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The Bridge to Your Financial Future

May 6, 2006

Steven R. Sheppherd
Check Book IRA, LLC
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Prineville, OR 97754
Toll Free 800.783.6409 Fax 866.302.5992

Dear Mr. Sheppherd:

You have asked for a legal opinion concerning the following:

ISSUES:

May an LLC that is 100% or 95% owned by an IRA buy gold and the manager, who is the beneficiary of the IRA, physically take possession of the gold for storage purposes. What gold is allowed to be owned by an IRA and would those items be allowed to be owned and held by an IRA-LLC that's managed by the owner of the IRA?

SHORT ANSWER:

1. Can the Manager of the LLC – beneficiary of the IRA- physically take possession of gold for storage purposes?

ANSWER: I contacted Gary Lefkowitz of the Dept. of Labor (202) 693-8546 as a prelude to answering your question. Gary confirms that the LLC Manager may keep gold in a safe for and on behalf of the LLC as long as there is no “self-dealing” (personal gain by the transaction). See Prohibited Transactions (D) and (E). See also discussion below.

2. What gold is allowed to be owned by an IRA and would those items be allowed to be owned and held by an IRA-LLC that's managed by the owner of the IRA?

ANSWER: Generally any asset of the LLC to which a retirement plan is involved is acceptable. However, where more than 25% of the LLC is owned by one or more IRAs, the assets of the LLC may be considered assets of the “plan(s)” and the LLC must conform to the rules for IRAs. Here are the rules of which your clients should be aware.

LAW:

Prohibited Transactions

IRC § 4975(c)(1) states that a “prohibited transaction” includes any “direct or indirect”:

- (A) sale or exchange, or leasing, of any property between a plan and a disqualified person;
- (B) lending of money or other extension of credit between a plan and a disqualified person;
- (C) furnishing of goods, services, or facilities between a plan and a disqualified person;
- (D) transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a plan;
- (E) 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
- (F) 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:

Disqualified Person includes a “member of the family” as that term is defined in IRC 4975(e)(6). The family of an individual, or fiduciary, “**shall include his spouse, ancestor, lineal descendant, and any spouse of a lineal descendant.**” *Id.* Note that the definition does not include brothers, sisters, aunts, uncles or other non-lineal descendants. Again, the interaction between the plan and ANY disqualified person must be reviewed on a case-by-case basis.

EXEMPTIONS:

Since 1978 the Secretary of the Department of Labor has had the authority to issue interpretations regarding prohibited transactions and the IRS is bound by those interpretations. Since receiving this authority, the Department of Labor has issued hundreds of exemptions.

The Employee Retirement Income Security Act of 1974 (ERISA) prohibits certain classes of transactions between employee benefit plans and certain persons defined as "parties in interest". The law does, however, contain a number of statutory exemptions from the prohibited transaction rules.

The ERISA law contains several specific exemptions whereby plans may engage in transactions otherwise prohibited by law. In order to use these statutory exemptions, parties must meet the conditions of the applicable exemption.

ERISA generally provides statutory exemptions for, among other things, loans to participants, the provision of services necessary for the operation of a plan for no more than reasonable compensation, loans to employee stock ownership plans, and deposits in certain financial institutions regulated by other State or federal agencies.

Under ERISA, the Department may grant administrative exemptions to an individual or a class of individuals allowing them to engage in a variety of transactions involving employee benefit plans.

PLAN ASSET RULE:

Investment of IRA funds into a business entity is clearly permitted.¹ However, the assets of the LLC are assets of the IRA where the plan owns 100% of the LLC.² This is significant because where the LLC assets are considered "plan assets" any transaction between the LLC and a disqualified person is potentially subject to the prohibited transactions Code.³ This could arise in transactions such as loans between the IRA/LLC and the plan owner, employee or management payments to the plan owner or a lineal descendant, etc.

