Service Providers Can & Will Destroy Your IRA

By CPA & Seasoned IRA Tax Attorney

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I have started to notice a disturbing pattern: Service providers destroying their clients' IRA's. Nothing speaks like examples, I shall provide two that I have seen in the last year. I have edited the facts for the sake of privacy. One example involves a title company, one of them involves a loan broker.

Lazy Title Company Costs Family Millions. Dad and his four adult children each owned IRA's. Each IRA averaged over $1 million in assets. Dad and the children were *very* savvy as far as IRA's go. They had first class education and paid attention to details.

They looked to enter into an out-of-state property purchase as Tenants in Common with each IRA owning a percentage of the property. Each IRA would own a percentage in the property commensurate with its dollar contribution. Such transactions are common, and if properly structured, legitimate.

Enter the title company. For whatever reason, they said the transaction "couldn't be done that way".
Translation: It did not fit their template, and they did not want to take the effort to adjust their model. At the last minute they told the clients to restructure the transaction as a loan from the children's IRA's to Dad's IRA. Such a loan is of course a blatant prohibited transaction. In spite of being very knowledgeable people, the family went along with it. The change was very last minute, they were busy, likely stressed or distracted by other things in life, so they pulled the trigger under pressure from the title company.

A few years later, the IRS audited the IRA's. They caught the transaction. As a result the IRA's were all distributed and about 50% of the balance in each went to the government in the form of taxes. The case was black & white, there was no point in fighting it in Tax Court. Due to a title company's laziness, a last minute rush, a desire to close the deal, and a moment of inattention by some normally very sharp people, millions of dollars were lost.

The lesson: The vendor does not drive the deal. You do. Further: "No deal" beats "a deal that destroys the IRA". Stay in control, on top of things, and be ready to say to last minute changes – even if it kills a good deal. Better a dead deal than a dead IRA.

Dishonest Loan Broker Creates a Prohibited Transaction. An IRA owner was set to close on a property. The deal had been vetted by a tax attorney. It involved a Tenants in Common[1] ownership structure whereby the Taxpayer would use both 1031 proceeds and debt to fund his portion of the property. The debt was non-recourse as to the taxpayer and the IRA. The IRA's portion of the property was to be funded with its own cash. The taxpayer could have done the deal on his own, without the IRA, which is important because it showed that the taxpayer was not using the IRA for his own personal benefit by getting into a deal he could not have closed without the IRA's funds.

[1] For the sake of simplicity and reduction of risk, I very much prefer to see a single IRA do a deal if at all possible. Bringing in multiple IRA's or other parties to do a deal, while possible if correctly structured, creates complexity and risk. These deals happened to involve multiple parties in a Tenant-in-Common format. While I can and have structured such deals, I do not want these examples to convey the message of "that's the way to go". Indeed, the final outcome should encourage caution.

At the absolute last minute, the loan broker, who assured everyone he could come up with a nonrecourse loan, stated that the taxpayer would have to guarantee the loan. This revelation came at the closing table. "Sign here now or lose the deal, no pressure". The taxpayer had minutes to decide whether to lose the deal and forfeit a substantial deposit or to close on the property. The broker clearly wanted the sale and was willing to promise things he could not deliver to get the commission.

The taxpayer signed the loan docs and closed the deal.

The problem?

His signing personally for the loan could be viewed as an "extension of credit" from him to the IRA. He has an argument that since the loan was used only to fund his portion of the deal, no prohibited transaction occurred. The IRS has an argument in that since the loan was secured on the entire property, an "extension of credit" occurred. Had the loan been non-recourse as to all parties and secured only on IRA assets – as originally planned – this problem would have been avoided.

A well-researched and conceived deal became a possible prohibited transaction because the loan broker did not do what he was supposed to do, and did not admit it until the last possible moment. The taxpayer was not in control of the deal.

The lesson: The vendor does not drive the deal. You do. Stay on top of all the players. Push for information and results, stay in control. Trust but verify. Experienced players who have actually closed the type of deal you are engaged in are worth the money. Training the JV team on your IRA will cost you. Be ready to walk on the deal. Watch out for that last minute pressure!

John is a highly respected tax attorney, CPA and a fellow real estate investor. He speaks all over the country on these and related maters. If you're a Dyches Boddiford fan, you may have noticed that John speaks along side Dyches at some of his events. He advises clients nationwide on to avoid tax trouble when structuring their self-directed IRA's, 401(k)'s, HSA's and CESA's. John has also successfully defended SDIRA's from IRS attack in audits and in Tax Court.