

IRA Owner Inadvertently Triggers Income Tax Liability

by Charles E. Falk

The United States Department of Labor in advisory opinion 2009-03A, dated October 27, 2009, held that where the IRA owner of a self-directed IRA account proposed to give the broker where the IRA account would be held a security interest in non-IRA assets held by the same broker, that such security interest would constitute a “prohibited transaction” under the Internal Revenue Code and subject the IRA owner to an excise tax penalty. The Department of Labor stated:

You make the following representations in support of your request. Your client currently has a personal brokerage account at the Broker. He now wishes to open an IRA with the Broker, and will self-direct investments made with the IRA's assets. In connection with the establishment of the IRA, the Broker has asked your client to agree to the following clause:

All securities and other property now or hereafter held, carried or maintained by us in our possession or control, for any purpose, in or for the benefit of any of your Accounts, now or hereafter opened, including any Account in which you may have an interest, shall be subject to a continuing first lien and first priority perfected security interest in favor of us for the discharge of all indebtedness and your obligations to us, and are to be held by us as security for the payment of any liability or indebtedness of yours to us in any of your accounts. You authorize us the right to transfer securities and other property so held by us from or to any other of your Accounts held by us, whenever, in our judgment, we consider such transfer necessary for our protection.

You state that this language requires your client to pledge his personal assets, as handled in certain accounts maintained by the Broker, to cover indebtedness that the IRA may incur. You express concern that prohibited transactions would occur if your client establishes the IRA with the Broker pursuant to such terms.

It is the opinion of the Department that the grant by an IRA owner to the Broker of a security interest in his non-IRA accounts in order to cover indebtedness of, or arising from, his IRA, as you describe, would be a prohibited transaction under Code section 4975(c)(1)(B).

In addition to holding that the proposed transaction constituted a prohibited transaction as an extension of credit by the IRA to the IRA's owner, the Department of Labor also found that such a security interest also constituted an improper use of the assets of the IRA by the IRA owner and an improper use by the IRA owner of IRA assets in his capacity as a “fiduciary”. The lesson from all of this is that anyone who has a self-directed IRA must exercise extreme caution not to breach fiduciary duties or engage in improper acts with regard to the IRA.