

## Funding Employee Benefits With In-kind Contributions

In-kind contributions are assets such as securities and real property that can be used to help fund pension and welfare plans without using cash. Properly structured, in-kind contributions offer tangible advantages to both the plan and the sponsoring employer. While most in-kind contribution transactions have taken place with private sector employers, state and local governments can use the same strategy.

### **In-Kind Contributions Defined**

An employer who sponsors a defined benefit pension plan typically funds the plan with cash consisting of mandatory minimum funding contributions and, when circumstances permit, so-called “excess” contributions to improve the plan’s funding status beyond legally required minimum standards. In addition, employers with obligations to fund health insurance benefits through trust arrangements usually meet those obligations with cash.

With an in-kind contribution, the employer satisfies its funding obligation with an asset other than cash, and the plan credits the employer with a funding credit equaling the asset’s current fair market value. Sometimes the asset contributed consists of securities, such as the employer’s common stock or stock in a subsidiary, or warrants to buy the stock. The asset may also consist of real estate, such as an office building, a warehouse or even raw land. When the asset is real estate used in operating the employer’s business, the transaction usually has two components: the contribution itself, and a leaseback of the property from the plan, as owner/landlord, to the employer as tenant, with the fair market rental payments providing cash flow to the plan.

### **Advantages of an In-Kind Contribution**

For the employer, an in-kind contribution reduces or satisfies a current or future funding obligation while preserving the company’s cash to strengthen the balance sheet, operate the business, fund research or achieve other corporate goals. And in a contribution/leaseback transaction, the employer’s rent obligation may be lower than the ongoing benefit funding obligation the employer would have had but for the contribution. Improving the plan’s funding condition itself also can improve the company’s balance sheet. In addition, if the employer is carrying the asset at an historic book or cost value, completing the transaction based on the asset’s current market value allows the employer to realize the value of the gain in the form of credit toward its contribution obligations (although a taxable employer may realize taxable income on that gain which can offset a portion of the tax deduction available for the value contributed to the plan).

From the plan’s perspective, an in-kind transaction can result in a contribution that otherwise might never have happened, might have been lower in value, or would have been delayed, if the employer were forced to contribute only cash. And the plan receives a fairly valued asset suitable in the context of its overall investment profile and which, in the case of dividend-paying stock or rented real estate, produces a cash flow.

## Fiduciary Requirements

A plan's decision to accept an asset other than cash is a fiduciary decision that must be made prudently, based solely on whether the transaction is in the interest of the plan and its participants and beneficiaries. To satisfy regulatory and fiduciary requirements, every in-kind contribution must be negotiated as an arms-length transaction between the employer and the plan. That requires protecting the plan's interests with a fiduciary independent of the employer.

The independent fiduciary must decide such issues as:

- The value of the asset
- How accepting the asset will affect the plan's actuarial and financial condition
- Whether the asset fits within the plan's overall investment profile
- How the logistical and financial burdens of owning the asset will be managed and funded
- Whether and how the asset may later be sold or otherwise monetized and, in the case of real estate, used by a party other than the employer
- The terms acceptable to the plan of the contribution agreement between the employer and the plan and, if applicable, the lease of the asset back to the employer

If, in the case of a private sector employer, the contribution requires a formal exemption from the U.S. Department of Labor from ERISA's prohibited transaction rules, the independent fiduciary must also submit to the Department a report explaining its reasons for concluding that the transaction is in the plan's interest. And if the asset is ultimately contributed to the plan, it is often necessary for the independent fiduciary to act for the plan on an ongoing basis to manage the asset and decide whether, when and on what terms to sell it.

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