Prohibited Transactions

What is a prohibited transaction?

A prohibited transaction is an improper transaction between an IRA and a Disqualified Person/Party. A ***transaction*** is defined as:

- A purchase/sale
- A lease/rental
- Lending of money/extension of credit
- Repairing/furnishing of goods and/or services
- Agreement/payment from any of the above

A ***Disqualified Person or Party (DQP)*** is defined as:

- An IRA owner
- Lineal ascendants and descendants
- Spouses of the above
- Fiduciary of the IRA
    - Includes persons like LPOA, IPD, financial advisors
- Company/business majority ownership
    - Where any of the above disqualified person(s), total more than 50% ownership
- Key person(s) of the above disqualified company/business
    - Officer, Director, or 10% or more shareholder
    - Highly compensated employee (earns 10%+ of the company's wages)

Types of Prohibited Transactions

Per Se Transaction – Funds are exchanged.

- Occurs when an IRA engages in a transaction with a DQP
- Involves all three components: IRA, DQP, and a transaction

Self-Dealing ("Conflict of Interest") – No funds are exchanged, but goods and/or services are performed or received involving a DQP without the exchange of funds.

- Occurs when a DQP benefits personally from the IRA or vice versa
- Can easily arise when the IRA invests into a Company the IRA owner runs or manages
- Difficult to determine and are based on the investment facts and circumstances

Extension of Credit

- IRA can use debt to leverage an investment, but the debt cannot be un-secured
    - IRA owner cannot use the IRA as collateral and vice versa
- The loan must be ***non-recourse*** (type of loan secured by collateral, which is typically property. If the borrower defaults, the lender can seize the collateral but cannot seek out the borrower for any further compensation, even if

the collateral does not cover the full value of the defaulted amount.)
    - No liability or personal guarantee to the IRA, owner, or their spouse
    - Lender cannot be a DQP
- IRA cannot guarantee or obtain a ***Margin Trading Account*** (a brokerage account in which the broker lends funds to the investor as a line of credit. The collateral for the loan is normally securities and/or cash in the investor's account.)
    - Because the owner would have to personally agree to be liable

Correcting a Prohibited Transaction

A prohibited transaction must be corrected within the tax year of occurrence. If it is outside the tax year, the IRS allows a correction within 90 days after the IRA mails a notice of deficiency.

Statue of Limitations

3 years

- IRS can perform an audit up to the previous 3 years
- If the PT is disclosed within the tax return filed by the IRA

6 years

- With Supervisor's approval
- When there is clear evidence of tax fraud or evasion

Unlimited

- If there has been no disclosure, the statute of limitations is indefinite

Consequences of Prohibited Transactions

Consequences only apply to the IRA that the prohibited transaction occurs in; it does not apply to other IRA accounts that the owner holds.

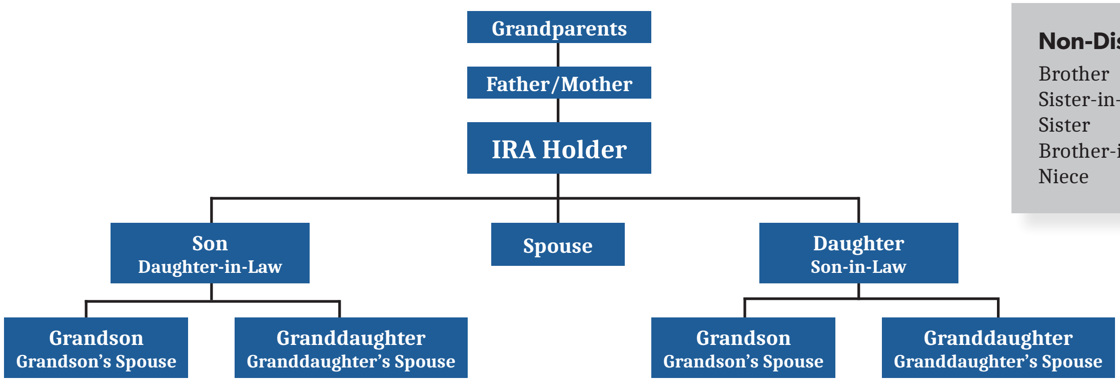
When a prohibited transaction occurs that does not involve the IRA owner, an excise tax of 15% on the amount involved is charged to the DQP, with the potential of an additional 100% penalty, if not corrected.

When the IRA owner enages in a prohibited transaction, the penalty is full distribution of the entire account, based on the FMV as of Jan. 1 of the year the prohibited transaction occured. The distribution is subject to any applicable taxes or penalty from the distribution, including an early withdrawal penalty. In addition, preferred tax treatment is revoked.

If the Roth IRA is not equal to the qualified distribution, contributions and conversions are not subject to tax, however, income and gains will be subject to tax.

The IRS may assess an accuracy related penalty of 20% on substantial underreporting of taxes (applies to negligence, disregard of filing, and non-payment of taxes).

Disqualified Persons (DQPs)



Non-Disqualified Persons:

Brother	Nephew
Sister-in-law	Aunt
Sister	Uncle
Brother-in-law	Cousin
Niece	