88 T.C. 1440 (1987)

To qualify for an exemption from prohibited transaction rules under ERISA and IRC section 4975, employer real property held by a profit-sharing plan must be geographically dispersed to protect plan assets from localized economic downturns.

Summary

In *Lambos v. Commissioner*, the Tax Court addressed whether lease transactions between a profit-sharing plan and the owners of the sponsoring company constituted prohibited transactions under IRC § 4975. Anton Lambos, owning over 50% of KendallHouse, Inc., and his wife Olga leased properties from the company's profit-sharing plan. The IRS assessed excise taxes, arguing these were prohibited transactions. The Lamboses contended the leases were exempt as they involved "qualifying employer real property." The Tax Court held that the leased properties, all located in Stark County, Ohio, were not geographically dispersed as required by ERISA § 407(d)(4)(A), thus the leases were prohibited transactions subject to excise taxes. This case clarifies the geographic dispersion requirement for the qualifying employer real property exemption.

Facts

Anton Lambos owned 100% of KendallHouse, Inc. during 1976-1979 and over 94% during 1980-1981.
KendallHouse, Inc. maintained a profit-sharing plan for its employees.
The plan owned three properties in Canton, Ohio, each housing a Kentucky Fried Chicken restaurant.
Two of these properties, located on Hills and Dales Road and West Tuscarawas Avenue, were leased to Anton and Olga Lambos.
The IRS determined these leases were prohibited transactions and assessed excise taxes under IRC § 4975.

Procedural History

The Commissioner of Internal Revenue issued notices of deficiency to Anton and Olga Lambos for excise taxes related to prohibited transactions.
The Lamboses petitioned the Tax Court for redetermination of these deficiencies.

Issue(s)

1. Whether Anton and Olga Lambos were disqualified persons within the meaning of IRC § 4975(e)(2)?
2. Whether the lease transactions between the Lamboses and the profit-sharing plan were prohibited transactions under IRC § 4975(c)?
3. Whether the leased properties constituted "qualifying employer real property" under ERISA § 407(d)(4), thus exempting the transactions under IRC § 4975(d)(13)?

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4. How is the “amount involved” in these prohibited transactions determined for excise tax purposes?

Holding

1. Yes, Anton and Olga Lambos were disqualified persons because Anton owned more than 50% of the sponsoring company and Olga is his spouse.
2. Yes, the lease transactions were prohibited transactions because they were leases between a plan and disqualified persons, and no exemption applied unless the property was “qualifying employer real property.”
3. No, the leased properties were not “qualifying employer real property” because they were not geographically dispersed, as all were located in Stark County, Ohio. Geographic dispersion is necessary to protect plan assets from localized economic downturns.
4. The “amount involved” is determined by considering the leases as separate and continuing prohibited transactions on the day they occur and on the first day of each taxable year within the taxable period.

Court’s Reasoning

The court determined Anton and Olga Lambos were disqualified persons under IRC § 4975(e)(2)(E) and (F). The leases were considered prohibited transactions under IRC § 4975(c)(1)(A) unless exempted.

The Lamboses argued for exemption under IRC § 4975(d)(13), which incorporates ERISA § 408(e), exempting transactions involving “qualifying employer real property.” “Qualifying employer real property” is defined in ERISA § 407(d)(4) and requires, among other things, that “a substantial number of the parcels are dispersed geographically.”

The court emphasized the legislative intent behind the geographic dispersion requirement, quoting the House Conference Report: “*It is intended that the geographic dispersion be sufficient so that adverse economic conditions peculiar to one area would not significantly affect the economic status of the plan as a whole.*”

The court found that properties located within Stark County, Ohio, did not meet the geographic dispersion requirement. “*In our view, the Hills and Dales Road property and the West Tuscarawas Avenue property are not dispersed geographically. An adverse economic condition peculiar to Stark County, Ohio, would significantly affect the economic status of the plan as a whole.*”

Regarding the “amount involved,” the court upheld the IRS’s “pyramiding method,” treating the lease as a new prohibited transaction on the first day of each taxable year. This approach, derived from regulations under IRC § 4941 (private foundations self-dealing rules, which Congress intended to parallel § 4975), was deemed a reasonable interpretation of the statute.

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Practical Implications

Lambos highlights the importance of geographic dispersion when a retirement plan invests in employer real property intended to qualify for an exemption from prohibited transaction rules. Plans must ensure real property holdings are spread across different geographic areas to mitigate risks associated with localized economic downturns. This case serves as a reminder that merely having multiple properties is insufficient; they must be genuinely dispersed to provide economic diversification for the plan. For practitioners, this case underscores the need for careful due diligence regarding the location of employer real property investments within ERISA plans and the potential excise tax consequences of non-compliance with the geographic dispersion rule. Subsequent cases and IRS guidance would further refine the interpretation of "geographic dispersion," but *Lambos* remains a key precedent for understanding this requirement.

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