However, the assets of an LLC are not necessarily considered "plan assets."⁴ Under the plan asset rule:

...when a plan invests in a non-publicly traded entity, the assets of the plan include BOTH the equity interest and an undivided interest in each of the underlying assets of the entity, unless:

(1) The entity is an operating company, or

(2) Equity participation in the entity by benefit plan investors is not significant."⁵

Under the Code, when a plan owns less than 25% of an entity, equity participation is not "significant" so the assets of the entity are not assets of the plan.⁶ The issue then, is whether entity assets are considered "assets of the plan" when 25% to less than 100% of the entity is owned by the plan. This is what we refer to as the "gray area" and can only be definitively answered based upon the facts of each case.

Your question concerns when the assets of the LLC are in fact considered "plan assets" are there exceptions in the code for the plan (e.g. the LLC) to hold gold and coins?

PROHIBITED IRA INVESTMENTS:

The IRS does not "approve" assets in retirement plans but they do indicate which assets won't be allowed. Collectibles such as artworks, rugs, stamps, certain coins, beverages and antiques, etc. are not allowed within your IRA as the self-directed asset. A partnership or company that owns, sells, or buys these items *could be* a named asset within an IRA.

The IRC is specific as to what defines a collectible. Some notable exceptions are allowed for IRAs—in particular, certain gold (such as American Eagle) and silver coins and any coins issued by a state. Legislation in 1997 further liberalized the rules for IRAs by making reference to specific definitions of acceptable coins in USCS, title 31; IRC sections 5112(a), (e) and (k); the Commodity Exchange Act; and IRC section 408(m)(3). This change may result in a bonanza for individual collectors as well as coin and precious metal dealers (all of the coins allowed must be minted by the U.S. government or the states).

26 U.S.C. 408(m)

(3) Exception for certain coins and bullion

For purposes of this subsection, the term "collectible" shall not include—

(A) any coin which is—

(i) a gold coin described in paragraph (7), (8), (9), or (10) of section 5112 (a) of title 31, United States Code,

(ii) a silver coin described in section 5112 (e) of title 31, United States Code,

(iii) a platinum coin described in section 5112 (k) of title 31, United States Code, or

(iv) a coin issued under the laws of any State, or

(B) any gold, silver, platinum, or palladium bullion of a fineness equal to or exceeding the minimum fineness that a contract market (as described in section 7 of the Commodity Exchange Act, 7 U.S.C. 7) requires for metals which may be delivered in satisfaction of a regulated futures contract,

if such bullion is in the physical possession of a trustee described under subsection (a) of this section.

Subsection (a) states:

(a) Individual retirement account

For purposes of this section, the term “individual retirement account” means a trust created or organized in the United States for the exclusive benefit of an individual or his beneficiaries, but only if the written governing instrument creating the trust meets the following requirements:

- (1) Except in the case of a rollover contribution described in subsection (d)(3) in ^[1] section 402 (c), 403 (a)(4), 403 (b)(8), or 457 (e)(16) ^[2] no contribution will be accepted unless it is in cash, and contributions will not be accepted for the taxable year on behalf of any individual in excess of the amount in effect for such taxable year under section 219 (b)(1)(A).
- (2) The trustee is a bank (as defined in subsection (n)) **or such other person who demonstrates to the satisfaction of the Secretary that the manner in which such other person will administer the trust will be consistent with the requirements of this section.**
- (3) No part of the trust funds will be invested in life insurance contracts.
- (4) The interest of an individual in the balance in his account is nonforfeitable.
- (5) The assets of the trust will not be commingled with other property except in a common trust fund or common investment fund.
- (6) Under regulations prescribed by the Secretary, rules similar to the rules of section 401 (a)(9) and the incidental death benefit requirements of section 401 (a) shall apply to the distribution of the entire interest of an individual for whose benefit the trust is maintained.

