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LEGAL ALERT

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DOL Opines that Security Interest in Non-IRA Brokerage Assets to Cover IRA Indebtedness is a Prohibited Transaction

In Advisory Opinion 2009-03A (October 27, 2009), the U.S. Department of Labor (DOL) opined that the pledge of an IRA owner's personal accounts at a brokerage firm to secure the payment of any debt or liability in his self-directed IRA maintained with that firm would violate the prohibited transaction rules of Internal Revenue Code § 4975.

On the facts of the opinion, the IRA owner already maintained a personal brokerage account at a securities firm. The documentation creating a new self-directed IRA granted that firm a security interest in the IRA owner's personal assets, as handled in certain accounts maintained by the broker, to cover the payment of any liability or indebtedness incurred in the IRA. DOL determined that the IRA owner was a fiduciary of the IRA – because of the self-direction of IRA investments – and thus a disqualified person under § 4975. That provision in turn prohibits a loan or other extension of credit between a disqualified person and an IRA. DOL judged that the grant of a security interest in the IRA owner's personal assets was akin to a guarantee of the IRA's debts, which the legislative history of § 4975 characterizes as a prohibited extension of credit.

In addition, DOL volunteered that the inverse transaction – the granting of a security interest in the IRA assets to cover liabilities or debts incurred in the IRA owner's personal brokerage account, which was provided for under this same documentation – would also be a prohibited transaction. The Opinion makes no mention of any prohibited transaction exemption.

Brokerage account agreements sometimes include general "security for indebtedness" provisions to this effect (which are in addition to margin account provisions). To the extent one of the accounts may be an IRA, this provision may alternatively be framed as an agreement by the customer to take a distribution from the IRA to discharge obligations to the broker incurred in non-IRA accounts, rather than as a security interest in the IRA assets. An important purpose of these provisions is to provide the securities firm recourse for debit balances arising out of investment transactions, or out of overdrafts, garnishments and similar activity, when the assets in the particular brokerage account are insufficient to meet these obligations. (In IRAs, margin calls generally are not a concern; the unrelated business income tax rules separately discourage leveraged investments in IRAs.) To the extent § 4975 renders unenforceable the operation of these provisions as between IRA and non-IRA accounts, the effect may be, among other things:

- Indirectly to limit the types of investment transactions – in particular, those that can give rise to debit balances – available in IRA accounts; and

- To exclude IRA assets from consideration of a customer's financial capacity to engage in such investment transactions or leveraged investments in personal brokerage accounts.

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If you have any questions about this development, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.

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