

# Legal Issues Involving Self-Directed IRAs

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# Topics of Discussion

- Self-dealing issues
- How to have “checkbook control” over an IRA through use of an LLC

Other legal risks

# Self-Dealing Rules – IRC 4975

- An IRA owner cannot use his/her IRA to engage in certain “prohibited transactions” without incurring severe taxes, interest and penalties
- A “prohibited transaction” is a transaction involving a “disqualified person”
- “Disqualified persons” include an IRA owner’s spouse, lineal descendants

# Prohibited Transactions

- Sale or exchange, or leasing, of any property between a plan and a disqualified person
- Lending of money or other extension of credit between a plan and a disqualified person
- Furnishing of goods, services or facilities between a plan and a disqualified person
- Transfer to, or use by or for the benefit of a disqualified person of the income or assets of a plan
- Act by a disqualified person who is a fiduciary whereby he deals with the income or assets of a plan in his own interest or for his own account; or
- Receipt of any consideration for his own personal account by any disqualified person who is a fiduciary from any party dealing with the plan in connection with a transaction involving the income or assets of the plan.

# Disqualified Persons

- (A) a fiduciary;
- (B) a person providing services to the plan;
- (C) an employer any of whose employees are covered by the plan;
- (D) an employee organization any of whose members are covered by the plan;
- (E) an owner, direct or indirect, of 50 percent or more of—
  - (i) the combined voting power of all classes of stock entitled to vote or the total value of shares of all classes of stock of a corporation,
  - (ii) the capital interest or the profits interest of a partnership, or
  - (iii) the beneficial interest of a trust or unincorporated enterprise,
- which is an employer or an employee organization described in subparagraph (C) or (D);
- (F) a member of the family (as defined in paragraph (6)) of any individual described in subparagraph (A), (B), (C), or (E);
- (G) a corporation, partnership, or trust or estate of which (or in which) 50 percent or more of—
  - (i) the combined voting power of all classes of stock entitled to vote or the total value of shares of all classes of stock of such corporation,
  - (ii) the capital interest or profits interest of such partnership, or
  - (iii) the beneficial interest of such trust or estate,
- is owned directly or indirectly, or held by persons described in subparagraph (A), (B), (C), (D), or (E);
- (H) an officer, director (or an individual having powers or responsibilities similar to those of officers or directors), a 10 percent or more shareholder, or a highly compensated employee (earning 10 percent or more of the yearly wages of an employer) of a person described in subparagraph (C), (D), (E), or (G); or
- (I) a 10 percent or more (in capital or profits) partner or joint venturer of a person described in subparagraph (C), (D), (E), or (G).

# Checkbook Control

- *Swanson v. Commissioner*
- Court decision in favor of a taxpayer who served as President/director of a corporation which issued stock to taxpayer's IRA
- Court held for taxpayer
- Decision has been relied upon for the precedent of an IRA owner serving as officer/director of an entity owned by his/her IRA

# Checkbook Control with LLCs

- The ideal entity for real estate investment = limited liability company (LLC)
- IRA owns the LLC
- IRA owner serves as manager/governor of the LLC

# Checkbook Control with LLCs

- An LLC provides a liability shield over a member's assets
- Single-member LLCs are "disregarded" for Federal income tax purposes; no separate tax filing required



# Checkbook Control with LLCs: Required Documents

- Articles of Organization (filed with the Secretary of State)
- Bylaws (aka Operating Agreement)
- Contribution Agreement (signed by the administrator on behalf of the IRA)
- Written Actions of the Board of Governors
- IRS Form SS-4, Application for Tax Identification Number

# Other Risks – Unrelated Business Income Tax (UBIT)

- Income derived from sources unrelated to the primary function of the IRA account may be subject to significant tax
- Exceptions exist
- BUT: certain rental income is still subject to UBIT
- Moral of the story: consult with a tax advisor



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# Questions?

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