Hard to Value Plan Assets

NOBLE DAVIS CONSULTING, INC
PEACE of MIND

Holding assets in the plan that are hard to value causes serious problems.

Sometimes, plan sponsors wish to add items to the list of their plan investments that are difficult to value. We've had plans that are invested in jewelry, plots of land, sports cars and antiques. There are also plans that are invested in small partnerships that do not have an established fair market value. The problem is that retirement plans aren't really designed to invest in items that do not have a readily determinable value.

The issues that can arise from holding these assets are:

- Prohibited transaction issues
- Unrelated Business Taxable Income
- Adequate ERISA Bond coverage
- Problems with ascertaining fair market value
- Having the investments held by a qualified custodian
- Benefits, Rights and Features issues
- Additional plan costs to value the assets

So while there may be investments that are sound and make sense financially, they may not belong in a retirement plan.

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Why you shouldn't hold hard to value assets in a plan

There are many reasons that holding assets without a readily determinable value causes issues within a retirement plan.

1. Prohibited Transaction Rules— A prohibited transaction can arise when the purchase of an asset is not an arms-length transaction. If the fiduciary of the plan will benefit from the transaction, then it becomes a prohibited transaction and 15% excise tax will be due on the transaction until it is corrected. An example would be if a company that builds homes for a living decided that the plan should purchase the plots of land that it will build future homes upon. If the plan sponsor owned the land and sells it to the plan, it is not an arms-length transaction.
2. Unrelated Business Tax Income (UBTI) - UBTI may be applicable if the asset generates ordinary business income. Income derived from dividends, interest, market gains/losses, royalties, and some rents are exempt. Debt financed assets are non-exempt and are subject to UBTI. IF UBTI applies, the plan must file an annual Form 990 and pay taxes at trust rates.
3. ERISA Bond Coverage—A small plan is exempt from the requirement to obtain a plan audit if 95% of the assets in the plan are invested in certain types of assets that have a readily determinable value. If more than 5% of the assets are considered "non-qualified assets," then the plan must increase it's ERISA bond coverage to 100% of the fair market value of the non-publicly traded assert or the plan will be subject to an annual audit prepared by an independent certified public accountant.
4. Fair Market Value—The non-publicly traded assets must be valued periodically. Annual valuations are required for an asset held in a pooled account. Periodic valuations are required for those assets held in segregated accounts. Most importantly, the assets must be valued by an independent appraiser at the time of a distribution from the plan.
5. Custodian—The assets must be held by a qualified custodian.
6. Benefits, Rights & Features—By law, all participants must be permitted to invest in the same or similar assets. So, if you purchase a diamond from the owner's account, all of the plan participant have the right to purchase precious gems from their plan accounts as well or the plan is considered discriminatory.
7. Independent Appraisals— The plan will need to pay for someone to independently appraise the assets either on an annual or periodic basis.

These issues show that having hard to value assets in a plan is problematic and costly.