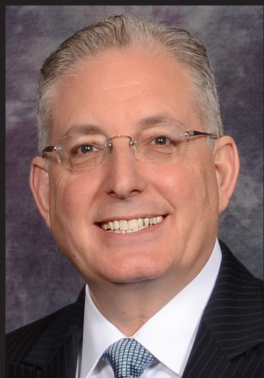

ED SLOTT'S IRA ADVISOR

October 2012

TAX & ESTATE PLANNING FOR YOUR RETIREMENT SAVINGS

Deadline to Recharacterize 2011 Roth Conversions is Near - October 15, 2012

October 15, 2012 marks the last day on which clients with 2011 Roth IRA conversions can reverse the conversion and get back any taxes paid as a result. The more formal name for this transaction is a Roth recharacterization, but for most clients, it's simply the way they were promised that they could undo their Roth IRA conversion, and the resulting tax consequences.

The Roth recharacterization deadline is nothing new, but like a modern remake of a classic film, this latest version has the same overall message, with a slightly different twist. Helping clients and prospects to understand the subtle wrinkles that make this year's Roth recharacterization deadline unique can help advisors solidify themselves as experts who maintain a solid handle on the ever-changing economy, stock market and tax laws.

What's Different About 2011 Roth Recharacterizations?

So what's different about this year's recharacterization deadline? Well, one big factor in determining whether or not clients should keep their Roth conversions intact or recharacterize is the performance of their investments within the Roth IRA after conversion. If the value of the Roth IRA conversion has declined substantially, it often makes sense to recharacterize the conversion to recoup the tax paid on value that no longer exists, perhaps with an eye on reconverting in the future. Partial recharacterizations can also be done.

This year, for the first time since the floodgates opened on Roth conversions in 2010 (when the Roth conversion restrictions were permanently repealed), the majority of Roth IRAs being evaluated for recharacterization *should* be up in value.

Since the start of 2011 through the first two-thirds of 2012 (the end of August), the S&P 500 index is up roughly 12%. In contrast the S&P 500 was down roughly 6.5% from January 2010 through the end of August 2011 (and was still down about 2.5% on the October 15, 2011 recharacterization deadline for 2010 conversions). For the most part, the market has cooperated

WHAT'S INSIDE?

since 2011, so fewer recharacterizations will be made as a result of lost value. That's good news for clients who see the potential long-term benefits of the Roth IRA and good news for advisors, who may be able to cut-down on paperwork as opposed to this time a year ago.

Another potentially unique aspect of this year's Roth recharacterization deadline is that the favorable "low" federal income tax rates clients have enjoyed for 10 years may soon be coming to an end. As it stands now, income tax rates are set to increase in 2013, with the top rate going from the current 35% up to 39.6%. Add in the 3.8% surtax on net investment income also slated to kick in at the start of 2013 and high-income clients could pay as much as 43.4% in federal income tax on their net investment income.

Recharacterization and Reconversion

A recharacterization could make sense for clients for any number of reasons, but they should still be mindful such a transaction might ultimately lead to a greater tax burden in the future.

Key Point: If a recharacterization of a 2011 Roth conversion makes sense now, but the Roth IRA is still desired long-term, clients can still lock in the current low tax rates. Any 2011 Roth conversion recharacterized by the October 15, 2012 deadline can later be reconverted back to a Roth IRA in 2012, guaranteeing that the tax on the conversion will result in no more than a 35% federal income tax hit.

If a recharacterization of a 2011 Roth conversion makes sense, clients can still lock in the current low tax rates.

Don't reconvert right away though! A 2011 conversion recharacterized in 2012 can only be reconverted back to a Roth IRA after 30 days have passed since the recharacterization.

There's no need to wait until the last minute to act if this strategy makes sense but technically, as long as the funds are *distributed* from the traditional IRA in 2012, it will be considered a 2012 conversion, even if the funds don't get into the Roth IRA until 2013. The usual 60-day window applies for rollovers from an IRA to a Roth IRA.

