



# Pioneer Bank & Trust

## Trust & Investments

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## Q&A on IRAs

A new report from the GAO estimates that 43 million taxpayers have IRAs, worth an estimated \$5.2 trillion. Some 42.3 million of these IRAs are worth less than \$1 million, and 800,000 are worth more. 314 taxpayers have IRAs worth \$25 million or more. That is some serious capital, which can raise serious questions. Here are four that crossed our desk recently.

### Inherited IRAs, nonspouses

*Q. I've inherited a substantial IRA from my parent. What are my choices? Can I roll over the money into my own IRA? What I'd really like to do is convert the inherited IRA to a Roth IRA.*

A. Those approaches are not available to you. Because you are not the spouse of the decedent, you only are permitted to arrange a trustee-to-trustee transfer of the money to another IRA in the name of the decedent and yourself. A death triggers the process of exposure of the IRA accumulation to taxation. Although that taxation can be extended over your actuarial lifetime, it can't be delayed beyond that, which is why the decedent's name always must appear on the IRA.

If you attempt to convert an inherited IRA into a Roth IRA, the conversion will be treated as a complete and taxable distribution of the IRA followed by an excess contribution to the Roth IRA. Similarly, if you attempt a trustee-to-trustee transfer from the inherited IRA to one in your own name, it will be treated as a complete distribution followed by a regular contribution to your IRA (not a rollover contribution).

### Deemed distributions

*Q. Can I use my IRA as collateral for a loan?*

A. No, you cannot. Any portion of an IRA used as security for a loan is a deemed distribution, and that amount becomes taxable. The acquisition of a collectible by an IRA, such as a work of fine art, is also a deemed distribution. The amount of the distribution is the cost of the collectible.

### Prohibited transactions

*Q. My son needs to borrow \$100,000. Can I lend him money from my IRA if he signs the appropriate paperwork and the IRA charges him an appropriate interest rate? The rate of return on my IRA has been poor lately, and this could be a win-win all around.*

A. No, you cannot do this. Any direct business transaction between an IRA or a Roth IRA and a "disqualified person" is a "prohibited transaction." You are a disqualified person, and so are your spouse, your ancestors and descendants, and your spouse's ancestors and descendants. A prohibited transaction results in the end of the IRA being treated as an IRA. Instead, the entire IRA is treated as distributed on January 1 of the year that the prohibited transaction occurs, with the full amount subject to income taxes. With a Roth IRA, there may not be immediate taxation, but the future tax deferral is lost at that point. Prohibited transactions must be avoided.

What if the borrower is a brother or sister? Although such an individual may not be named a "disqualified person" in the statute, this is at best a grey area. Better to avoid courting trouble.

*Q. I have an asset that I think is worth at least \$100,000. I'd like to sell it to my IRA for \$50,000. That can't hurt the IRA, can it?*

A. Prohibited transactions are prohibited regardless of whether or not the IRA is harmed. As you are a disqualified person, you can't sell assets to your IRA. If you think about it, your bargain sale could really be considered an excess IRA contribution. Other examples of prohibited transactions:

- An IRA owner and his spouse tried to purchase from an unrelated party (a bank) a promissory note on which the couple were the obligors. The Department of Labor considered this an extension of credit between the IRA and its owners, even though the IRA was not a party to the original transaction and the purchase of the note was at arm's length [Advisory Opinion 2011-04A].

- An IRA owner signed an agreement with a brokerage firm that gave the firm a security interest in the IRA to secure the owner's potential liability associated with a taxable futures trading account. The Department of Labor found this to be a prohibited extension of credit [Advisory Opinion 2011-09A]. However, the IRS has stated that if the cross guarantee is not actually activated, the penalty may not be imposed [IRS Announcement 2011-81].

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