

INDIRECT LOAN DOESN'T AVOID IRA LIMITATIONS

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Generally, an IRA beneficiary cannot enter into a loan transaction with the IRA. Per Code §4975(c)(1)(B), the lending of money between a plan and a disqualified person is a prohibited transaction. For this purpose, a “plan” includes an IRA. Code §4975(e)(1).

What if the IRA purchases a preexisting note and mortgage from a bank, on property owned by the beneficiary and other disqualified persons (the beneficiary’s spouse and a trust)? Is this a prohibited loan transaction?

According to the Department of Labor it is. The DOL has recently advised that the use of IRA funds to acquire such note and mortgage is as much a lending transaction as a direct loan to the beneficiary. Clearly, when the dust settles, the beneficiary will owe the IRA on the note (instead of the bank). Nothing that surprising here – just a confirmation that the IRA and its beneficiary cannot do indirectly what they cannot do directly. Indeed, the statute itself specifically targets both direct and indirect credit transactions as problematic.

As if this wasn’t enough to dissuade the beneficiary from proceeding, the DOL further opined that the transaction would also be a prohibited transaction under Code §4975(c)(1)(D), which prohibits to a disqualified person the use or benefit of the assets of the plan.

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