You might be thinking to yourself, "What's the big deal? Congress might extend the current income tax rates later this year." That's true and it may very well happen, but the opposite is also true. Congress may bicker and argue so much that nothing gets done at all, in which case higher rates are on the way. So why not reconvert to a Roth IRA this year and be safe? After all, what's the worst that happens, right? The worst case scenario is that you decide to recharacterize again next year.

While there are a variety of reasons for clients to consider forgoing a recharacterization, there are also a number of reasons a recharacterization might make perfectly good sense. Maybe they had an unexpected year of high-income in 2011 pushing them into a higher-than-expected tax bracket. Maybe they ran into some hard times and could not come up with the money to pay the tax on the conversion. Or… gasp… perhaps they had Roth investments that went down in an up market.

Another reason some people may want to recharacterize is because they may have forgotten about the 2010 Roth conversion they did. If they took the 2-year deal, as most did, their 2011 tax return may include more income than they counted on and now they cannot pay the tax on both the first half of the 2010 conversion and the 2011 conversion they did. They cannot undo the 2010 conversion. Even though that income now appears on their 2011 tax return, the deadline to recharacterize a 2010 conversion was October 15, 2011. The 2011 converted funds though can still be recharacterized.

Recharacterizations May Produce Tax Refunds

Whatever the reasoning, if your client recharacterizes they should be sure to get any tax paid as a result of the conversion back. Contrary to some clients' beliefs, they are actually responsible for notifying IRS of the recharacterization. This is generally not a difficult process and, in most cases, takes little more than a note attached to the appropriate tax return.

If your client has already filed their 2011 tax return, they should contact their tax professional and have them file an amended return. Upon filing an amended return, your client will receive a refund of any overage paid, plus interest. That's not a bad deal when you realize the applicable interest rate through the first three quarters of 2012 has been an annualized 3%. That's even better than most 5-year CD rates these days!

While the Roth recharacterization deadline for 2011 Roth conversions is October 15, 2012, taxpayers generally have three years from the date they initially filed their return or two years from the time they paid the tax owed – whichever is longer - to file an amended tax return. Therefore, taxpayers who filed by the original due date typically have until April 17, 2015 to file an amended 2011 tax return, while those who filed their returns after first filing an extension could have longer. But let's think about this for a second… if your client is filing an amended return to receive a tax refund as a result of a Roth recharacterization, don't you think they'll want to file that return sooner rather than later. Don't forget to file an amended state tax return too for any refunds applicable there.

If, for whatever reason, your client had not yet filed a return, they must simply file their normal return by the October 15, 2012 deadline. They must attach a note detailing the date and amount converted and the date and amount recharacterized. In all likelihood, if proper guidance was given, even though these clients had not filed a return, they had made a payment by April 17, 2012 large enough to cover most or all of the tax owed on their 2011 return in order to avoid any underpayment penalties and/or interest. Filing the actual return now showing the proper less-than-previously-expected income will entitle the client to a refund of any overage.

Late Recharacterizations

The October 15, 2012 deadline to recharacterize a 2011 conversion is a firm deadline, but not an absolute one. Under the law, IRS has the authority to grant an extension to recharacterize when there are extenuating circumstances, such as advisor error. Getting such an exception is neither easy nor cheap.

IRS has been taking a tougher stance on granting extensions now that conversions no longer ***have*** to be recharacterized (since there are no conversion restrictions) and the IRS fee alone for such a ruling runs $4,000 – a “bargain” rate when you consider the typical IRA ruling runs $10,000. And remember, the IRS fee does not include professional fees, which could easily double the cost. Therefore, advisors and clients should do whatever necessary to make sure any recharacterizations of 2011 Roth conversions are *completed* far enough before the deadline to deal with any unforeseen delays.

