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Advisory Letter
Holding Precious Metals in Retirement Accounts

The purpose of this letter is to offer self-directed IRA holders some clarity regarding investments in precious metals through self-directed retirement plans.

"Self-directed" IRAs

Self-directed IRAs have been around since the IRA was created in 1974, though their widespread use has only been recent, most likely due to favorable tax court rulings and regulations, discussed later in this letter. Thus, encountering financial advisors and CPAs who have not yet heard of self-directed IRAs is not uncommon, even though alternatives to stocks, bonds, and mutual funds in a retirement plan has always been allowed by the IRS (IRS Publication 590).

Avoiding Prohibited Transactions

IRS regulations prohibit transactions that are an improper use of the account by the account owner, the account owner's beneficiary, or any other disqualified persons, as defined under Internal Revenue Code Section 4975. In essence, IRA prohibited transactions are transactions that Congress has deemed inappropriate between IRAs and certain people associated with those IRAs.

Disqualified persons include the IRA holder, a fiduciary (e.g., the IRA custodian) and members of the IRA holder's family, such as his or her spouse, ancestors, issue (e.g. children and grandchildren), and any spouse of issue. In addition, other disqualified persons include: service providers of the IRA (e.g., custodian, CPA, financial planner, or trustee); an entity (such as a corporation, partnership, limited liability company, trust or estate) of which 50% or more is owned directly or indirectly or held by a fiduciary or service provider; an entity that is a 10% or more partner or joint venturer of with an entity that is 50% or more owned directly or indirectly or held by a fiduciary or service provider; and in the case of a SEP or SIMPLE IRA, the employer; 50% or more owner of the employer; officers, directors, 10% or more shareholders, and highly compensated employees of the employer; an entity 50% or more owned by the employer; or a 10% or more partner or joint venturer of the employer.

It's important, then, to know what prohibited transactions with an IRA look like—here are some examples of things the IRA account owner cannot do:

- Borrow money from it;
- Sell property to it;
- Get payment for managing it;
- Personally guarantee an IRA loan;
- Use the IRA assets as security for a personal loan;
- Buy property for personal use with IRA funds;
- Have the IRA buy property/assets from a disqualified person;
- Get a credit card from a self-directed IRA LLC;
- Pay personal expenses with IRA assets;
- Grant a mortgage on a relative's residence;
- Buy stock in a closely-held corporation in which the account owner has a controlling interest;
- Buy stock from a family member who is a disqualified person;
- Live in a property owned by the IRA.

The self-dealing and conflict of interest types of prohibited transactions, as outlined in IRC sections 4975(c)(1(D) and 4975(c)(1)(E), are the broadest categories of prohibited transaction, but self-dealing or a conflict of interest transaction can occur even if the disqualified person owns less than 50% of an entity or an investment. To trigger a self-dealing or conflict of interest transaction, the IRS simply has to show that a disqualified person received some direct or indirect personal benefit.

Using an LLC

In order to reduce processing delays and title issues, as well as provide the IRA holder with greater investment control, some self-directed IRA investors choose the Limited Liability Company (LLC) IRA structure. An LLC is a pass-through entity for tax purposes but treated like a corporation in that it limits liability.

Because it's a pass-through entity, the LLC does not pay any federal income tax on income it receives, but instead, the LLC members (owners) would be responsible for paying tax. An IRA is exempt from tax pursuant to Internal Revenue Code Section 408, so by using an LLC to make IRA investments, in general, no federal income tax would apply to any income or gains generated by the LLC. In addition, the members of the LLC are offered limited liability protection, which makes it attractive to IRA custodian companies. As a result, the LLC is the most common type of entity used in making retirement investments.

The account holder directs the IRA custodian to invest into an LLC in return for a percentage interest in the LLC that the account owner or a third-party manages himself or herself. The self-directed IRA LLC manager (which can be the IRA account owner) can then execute transactions for the IRA LLC without the involvement of the IRA custodian, thus reducing fees and delays.

