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LEGAL ALERT

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IRS Rules on Additional Wrap Programs Paid for Outside of IRAs

In PLR 201104061 (November 4, 2010), the Internal Revenue Service ruled favorably on the payment of certain wrap fees by IRA owners with assets held outside the IRA. Previously, the Service had ruled that:

- IRA trustee fees ordinarily may be paid outside the IRA without being considered IRA contributions, and deducted by the IRA owner to the extent they satisfy the requirements of Internal Revenue Code §212 (Rev. Rul. 84-146). An annual maintenance fee charged by the trustee for an IRA self-directed brokerage account is another example of such a fee (PLR 8835062). It may be that the fees need to be separately billed and paid to qualify for this treatment (e.g., PLR 9005010); but

- Brokerage commissions and fees paid outside the IRA would be considered IRA contributions and only deductible within the limits of §219, because they are intrinsic to the value of the IRA's assets rather than recurring administrative or overhead expenses incurred in maintaining the IRA (Rev. Rul. 86-142). These two revenue rulings are applications of principles developed for qualified retirement plans; except

- "Full" wrap fees may be paid and deducted outside a traditional or Roth IRA, provided that the fee is based on a percentage of assets under management, paid periodically rather than on a transactional basis, and does not vary with the number or frequency of the transactions performed (PLR 200507021). This ruling considered five different fact patterns involving various discretionary and non-discretionary investment services, including one fact pattern where primarily brokerage services were provided; a securities trading service was included in all five arrangements. In the Service's view, the fees for all those arrangements were recurring fees for account administration or overhead akin to those considered in Rev. Rul. 84-146.

The new ruling applies the analysis of the 2005 ruling to a discretionary or nondiscretionary "separately managed account" (SMA) with a full wrap fee; a financial planning and nondiscretionary advisory service where certain expenses (but not brokerage commissions and fees) were paid by the client in addition to the wrap fee; and a nondiscretionary asset allocation service, which also entailed the payment of certain other expenses by the client in addition to the wrap fee. In each case, a securities trading service was included in the arrangement, and the wrap fee was determined and paid comparably to the wrap fees in the 2005 ruling. In each case, the Service ruled that the wrap fee could be paid by the IRA owner outside the IRA without being deemed an additional IRA contribution.

Comments

- PLR 201104061 helpfully extends the analysis of PLR 200507021 to three forms of advisory services that have become more prevalent since 2005.

- It is important to note, however, that the ruling is limited to the wrap program fees, and explicitly does not extend to any additional fees or expenses payable under these arrangements.

- It is also noteworthy that, while it does not seem to break new ground conceptually, this ruling was issued 2½ years after it was requested.

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