The Right Way to Recharacterize

It should also be noted that while some of the discussions surrounding the October 15, 2012 deadline will be unique to the issues of the moment, much of the basics regarding recharacterizations remain unchanged. As such, advisors and their clients should make sure to follow the general Roth recharacterization rules, such as making sure the recharacterization is completed by the deadline, that the funds go back to an IRA (or inherited IRA) only and never to a plan, and that the funds are moved from the Roth IRA to the IRA in a trustee-to-trustee transfer.

If the recharacterization is not done correctly, clients can end up owing income tax and have no Roth IRA – or IRA for that matter. For example, if the funds are withdrawn from the Roth IRA and "rolled over" to a traditional IRA instead of being directly transferred back to a traditional IRA by the custodian(s), it is not a valid recharacterization. The tax on the initial conversion must still be paid, even though the funds are no longer Roth IRA funds. To make matters worse, depending on the situation, clients could get hit with the 6% excess contribution penalty and/or the 10% early distribution penalty. Be sure to recharacterize correctly and avoid these costly errors.■

October 31st Trust Deadline for Inherited IRAs

The October 15th deadline for Roth recharacterizations may get most of the headlines, but there’s another IRA deadline in October that, for some clients, is even more important. October 31, 2012 is the documentation deadline for trust beneficiaries, of IRA owners who died in 2011, to qualify as see-through trusts.

Any trust can be named as the beneficiary of an IRA, but what makes a see-through (a.k.a. look-through) trust so desirable is that it allows the trust to stretch distributions from an inherited IRA over the age of the oldest applicable trust beneficiary. In comparison, non see-through trusts are treated as non-designated beneficiaries and must withdraw inherited IRA funds in just five years or over the owner’s remaining life expectancy, had they lived, depending on whether death occurred before or after the owner’s required beginning date (RBD). Preserving the stretch over the oldest trust beneficiary’s life typically results in smaller inherited IRA distributions, keeping the tax bite lower and maximizing tax-deferred growth.

A see-through trust allows the trust to stretch distributions over the age of the oldest applicable trust beneficiary.

There are, obviously, some rules that need to be followed in order for trusts to be qualified see-through trusts. In fact, the IRS Regulations outline four such rules. Under the Regulations [Section 1.401(a)(9)-4, A-5 (b)], a see-through trust is one that is valid under state law, has identifiable beneficiaries and is irrevocable at death. The fourth rule is a record keeping requirement that simply states a copy of the trust (or, a list of the trust beneficiaries, including contingent and remainder beneficiaries and the conditions on their entitlement) must be provided to an IRA custodian (or plan administrator) by October 31st of the year following the year of an IRA owner’s death. Generally it’s best to provide a complete copy of the trust to make sure all the required trust documentation is provided.

This fourth requirement really could not get much easier, and yet, all too often failure to comply with this requirement is the only reason a trust fails to qualify as a see-through trust. Why? Well, for one thing, everyone thinks it’s someone else’s responsibility. The financial advisor thinks the CPA is following up on it, the CPA thinks the lawyer is taking care of everything and the lawyer thinks the financial advisor is handling it since the trust has to be given to the IRA custodian. The irony of the situation is that *technically*, it’s none of their responsibilities.

Truth be told, it’s the trustee of the trust’s responsibility to do this. However, that trustee is usually a family member, like the surviving spouse or a child, who is relying on the professionals around them to guide them appropriately. So while technically if the required documentation is not provided to the custodian in a timely manner it's the trustee's fault, advisors shouldn't be surprised to find some very, dissatisfied clients if the deadline is missed.

Another question that clients and advisors typically ask is "Can't I just give my custodian a copy of the trust now?" There's no formal guidance on this question and informally, positions seem to have varied over the years. But why this should even be a problem is beyond me. If your client dies on December 31, 2012, that still leaves ten full months to get a copy of the trust to the IRA custodian (January 1, 2012 – October 31, 2012). No doubt that many advisors have demanding schedules, but even the busiest of advisors can surely find five minutes at some point in those ten months to forward on a copy of the trust. This way, there are no questions whatsoever.

