IRALERT

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TO: IRA Group Distribution

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RE: IRA Alert on PLR

The creativity of IRA investors seems to know no bounds. In a recent private letter ruling, the Internal Revenue Service allowed the investment of IRA assets in the form of a loan to a church secured by the assignment of an insurance policy on the life of the IRA holder (PLR 200741016 (October 12, 2007)).

Under the letter ruling, the taxpayer established a self-directed IRA and proposed to lend money from his IRA to a church. In exchange for the loan, the church would enter into a 20-year promissory note with the IRA and make annual interest payments and a final balloon payment of principal to the order of the IRA custodian. To further guarantee repayment of the loan the church would purchase and assign to the custodian an interest in an insurance policy on the life of the taxpayer as collateral.

The taxpayer requested two rulings with respect to the proposed transaction. First, the taxpayer requested the IRS rule that the proposed loan transaction is not a prohibited transaction such that the IRA would cease to be an IRA under the Code. Pursuant to the prohibited transaction rules, an IRA holder may not lend money to disqualified persons. Under section 4975(e)(2) of the Code disqualified persons include, among others, plan fiduciaries, those providing services to the plan such as trustees and custodians as well as the IRA holder's family members and spouse.

The IRS determined that the church was not related to the IRA in a way that would come within the definition of a disqualified person. In addition, the taxpayer would not control, own or have a financial interest in the church, nor would the taxpayer be a board member of the church. Under these facts, the church would not be a disqualified person under the prohibited transaction rules. Accordingly, the IRS ruled that the loan transaction would not be a prohibited transaction within the meaning of the Code.

Second, the taxpayer requested the IRS rule that the assignment of the life insurance policy as collateral would not be a prohibited investment in insurance. Under the regulations, no part of an IRA trust may be invested in life insurance contracts (Treas. Reg. § 1.408-2(b)(3)). In addition, the IRA may not have any incidents of ownership in the policy (Treas. Reg. § 20.2042-1(c)). Incidents of ownership include, among other things, the power to change the beneficiary, to surrender, cancel or assign the policy or pledge the policy for a loan.

Under the letter ruling, the church would purchase the life insurance policy, pay the premiums and have all rights of ownership and control over the terms of the policy. In the event the taxpayer dies, the IRS noted that only the promissory note would be repaid to the IRA. As such, the IRA would have no incidents of ownership in the policy. Accordingly, the IRS ruled that the assignment of the life insurance policy as collateral would not be a prohibited investment of insurance.

On the law, the ruling appears to be correct. It is important to note, though, that the ruling was based on very specific facts. If the loan were not bona fide, the taxpayer had a different relationship to the church, or the assignment of the policy had different terms, it is easy to imagine a different result.

Please feel free to direct questions to any of the Groom principals listed above or to IRA@groom.com.