

Growing the Dream Through Self-Directed IRAs: A Design Discussion

Presentation for:

Employee Benefits Academy Webinar Series
September 23, 2021

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Tony’s multi-disciplinary legal practice focuses on executive compensation, ESOPs and employee benefit arrangements (including their related tax, accounting, securities and corporate governance issues) in the United States and abroad.

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Purpose of Presentation

- The purpose of this presentation is to discuss how self-directed Individual Retirement Accounts (“IRAs”) can be used for purposes of investing in unique assets

Typical Analysis of Prohibited Transaction with IRAs

- Generally, a participant or beneficiary is not deemed to be a fiduciary simply because the individual exercises control over the assets in his or her account (i.e., participant-directed accounts); however, participant-directed accounts are not exempt from the prohibited transaction rules
- A prohibited transaction is typically is a transaction between a “disqualified person” and a “plan,” either: (i) the use of plan assets by a disqualified person, or (ii) self-dealing by a fiduciary
 - For purposes of applying the prohibited transaction rules, the term “plan” includes an IRA. See Section 4975(e)(1)(B) of the Code
 - Though Section 4975 is contained in the Code, the DOL has the authority to issue interpretations and the Secretary of the Treasury is bound by such interpretations. See Presidential Reorganization Plan No. 4 of 1978 (effective December 31, 1978)
 - However, a determination by the DOL that no prohibited transaction occurred does not bar possible liability from the IRS
- A typical prohibited transaction analysis flows as follows:
 - Is the IRA owner a “fiduciary”
 - Is the recipient of the investment a “disqualified person”
 - Does an exemption apply
 - Did the fiduciary personally use the assets of the IRA or did he/she self-deal

Is the IRA Owner Is a Fiduciary

- For purposes of the prohibited transaction analysis, the IRA owner would generally be considered to be a fiduciary if the IRA owner maintains or exercises the right to direct the assets of the IRA (i.e., a self-directed IRA)
 - A “fiduciary” is defined to include any person who exercises any discretionary authority or discretionary control respecting management of the IRA, or exercises any authority or control respecting management or disposition of its assets
 - Case law supports that an IRA owner is a fiduciary of a self-directed IRA because he/she had control over the investment of the IRA
 - DOL opinions support that individuals controlling the investment of their IRAs are fiduciaries for purposes of analyzing the prohibited transaction rules

Is There a Disqualified Person

- A prohibited transaction cannot occur unless there is a “transaction” between a “disqualified person” and a “plan”
- Types of transactions include:
 - Sale or exchange (or leasing) of property between a plan and a disqualified person;
 - Lending of money or extending credit between a plan and a disqualified person;
 - Furnishing of good, or services or facilities between a plan and a disqualified person;
 - Transfer to (or use by of for benefit of) a disqualified person of any assets or income of a plan;
 - A fiduciary dealing with the assets or income of a plan in the fiduciary’s own interest (other than as an IRA owner);
- A disqualified person includes a fiduciary of the plan
 - Though the IRA owner is a disqualified person by virtue of his or her status as a fiduciary, if the IRA owner is not a party to the transaction, then (after applying attribution rules) there might be no disqualified person in the transaction
- A disqualified person also includes a corporation, partnership or trust of which 50% of the entity’s voting stock or value is owned by a fiduciary
 - Thus, if the fiduciary’s ownership of the entity is less than 50%, then the entity would not be a disqualified individual unless his/her ownership in the entity affected his/her judgment to direct the investment

Did the Fiduciary Self-Deal

- But self-dealing provisions (last bullet prior slide) should also be analyzed to determine whether a prohibited transaction has occurred or could occur
 - Under the Code, self-dealing is a prohibited transaction and involves a disqualified person who is a fiduciary
 - A transaction is a prohibited transaction if the fiduciary deals with the income or assets of the plan in his or her own interest, or if the fiduciary receives consideration from a party dealing with the plan in connection with the transaction
 - The determination of whether self-dealing occurs is generally subjective, and depends upon the facts and circumstances
 - The key to whether self-dealing occurs is whether the fiduciary exercises the authority or control that makes that person a fiduciary in a manner that benefits the fiduciary (or a person in whom the fiduciary has an interest) or causes the fiduciary to receive consideration from a third party
 - Example: A transaction between the IRA and a company that is related to the fiduciary
 - The question to ask is whether the IRA's ownership in an entity directly or indirectly benefitted the IRA owner other than in his or her capacity as the account owner of the plan. See DOL Op. 2000-10A and 89-03A
 - In looking at self-dealing, a question to ask in factual scenarios where the IRA owner is also personally investing: Did the IRA owner have the personal means to effectuate the investment on his or her own, or did he or she need to IRA's investment in order to invest personally
 - Example: Minimum investment of \$100,000. IRA owner has only \$25,000 personally, and needs the \$75,000 investment from the IRA to satisfy the minimum investment threshold

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- Title:
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- When:
 - 10:00 am to 11:00 am Central
 - October 28, 2021