The most prudent of advisors will send the trust to the custodian via certified mail or through an alternate carrier that provides a tracking number. Or even better, confirmation can be requested directly from the custodian that such documentation has been received and is on file.

Make sure you identify every client who died in 2011 and named a trust as their IRA beneficiary and make sure the October 31st trust documentation deadline is not missed. This would be a costly oversight.■

Early Distribution due to Hurricane Ike is Not an Exception to the 10% Penalty

Carter v. Commissioner

T.C. Summ. Op. 2012-33, April 17, 2012

As Hurricane Isaac recently reminded us, Mother Nature can be a cruel and uncompassionate foe. In what seems like the blink of an eye, homes and lives can be irrevocably altered or destroyed. There's no question that some hurricanes are worse than others and cause more damage on a grand scale, but should the loss of any one man's home as a result of one hurricane be treated any differently than the loss of another man's home as a result of a different storm? Well, thanks to a Tax Court decision earlier this year, we know that in the eyes of the IRS and Tax Court, the answer is an emphatic "yes."

Facts of the Case

On September 13, 2008, Hurricane Ike made landfall as a category 2 storm. Hardin County, Texas was in the hurricane's path and was later designated a federal disaster area. As a federally declared disaster area, IRS had the authority to give the residents of Hardin County more time to complete certain acts such as completing IRA rollovers, correcting certain excess contributions, and filing certain tax returns.

When Hurricane Ike hit, Jeffrey Carter and his wife lived in Hardin County. Later that same year, they took a $20,000 early distribution from Jeffrey's qualified retirement plan to repair property damaged by the storm and to supplement income lost because of the storm. They properly paid federal income tax on the early distribution but they claimed an exception to the 10% early distribution penalty for a distribution made pursuant to Hurricane Ike by filing IRS Form 5329. The IRS disagreed, claiming there was no such exception, and determined that the Carters were subject to the 10% penalty. When the two sides could not agree, they ended up in Court.

The Court's Decision

The Tax Court ruled in favor of IRS and against Jeffrey Carter and his wife, finding that they owed the 10% penalty. Carter argued, unsuccessfully, that because the Government exempted the 10% early distribution penalty for Hurricanes Katrina, Rita, and Wilma and for the 2007 and 2008 storms in Kansas and the Midwest, it was only fair that they be given the same exemption.

Although the court sympathized with the Carters, they could not waive the 10% penalty. Hardin County, Texas was not included in the Midwestern Disaster Area for 2008 when Jeffrey Carter took his early distribution, despite the fact that the area was a federally declared disaster area. Since Congress did not explicitly extend the tax breaks to Hurricane Ike victims, the early distribution was not a qualified disaster recovery assistance distribution, so the 10% penalty applied. No matter how much sympathy the Tax Court may have felt for the Carters, its hands were tied. It simply had no authority to waive the penalty.

Qualified Hurricane Distributions

While Jeffrey Carter's situation may have ended unfavorably, over the years other clients in a similar position, as a result of a natural disaster, have been able to take distributions from their retirement accounts without incurring the 10% penalty. One type of relief came in the form of a *qualified hurricane distribution*.

Qualified hurricane distributions were distributions from an IRA during specific dates and for three specific hurricanes, Katrina, Rita, and Wilma. For example, a qualified hurricane distribution was permitted for Hurricane Katrina that devastated New Orleans in August 2005. Distributions taken by affected taxpayers between August 25, 2005 and December 31, 2006 were exempt from the 10% early distribution penalty, taxed over a three year period, and repayments were allowed within three years. In order to qualify for these special breaks, the individual must have suffered an economic loss as a result of the hurricane. These tax breaks applied to distributions from employer plans and IRAs.

