

Part III – Administrative, Procedural and Miscellaneous

Abusive Roth IRA Transactions

Notice 2004-8

The Internal Revenue Service and the Treasury Department are aware of a type of transaction, described below, that taxpayers are using to avoid the limitations on contributions to Roth IRAs. This notice alerts taxpayers and their representatives that these transactions are tax avoidance transactions and identifies these transactions, as well as substantially similar transactions, as listed transactions for purposes of § 1.6011-4(b)(2) of the Income Tax Regulations and §§ 301.6111-2(b)(2) and 301.6112-1(b)(2) of the Procedure and Administration Regulations. This notice also alerts parties involved with these transactions of certain responsibilities that may arise from their involvement with these transactions.

Background

Section 408A was added to the Internal Revenue Code by section 302 of the Taxpayer Relief Act of 1997, Pub. L. 105-34, 105th Cong., 1st Sess. 40 (1997). This section created Roth IRAs as a new type of nondeductible individual retirement arrangement (IRA). The maximum annual contribution to Roth IRAs is the same maximum amount that would be allowable as a deduction under § 219 with respect to the individual for the taxable year over the aggregate amount of contributions for that taxable year to all other IRAs. Neither the contributions to a Roth IRA nor the earnings on those contributions are subject to tax on distribution, if distributed as a qualified distribution described in § 408A(d)(2).

A contribution to a Roth IRA above the statutory limits generates a 6-percent excise tax described in § 4973. The excise tax is imposed each year until the excess contribution is eliminated.

Facts

In general, these transactions involve the following parties: (1) an individual (the Taxpayer) who owns a pre-existing business such as a corporation or a sole proprietorship (the Business), (2) a Roth IRA within the meaning of § 408A that is maintained for the Taxpayer, and (3) a corporation (the Roth IRA Corporation), substantially all the shares of which are owned or acquired by the Roth IRA. The Business and the Roth IRA Corporation enter into transactions as described below. The acquisition of shares, the transactions or

both are not fairly valued and thus have the effect of shifting value into the Roth IRA.

Examples include transactions in which the Roth IRA Corporation acquires property, such as accounts receivable, from the Business for less than fair market value, contributions of property, including intangible property, by a person other than the Roth IRA, without a commensurate receipt of stock ownership, or any other arrangement between the Roth IRA Corporation and the Taxpayer, a related party described in § 267(b) or 707(b), or the Business that has the effect of transferring value to the Roth IRA Corporation comparable to a contribution to the Roth IRA.

Analysis

The transactions described in this notice have been designed to avoid the statutory limits on contributions to a Roth IRA contained in § 408A. Because the Taxpayer controls the Business and is the beneficial owner of substantially all of the Roth IRA Corporation, the Taxpayer is in the position to shift value from the Business to the Roth IRA Corporation. The Service intends to challenge the purported tax benefits claimed for these arrangements on a number of grounds.

In challenging the purported tax benefits, the Service will, in appropriate cases, assert that the substance of the transaction is that the amount of the value shifted from the Business to the Roth IRA Corporation is a payment to the Taxpayer, followed by a contribution by the Taxpayer to the Roth IRA and a contribution by the Roth IRA to the Roth IRA Corporation. In such cases, the Service will deny or reduce the deduction to the Business; may require the Business, if the Business is a corporation, to recognize gain on the transfer under § 311(b); and may require inclusion of the payment in the income of the Taxpayer (for example, as a taxable dividend if the Business is a C corporation). See Sammons v. United States, 433 F.2d 728 (5th Cir. 1970); Worcester v. Commissioner, 370 F.2d 713 (1st Cir. 1966).

Depending on the facts of the specific case, the Service may apply § 482 to allocate income from the Roth IRA Corporation to the Taxpayer, Business, or other entities under the control of the Taxpayer. Section 482 provides the Secretary with authority to allocate gross income, deductions, credits or allowances among persons owned or controlled directly or indirectly by the same interests, if such allocation is necessary to prevent evasion of taxes or clearly to reflect income. The § 482 regulations provide that the standard to be applied is that of a person dealing at arm's length with an uncontrolled person. See generally § 1.482-1(b) of the Income Tax Regulations. To the extent that the consideration paid or received in transactions between the Business and the Roth IRA Corporation is not in accordance with the arm's length standard, the Service may apply § 482 as necessary to prevent evasion of taxes or clearly to reflect income. In the event of a § 482 allocation between the Roth IRA

Corporation and the Business or other parties, correlative allocations and other conforming adjustments would be made pursuant to § 1.482-1(g). Also see, Rev. Rul. 78-83, 1978-1 C.B. 79.

