9(a)(2)(i)(B), and the written plan requirement of § 1.403(b)-9(a)(2)(ii) (these requirements are described below in the Law section).

Situation 1. One of the investment options offered by the Plan is an investment in shares in a limited liability company (LLC 1). LLC 1 is structured so that its primary

function is to offer loans to Church, and the investment return to the Plan participants from LLC 1 is the interest paid by the Church on the loans. LLC 1 is not controlled directly or indirectly by Church.

Situation 2. One of the investment options offered by the Plan is an investment in shares in a limited liability company (LLC 2). LLC 2 is structured so that it is controlled, either directly or indirectly, by Church. Offering loans to Church is not LLC 2's primary function. LLC 2 makes a loan to Church.

## CONCLUSION

Situation 1. A Plan participant's investment in shares in LLC 1 violates the rule under § 1.403(b)-9(a)(2)(i)(C) prohibiting any loan or other extension of credit from assets in the Plan to Church because it is an indirect loan from the Plan to Church. Accordingly, the Plan fails to meet the requirements for being a § 403(b)(9) retirement income account plan.

Situation 2. A Plan participant's investment in shares in LLC 2 violates the rule under § 1.403(b)-9(a)(2)(i)(C) prohibiting any loan or other extension of credit from assets in the Plan to Church because it is an indirect loan from the Plan to Church. Accordingly, the Plan fails to meet the requirements for being a § 403(b)(9) retirement income account plan.

## LAW

Section 403(b)(9)(B) defines a "retirement income account" as a defined contribution program established or maintained by a church or a convention or association of churches, including an organization described in § 414(e)(3)(A), to provide benefits under § 403(b) for an employee or his beneficiaries.

Section 1.403(b)-2(b)(15) defines a "retirement income account" as a defined contribution program established or maintained by a church-related organization to provide benefits for its employees or their beneficiaries.

Section 1.403(b)-2(b)(6) defines a "church-related organization" as a church or a convention or association of churches, including a church retirement board described in § 414(e)(3)(A). Section 1.403(b)-2(b)(5) defines a "church," for purposes of the regulations under § 403(b), as "a church as defined in § 3121(w)(3)(A) and a qualified church-controlled organization as defined in § 3121(w)(3)(B)."

Section 1.403(b)-9(a)(2)(i) provides three requirements for a defined contribution program established or maintained by a church-related organization to be a retirement income account: (1) a separate accounting requirement described in § 1.403(b)-9(a)(2)(i)(A); (2) an investment performance requirement described in § 1.403(b)-9(a)(2)(i)(B); and (3) an exclusive benefit requirement described in

§ 1.403(b)-9(a)(2)(i)(C). Additionally, § 1.403(b)-9(a)(2)(ii) requires that a retirement income account must be maintained pursuant to a written plan and the plan document must state the intent to be a retirement income account.

The exclusive benefit requirement under § 1.403(b)-9(a)(2)(i)(C) provides that, in order to be a § 403(b)(9) retirement income account,

"the assets held in the account cannot be used for, or diverted to, purposes other than for the exclusive benefit of plan participants or their beneficiaries (and for this purpose, assets are treated as diverted to the employer if there is a loan or other extension of credit from assets in the account to the employer)."

Section 1.403(b)-11(c)(2) provided a now-expired transition rule that required § 403(b)(9) plans with such pre-existing loans to take "reasonable steps to eliminate the loan or other extension of credit to the employer."

## ANALYSIS

The exclusive benefit requirement of § 1.403(b)-9(a)(2)(i)(C) requires that assets cannot be used for, or diverted to, purposes other than for the exclusive benefit of plan participants or their beneficiaries. In addition, § 1.403(b)-9(a)(2)(i)(C) explicitly provides that a loan or other extension of credit from assets in a participant's retirement income account to the employer is treated as a diversion of assets to the employer, violating the exclusive benefit requirement of § 1.403(b)-9(a)(2)(i)(C). The expansive scope of this rule prohibiting loans to the employer is consistent with the transition rule in § 1.403(b)-11(c)(2) for sponsors of § 403(b)(9) retirement income accounts that had loans or other extensions of credit with the employer prior to issuance of the final regulations, which required the "eliminat[ion]" of any prior loans.

A direct loan from the plan to the employer results in a loan or other extension of credit from assets in a participant's retirement income account to the employer. In the case of an indirect loan, such as is described in Situation 1 and Situation 2, an arrangement has been structured so that the employer receives a substantially similar loan or other extension of credit using the assets of the retirement income account as it would have under a direct loan.<sup>1</sup> Accordingly, for purposes of § 1.403(b)-9(a)(2)(i)(C), both direct and indirect loans are loans or other extensions of credit from assets in a participant's retirement income account to the employer, which cause assets in the retirement income account to be treated as diverted to the employer, violating the exclusive benefit requirement of § 1.403(b)-9(a)(2)(i)(C).

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<sup>1</sup> In contrast, if the assets of a retirement income account are invested in the publicly traded stock of a financial institution and the employer receives a loan from that financial institution, there is not an indirect loan from the retirement income account to the employer. In that case, the arrangement has not been structured to provide the employer a loan using the assets of the retirement income account substantially similar to a direct loan.

In Situation 1, a participant's investment in shares in LLC 1 would be an indirect loan to Church because LLC 1's primary function is to make loans to Church, and LLC 1 is funded, in part, by Plan assets in the form of investments made at the direction of participants of amounts in their Plan accounts. While not a direct loan, the arrangement has been structured so that Church receives a substantially similar loan using the assets of the retirement income account as it would have under a direct loan. Such an indirect loan would violate the exclusive benefit requirement of § 1.403(b)-9(a)(2)(i)(C), and cause the Plan to no longer be treated as a retirement income account plan under § 403(b)(9).

In Situation 2, a participant's investment in shares in LLC 2 followed by a loan by LLC 2 to Church would also be an indirect loan to Church because LLC 2 is controlled by Church. This is true regardless of whether LLC 2 provides loans to other entities not related to Church. While not a direct loan, the arrangement has been structured so that Church may cause itself to receive a substantially similar loan using the assets of the retirement income account as it would have under a direct loan. Such an indirect loan would violate the exclusive benefit requirement of § 1.403(b)-9(a)(2)(i)(C), and cause the Plan to no longer be treated as a retirement income account plan under § 403(b)(9).

This Chief Counsel Advice does not address the tax consequences of the scenarios discussed in this writing, except as expressly provided, including the tax consequences of a retirement income account ceasing to be a retirement income account.

Please call Cheryl Press, Jason Levine, or Patrick Gutierrez at (202) 317-4148 if you have any further questions.