Qualified Disaster Recovery Assistance Distributions

In 2008, Congress expanded its relief to other natural disasters, such as tornados and flooding. As a result of significant tornados in Kansas in 2007, the special tax treatments previously given to qualified hurricane distributions were extended to the Kansas Disaster Area. Since then these tax breaks were also given to the Midwestern Disaster Area of 2008. Those distributions were known as "qualified disaster recovery assistance distributions."

IRS Can Postpone Deadlines for Disaster Areas

The IRS can postpone certain tax deadlines for individuals affected by federally declared disaster areas. The relief includes more time to complete certain acts such as rollovers or recharacterizations, correction of certain excesses, making plan loan payments, and extending tax filing deadlines such as the deadline for filing individual income tax returns and making IRA contributions. When a deadline is postponed, the IRS issues a news release or other information in the Internal Revenue Bulletin and on its website. In fact, IRS recently issued News Release 2012-70 which alerts certain victims of Hurricane Isaac (not to be confused with Hurricane Ike) that they may be eligible for some relief.

The authority to extend tax deadlines does not grant IRS unlimited power though. For instance, it cannot exempt certain distributions from the 10% penalty just because it feels like it. Such a change would require a change in the law and can only be made by Congress.

Stopping a Bad Situation from Getting Worse

Don't assume that clients who suffer an economic loss as a result of a federally declared disaster area will automatically qualify for the special tax breaks that apply to qualified disaster recovery assistance distributions. If clients need additional funds to meet expenses, advisors should try and seek other, more tax-friendly, forms of capital. If, however, retirement funds are the only asset the client has, there's not much an advisor can do. In such cases, the advisor should simply try and minimize any penalties by taking only as much as needed from the IRA and seeing if one of the other exceptions to the 10% penalty might apply. ■

Guest IRA Expert

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Making the Most (And Avoiding the Worst) of Self-Directed IRAs

Forbes has reported that 97% of Americans' IRA money is held by custodians who allow only conventional investments such as stocks, bonds, funds and bank accounts. That may be true, but the other 3% is held by custodians who allow IRA owners to venture off the beaten path in search of higher returns.

According to the Tax Code, your clients can invest IRA money in virtually anything, with two exceptions. IRA money can't be used to buy collectibles or life insurance policies. In addition, S corporation rules prevent an IRA from owning stock in S corporations, but other than these three restrictions, IRA owners pretty much have free reign. That leaves alternatives beyond securities, bank accounts and annuities. Increasingly, IRA owners are turning to so-called self-directed IRAs for out-of-the-mainstream investments, from local real estate to startup social media websites' closely held stock.

According to the Tax Code, your clients can invest IRA money in virtually anything, with two exceptions.

Self-directed IRA investments may generate exciting returns, especially in these times of volatile stock markets and low-yielding income vehicles. However, advisors and clients must proceed cautiously to avoid not only poor investments but also taxes, penalties, and possible IRA disqualification.

Ground Rules

The assets in a self-directed account must be held by a custodian or a trustee. Clients can't simply buy a car wash with funds distributed from an IRA and say, "That's my IRA investment."

Moreover, a custodian that agrees to hold self-directed, non-traditional IRA assets typically will work with an IRA administrator. The administrator may handle many tasks for the custodian; if an advisor has a question about what can or can't be done with a self-directed IRA, an experienced IRA administrator probably will be a valuable source of information.

Both clients and their advisors are responsible for seeing that all the IRA rules are followed. IRA assets, including self-directed assets, must be valued and reported at their fair market value for purposes such as required minimum distributions and Roth IRA conversions.

Invest In What You Know

The IRA rules permit a great deal of latitude in choosing investments. That may open up opportunities, especially for clients who have specialized knowledge.