31 U.S.C. § 5112 refers to Denominations, specifications and design of coins.

(a) The Secretary of the Treasury may mint and issue only the following coins:

- (1) a dollar coin that is 1.043 inches in diameter.
- (2) a half dollar coin that is 1.205 inches in diameter and weighs 11.34 grams.
- (3) a quarter dollar coin that is 0.955 inch in diameter and weighs 5.67 grams.
- (4) a dime coin that is 0.705 inch in diameter and weighs 2.268 grams.
- (5) a 5-cent coin that is 0.835 inch in diameter and weighs 5 grams.
- (6) except as provided under subsection (c) of this section, a one-cent coin that is 0.75 inch in diameter and weighs 3.11 grams.
- (7) A fifty dollar gold coin that is 32.7 millimeters in diameter, weighs 33.931 grams, and contains one troy ounce of fine gold.
- (8) A twenty-five dollar gold coin that is 27.0 millimeters in diameter, weighs 16.966 grams, and contains one-half troy ounce of fine gold.
- (9) A ten dollar gold coin that is 22.0 millimeters in diameter, weighs 8.483 grams, and contains one-fourth troy ounce of fine gold.
- (10) A five dollar gold coin that is 16.5 millimeters in diameter, weighs 3.393 grams, and contains one-tenth troy ounce of fine gold.

(e) Notwithstanding any other provision of law, the Secretary shall mint and issue, in quantities sufficient to meet public demand, coins which—

(1) are 40.6 millimeters in diameter and weigh 31.103 grams;

(2) contain .999 fine silver;

(3) have a design—

(A) symbolic of Liberty on the obverse side; and

(B) of an eagle on the reverse side;

(k) The Secretary may mint and issue platinum bullion coins and proof platinum coins in accordance with such specifications, designs, varieties, quantities, denominations, and inscriptions as the Secretary, in the Secretary's discretion, may prescribe from time to time.

DISCUSSION:

I did speak with the Dept. of Labor concerning an LLC's purchase of gold. My contact stated that an LLC could purchase "anything" as an investment. However, where one or more IRA accounts are involved in an LLC, there will be a "look through" to ensure that the transaction is acceptable under the plan asset rule.

Thus, if one or more IRAs own an LLC 100%, the assets of the LLC are considered "plan assets" and the rules for prohibited transactions for the IRAs also apply to the LLC.

Alternatively, if one or more IRAs own an LLC 25% or less, the plan asset rule does not apply and the LLC assets are assets of the LLC, NOT the plan or plans. Thus, any investment of the LLC is lawful.

The "gray area" is where one or more IRAs own between 26% and 99% of the LLC. In these cases the law is unclear so it is advisable to assume that the transaction MAY be prohibited, if the IRS investigates a potential prohibited transaction and finds that the assets of the LLC are assets of the plan.

Conclusion:

If your clients wish to purchase gold through an LLC, it may be kept in a safe by the manager of the LLC as long as the rules are followed. Annually, the manager will provide the self-directed IRA Custodian with the account value based upon the going rate for the gold or coins.

If your clients wish to purchase collectables other than those mentioned above, the LLC should be owned by plans that own less than 25% of the LLC.

If your clients wish to purchase the exempted coins through the LLC, there is no problem regardless of the ownership amount of the plans.

I hope this clarifies your inquiry.

Very Truly Yours,

A handwritten signature in black ink, consisting of a stylized, cursive 'D' followed by a horizontal line extending to the right.

Debra C. Buchanan
Attorney at Law

END NOTES:

¹ 29 CFR 2509.75-2

² 29 CFR 2510.3-101 (h) (3) See Also 29 CFR 2510.3-101(a)(2).

³ Department of Labor Opinion Letter 90-23. See Also H.R. Rep 93-1280, 93rd Cong., 2d Session, 308 (1974) and 26 USC § 4975(c)(1)(B).

⁴ 29 CFR 2509.75-2(a).

⁵ 29 CFR 2510.3-101(a)(2).

⁶ 29 CFR 2510.3-101(f).