A large number of tax attorneys believe that this IRA LLC strategy has been legitimized through a case in the tax court, *Swanson v. Commissioner, 106 T.C. 76 (1996)*, and IRS Field Service Advice Memorandum 200128011, which has similar facts to and confirms the Tax Court's conclusion in *Swanson*.

Since *Swanson*, the the IRS has not attacked the self-directed IRA LLC. And on October 29, 2013, the tax court (in *T.L. Ellis, TC Memo 2013-245*), held that establishing a special purpose LLC to make an investment did not trigger a prohibited transaction, as a newly established LLC

cannot be deemed a disqualified person pursuant to Internal Revenue Code Section 4975.

A self-directed IRA LLC owned by just one IRA is treated as a disregarded entity for Federal Income tax purposes and no Federal income tax return is required to be filed. If the LLC is owned by two or more IRAs, a Partnership Tax Return (IRS Form 1065) is required to be filed, and most states will require the multiple-member LLC to file a state partnership tax return.

Although *Swanson* doesn't directly deal with a single member IRA LLC, it allows that an individual can manage and control an entity owned by an IRA or IRAs that he or she is a disqualified person to. In addition, other cases, private letter rulings and IRS Memorandums allow the validity of using retirement funds to invest in a special purpose entity, such as an LLC, owned by an IRA.

The recent tax court case *Peek v. Commissioner, 140 T.C. No. 12 (2013)* reinforced the ability for a retirement account holder to use retirement funds to invest in an IRA-owned entity without causing a prohibited transaction. In *Peek*, the U.S. Tax Court ruled that a taxpayer's personal guaranty of a loan by a corporation owned by the individual's IRA is a prohibited transaction under section 4975(c)(1)(B). The court found that the taxpayers had provided an indirect extension of credit to the IRAs, a prohibited transaction under Internal Revenue Code Section 4975. However, the court did not have an issue with the taxpayer forming a special purpose corporation to make the investment, as well as serving as director and registered agent of the corporation.

Coins and their storage

Coins approved under the Internal Revenue Code (section 408(m)), namely American Eagles, can be stored at home, provided they are not used in prohibited transactions, and should be held in the name of the IRA LLC. It would be better that they are kept at a bank safe deposit box, also in the name of the IRA LLC, though, in that this would provide another level of separation between the IRA owner and the IRA LLC. Otherwise, keeping the coins in the physical possession of a disqualified person puts the burden on the IRA owner to prove that no self-dealing or conflict of interest event occurred. In addition, I suggest IRA owners sign an affidavit providing that the coins are being held solely for the benefit of the IRA and not for any personal or other benefit.

Precious metals and their storage

Internal Revenue Code section 408(m) further outlines the type of precious metals and coins that are permitted investments for an IRA: gold, silver, platinum or palladium bullion of a certain fineness, and that is in the physical possession of a trustee that meets the requirements for IRA trustees under Internal Revenue Code section 408(a).

A trustee is defined in Internal Revenue Code Section 408(a) as 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 the section—IRS-approved IRA custodians meet this definition.

Internal Revenue Code Section 408(n) defines a bank as any bank (as defined in section 581) or an insured credit union (within the meaning of paragraph (6) or (7) of section 101 of the Federal Credit Union Act). Section 581 defines a bank as a bank or trust company incorporated and doing business under the laws of the United States (including laws relating to the District of Columbia) or of any State, a substantial part of the business of which consists of receiving deposits and

making loans and discounts, or of exercising fiduciary powers similar to those permitted to national banks under authority of the Comptroller of the Currency, and which is subject by law to supervision and examination by State, Territorial, or Federal authority having supervision over banking institutions.

Meeting the “physical possession” requirement, then, would require the precious metals to be at a bank or IRA custodian. A safe deposit box at a bank, while constructively in the control of the IRA holder, is in the physical possession of the bank. Thus, I, and a large number of tax attorneys believe that storing precious metals in a safe deposit box, which is in the name of the IRA LLC, meets the physical possession requirement under Internal Revenue Code section 408(m). While the IRS has not offered clear guidance on this issue, the Code is clear that precious metals, other than American Eagle coins, must be stored in the physical possession of a bank or IRA custodian.