For example, suppose Bob is a real estate agent who has spent 20 years working mainly in his home county. He's been involved in the purchase and sale of real estate, both residential and commercial. Why should Bob invest his IRA money in stocks or funds he knows little about? Bob has a better chance of enjoying substantial returns if he puts his IRA money into local property that he believes has great potential.

Just to name one alternative, Bob might put his IRA money into tax liens, if he has become familiar with the process and is confident that his IRA is likely to make money that way.

Many clients will have some familiarity with real estate, especially local markets, but the possibilities for self-directed IRAs don't stop there. Engineers might be able to invest in patents; lawyers might know how to participate in judgments for collection or "structured settlements," in which a lump-sum payment is made in return for a stream of future payments, perhaps from a personal injury award.

Of course, virtually any client might have the inside track on a promising business just getting under way. All of these alternative investments may produce superior returns for clients who can use their unique knowledge and experience when making selections.

Avoid Making Critical Mistakes

That said, self-directed IRAs are not for everyone. Due to the specialized nature of these accounts, fees may be comparable or slightly higher than, say, putting IRA money into an S&P 500 index fund, and there's generally more risk of a total loss. (Nevertheless, there is a lower risk of total loss when investing in what you know, because of your specialized knowledge.)

Practical difficulties may arise, too. As mentioned, IRAs need to be valued at their fair market value, but how can you put an annual valuation on a warehouse?

In general, a respected third-party must be hired to do an annual valuation. Some appraisals may be relatively simple and inexpensive to obtain, such as letters from a real estate appraiser, but business valuations can be expensive. Those costs should be built-in to the client's long-term return expectations.

Beyond valuation, clients with certain self-directed IRAs investments face unexpected tax issues. That will be the case if their IRA invests in what is deemed an operating business which generates unrelated business taxable income (UBTI). In essence, the unrelated business income tax (UBIT) is meant to level the playing field, when a tax-exempt entity, such as a university, charity, or an IRA runs a business that competes against taxable entities.

Owning rental property generally is not considered operating an active business so UBIT won't be triggered if an IRA owns such real estate. If the IRA owns a hotel, though, that's considered an active business and a supposedly tax-deferred IRA may owe current tax. The tax must be paid by the IRA. Making such an IRA investment is a decision that's possibly worthwhile, if the investment is good enough to cover the tax obligation.

The self-dealing rules are not limited to the IRA owner and his or her IRA assets.

In practice, UBIT is typically a relatively modest outlay. Clients shouldn't ignore UBIT, though. They should determine the headaches and expenses likely to be incurred and decide whether an investment that will generate UBTI is still desirable.

Beware of Prohibited Transactions

Other risks commonly associated with self-directed IRAs can be far more serious. For example, some ventures may lend themselves to self-dealing, which is prohibited for IRAs. For some violations, all the money in an IRA will be considered distributed and fully taxable. Other unfavorable tax consequences, such as the 10% early withdrawal penalty, may apply as well.

Clients can't buy real estate from their own IRA or sell personal real estate to their IRA. It makes no difference whether the transaction is at fair market value or not. Such transactions are always off-limits.

Clients also are prohibited from using IRA assets personally. In one case, a taxpayer used her IRA money to buy a home intended to be used as rental property. That was fine, but when she changed her mind and moved into the home, using it as her residence, she committed a prohibited transaction and created a taxable event.

The self-dealing rules are not limited to the IRA owner and his or her IRA assets. Spouses, parents, children, grandchildren, sons- and daughters-in-law are all considered "disqualified persons." As a result, using IRA money to buy from or sell to any of these relatives or a business they control is prohibited.

Keeping Self-Directed IRA Investments at Arms-length

Nothing prevents clients from investing IRA money in rental property but other "contributions" are prohibited. Suppose that Len, a realtor, invests his IRA money in a home he rents to a third party. That's fine, but when Len starts to fix plumbing problems and mow the lawn, he's crossing the line. As the IRS interprets the rules, Len's efforts are contributions. This can lead to a penalty that disqualifies the IRA for self-dealing. The same consequences apply if Len's son or grandson does the lawn mowing.

