

IRAlert

February 7, 2007

TO: IRA Group Distribution

FROM: Groom Law Group

RE: DOL Advisory Opinion on IRA Investments in Family Businesses

Recently, the Department of Labor (“DOL”) issued an advisory opinion concluding that an IRA accountholder engaged in a prohibited transaction under section 4975 of the Internal Revenue Code of 1986, as amended (the “Code”), when he directed his IRA to invest in notes of a corporation whose majority shareholders were members of his family. Advisory Opinion 2006-09A (Dec. 19, 2006).

This new opinion is consistent with advice that Groom Law Group previously has given to our clients. It is perhaps more interesting for what it fails to address, *i.e.*, what is the proper penalty for engaging in the prohibited transaction – a 15% excise tax or disqualification of the IRA? Section 408(e)(2) of the Code provides for disqualification where an accountholder engages in a prohibited transaction with his or her IRA. It is not clear whether DOL was not asked to address this question, or thought that the answer was more properly within the jurisdiction of the Internal Revenue Service (“IRS”) pursuant to Reorganization Plan No. 4 of 1978.

On similar facts, roughly two years ago Groom Law Group was instrumental in obtaining a closing agreement with the IRS that limited the penalty to excise taxes. In our situation, the accountholder directed the investment of approximately 10% of his IRA in shares of family-owned corporation. We convinced the IRS not to impose disqualification on the account, but to permit the corporation to repurchase the shares at current fair market value, subject to paying the 15% excise tax. The IRS appears to have agreed with our position that the accountholder did not personally “engage” in any transaction with the IRA – the sole transaction was between the IRA itself and the corporation as the disqualified person which issued the shares.

We believe that this was the correct result. Considering how long IRAs have been in existence, it is curious that there is no clear authority on this issue. This is precisely the kind of guidance that we expect our new IRA industry group to pursue. First, we think that a group of this nature will have substantially more credibility with the IRS than any individual organization. Second, we believe that we are better situated to present clear and persuasive arguments for the “right” position before the IRS makes bad law on the basis of a bad fact pattern.