

For Other Informative Briefs go to www.TFSBRIEFS.com

WHO IS A DISQUALIFIED PERSON?

In addition to explaining what you can purchase in an IRA, Section 4975 explains who your IRA cannot do "business" with. The IRS refers to these individuals as Disqualified Persons.

THESE SPECIFIC INDIVIDUALS HAVE BEEN IDENTIFIED AS DISQUALIFIED PERSONS—IRC Section 4975(e)(5) Member of the Family

For the purposes of paragraph (2) (F), the family of any individual shall include his spouse, ancestor, lineal descendant and any spouse of a lineal descendant.

This means including yourself and your spouse, these individual are disqualified persons.

- Grandparents
- Parents
- Children
- Grandchildren

Other Disqualified Person identified in 4975 include:

- A Corporation, partnership, trust or estate that you own more than 50% of shares or interest.
- An officer, director, a 10% or more shareholder or a highly compensated employee
- A Fiduciary defined as any person who exercises authority or discretionary control, including the account holder
- 10% or more Joint Venturer

NOTE: Disqualified Persons can include indirect contacts. For Example, your IRA can not do business on a transaction on which your son would receive a commission. He is considered a Disqualified Person.

Prohibited Transactions inside an IRA

All transactions inside a retirement account share the same set of rules. These rules are outlined in Internal Revenue Code (IRC) Section 4975. All retirement accounts are defined as Trusts set up to benefit the owner when they retire. Breaking the Trust Rules is called a Prohibited Transaction. An easy definition of a Prohibited Transaction is the improper use of your IRA assets by certain disqualified persons as identified in the column to the left.

Typically a prohibited transaction occurs when you do one of three transactions with your IRA account; buy, sell or lease to a disqualified person with an existing IRA asset. For example, since you personally are disqualified, you cannot sell a personal investment to your IRA.

Other Examples of Prohibited Transactions include:

1. Borrowing money from your plan
2. Compensating yourself for management of your IRA
3. Using your IRA as security on a loan
4. Buying property for personal use
5. Renting to family members

PLANNING NOTE: Prohibited Transactions refer to existing IRAs or IRA assets. If your IRA wants to purchase a percentage of a new asset (one you have not owned) with yourself and a partner—this is allowed. The IRA can

usually partner with anyone on a new asset. For example real estate can be purchased as tenants in common interest with you and your IRA account.

WHAT ASSETS CAN I NOT INVEST IN?

The IRS does not tell you what you can invest in but rather what you cannot. The rules as defined by the Secretary of the Treasury state the following assets cannot be purchased.

- Life Insurance
- Artwork/Rugs/Antiques
- Metals/Gems/Stamps/Coins
- Alcoholic Beverages

Please know that you can purchase certain precious metals with your IRA based on the value of the metal, for example American Eagle Coins are allowed but coins with an intrinsic value like collector coins are prohibited.

WHAT HAPPENS IF YOU HAVE A PROHIBITED TRANSACTION?

Usually, the IRA assets involved in a prohibited transaction are treated as though they were distributed on the first day of the year in which the transaction occurred. This will mean that the assets will be reported on a 1099R to the IRA owner income. If the IRA owner is under age 59½, early-distribution penalties will apply. For prohibited transactions involving pledging the IRA balance as security on a loan, the amount pledged is considered disqualified and treated as a distribution. Please consult your tax advisor before any financial transaction.

Examples of Prohibited Transactions

1. Bob buys a rental condo with his IRA in Florida. His mother moves down and he would like to have her rent the condo from the IRA. **Result—PROHIBITED**
2. Bob is contemplating buying a beautiful beach house on Sanibel Island in his IRA. It has great cash flow and the price is low now. Bob would like to come down once a year to check out his investment and stay in the beach house. **Result—PROHIBITED**
3. Bob would like to purchase stock shares in TD Global, Inc.. TD Global is NOT publicly traded. Bob's son is the President of TD Global, Inc. **Result—PROHIBITED**
4. Sally would like to lend money to her 2nd cousin to purchase a rental house? **Result—ALLOWED** Now Sally's mother moves to the area and they would like her to move in the house **Result—PROHIBITED**
5. Bob's IRA would like to lend Sally \$25,000 to purchase a house. Bob and Sally get married after the loan. After the wedding they move in to Bob's house. **Result—ALLOWED**