Any amount that is borrowed from the IRA or improperly used as loan collateral will be deemed a distribution.

What if Len is paid for property repairs, landscaping, etc.? Will this solve the problem? Unfortunately, not. Business cannot be transacted between an IRA and a prohibited party. In this scenario, Len will have to set the price he's paid by the IRA for his services. That's considered self-dealing, which is not allowed.

If a client wants to invest IRA money in real estate, the administrator of the self-directed IRA probably can provide guidance. Often, the safest course is to hire qualified professionals to manage the property.

Avoiding Common Debt Mistakes

Many real estate purchases and business investments are funded with borrowed money. This can be a problem for IRAs. The basic rule is that an IRA owner (or another disqualified person) can't borrow from his or her IRA. This will disqualify the IRA. The IRA can't be used as collateral to secure a personal loan either. Any amount improperly used as loan collateral will be deemed a distribution. The IRA owner will owe income tax and perhaps an early withdrawal penalty.

One solution is for the IRA to use a non-recourse loan to acquire property in the IRA. Such loans are backed only by the property and not by the IRA owner, so they're not prohibited. IRAs may take out loans with recourse, but ***only*** when that recourse is limited to assets in the IRA. Also, the use of debt to acquire IRA investments can make the IRA subject to UBTI.

What's more, advisors should tell all of their clients to be wary of margin accounts for IRAs. If a margin account requires investors to personally guarantee to cover any margin calls, which usually is the case, just opening such an account can be considered a prohibited transaction (IRS Notice 2011-81 may provide temporary relief).

Keeping Clients From Pressing Their Luck

Some mistakes related to self-directed IRAs result from carelessness or lack of knowledge. A client who invests in a restaurant, for instance, might co-mingle personal money with IRA money, generating a prohibited transaction. However, some "mistakes" are clearly intended to bend, break, and bypass the rules.

One client, for example, deposited a few thousand dollars in a Roth IRA as his annual contribution. The client took $1,000 of that money and bought an interest in a limited liability company (LLC). Forty days later, the Roth IRA sold that interest in the LLC for more than $500,000.

Obviously, this was an attempt to undervalue an asset with a low cost basis. By moving that asset to a Roth IRA, the investor planned to eventually withdraw the sales proceeds (including the profit), tax-free.

In another attempt to skew valuations, a taxpayer had his IRA buy two real estate lots for over $100,000. One year later, in 2011, he reported those lots with a fair market value of $15,000 apiece. The local real estate market might have suffered in a year, but not that badly!

The next year, in 2012, the taxpayer wrote both lots down to zero. Again, this was hard to believe. As it turned out, the taxpayer had used IRA money to buy the lots from himself. He reported no taxable gain on a real estate investment, and he got his hands on some cash.

By structuring the deal as an "investment" within his IRA, the taxpayer did not report a taxable distribution when the money came out of the IRA. In the future, the "worthless" lots can be withdrawn without triggering a taxable distribution. So this scheme was a way to take money from the taxpayer's IRA without paying tax.

Such ploys can backfire painfully. Advisors who learn the rules for self-directed IRAs can help their clients stay on the proper path.■

Curtis L. DeYoung founded American Pension Services, Inc.®, a neutral third-party self-directed IRA and 401(k) administrator, in 1982 for the purpose of allowing investors to self-direct their retirement funds as broadly as the law allows. He is also a nationally recognized speaker and educator dedicated to teaching both independent investors, and professionals about the opportunity to invest using Genuine Self-Direction®. Curtis is a member of Ed Slott's Master Elite IRA Advisor Group, and has appeared on CNBC's Power Lunch, in the Wall Street Journal and other financial publications. To learn more about American Pension Services, visit their website www.americanpension.com. Curtis can be reached at (801) 571-0667 or at Candace@americanpension.com.

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