In addition to any other tax consequences that may be present, the amount treated as a contribution as described above is subject to the excise tax described in § 4973 to the extent that it is an excess contribution within the meaning of § 4973(f). This is an annual tax that is imposed until the excess amount is eliminated.

Moreover, under § 408(e)(2)(A), the Service may take the position in appropriate cases that the transaction gives rise to one or more prohibited transactions between a Roth IRA and a disqualified person described in § 4975(e)(2). For example, the Department of Labor¹ has advised the Service that, to the extent that the Roth IRA Corporation constitutes a plan asset under the Department of Labor's plan asset regulation (29 C.F.R. § 2510.3-101), the provision of services by the Roth IRA Corporation to the Taxpayer's Business (which is a disqualified person with respect to the Roth IRA under § 4975(e)(2)) would constitute a prohibited transaction under § 4975(c)(1)(C).² Further, the Department of Labor has advised the Service that, if a transaction between a disqualified person and the Roth IRA would be a prohibited transaction, then a transaction between that disqualified person and the Roth IRA Corporation would be a prohibited transaction if the Roth IRA may, by itself, require the Roth IRA Corporation to enter into the transaction.³

Listed Transactions

The following transactions are identified as "listed transactions" for purposes of §§ 1.6011-4(b)(2), 301.6111-2(b)(2) and 301.6112-1(b)(2) effective December 31, 2003, the date this document is released to the public: arrangements in which an individual, related persons described in § 267(b) or 707(b), or a business controlled by such individual or related persons, engage in one or more transactions with a corporation, including contributions of property to such corporation, substantially all the shares of which are owned by one or more Roth IRAs maintained for the benefit of the individual, related persons

¹ Under section 102 of Reorganization Plan No. 4 of 1978 (43 FR 47713), the Secretary of Labor has interpretive jurisdiction over § 4975 of the Internal Revenue Code.

² For the Roth IRA Corporation to be considered as holding plan assets under the Department of Labor's plan asset regulation, the Roth IRA's investment in the Roth IRA Corporation must be an equity interest, the Roth IRA Corporation's securities must not be publicly-offered securities, and the Roth IRA's investment in the Roth IRA Corporation must be significant. 29 C.F.R. §§ 2510.3-101(a)(2), 2510.3-101(b)(1), 2510.3-101(b)(2), and 2510.3-101(f). Although the Roth IRA Corporation would not be treated as holding plan assets if the Roth IRA Corporation constituted an operating company within the meaning of 29 C.F.R. § 2510.3-101(c), given the context of the examples described in this notice, it is unlikely that the Roth IRA Corporation would qualify as an operating company.

³ See 29 C.F.R. § 2509.75-2(c).

described in § 267(b)(1), or both. The transactions are listed transactions with respect to the individuals for whom the Roth IRAs are maintained, the business (if not a sole proprietorship) that is a party to the transaction, and the corporation substantially all the shares of which are owned by the Roth IRAs. Independent of their classification as “listed transactions,” these transactions may already be subject to the disclosure requirements of § 6011 (§ 1.6011-4), the tax shelter registration requirements of § 6111 (§§ 301.6111-1T and 301.6111-2), or the list maintenance requirements of § 6112 (§ 301.6112-1).

Substantially similar transactions include transactions that attempt to use a single structure with the intent of achieving the same or substantially same tax effect for multiple taxpayers. For example, if the Roth IRA Corporation is owned by multiple taxpayers' Roth IRAs, a substantially similar transaction occurs whenever that Roth IRA Corporation enters into a transaction with a business of any of the taxpayers if distributions from the Roth IRA Corporation are made to that taxpayer's Roth IRA based on the purported business transactions done with that taxpayer's business or otherwise based on the value shifted from that taxpayer's business to the Roth IRA Corporation.

Persons required to register these tax shelters under § 6111 who have failed to do so may be subject to the penalty under § 6707(a). Persons required to maintain lists of investors under § 6112 who have fail to do so (or who fail to provide such lists when requested by the Service) may be subject to the penalty under § 6708(a). In addition, the Service may impose penalties on participants in this transaction or substantially similar transactions, including the accuracy-related penalty under § 6662, and as applicable, persons who participate in the reporting of this transaction or substantially similar transactions, including the return preparer penalty under § 6694, the promoter penalty under § 6700, and the aiding and abetting penalty under § 6701.

The Service and the Treasury recognize that some taxpayers may have filed tax returns taking the position that they were entitled to the purported tax benefits of the type of transaction described in this notice. These taxpayers should consult with a tax advisor to ensure that their transactions are disclosed properly and to take appropriate corrective action.

Drafting Information

The principal author of this notice is Michael Rubin of the Employee Plans, Tax Exempt and Government Entities Division. However, other personnel from the Service and Treasury participated in its development. Mr. Rubin may be reached at (202) 283-9888 (not a toll-free call).