

### **IRS Offers Temporary Relief to IRA Owners; Awaits DOL Guidance**

*The IRS announces that, pending further action by the DOL, indemnification arrangements described in AO 2011-09A will not be considered prohibited transactions.*

**December 16, 2011**

On December 12, the Internal Revenue Service (IRS) issued Announcement 2011-81, providing temporary relief from the potential negative tax consequences resulting from Department of Labor (DOL) Advisory Opinions (AOs) 2011-09A and 2009-03A. This temporary relief is pending further action by the DOL and further guidance from the IRS.

As explained in a previous LawFlash,<sup>1</sup> on October 20, the DOL issued AO 2011-09A, in which it concluded that relief under Prohibited Transaction Class Exemption 80-26 is not available for an indemnification arrangement involving a futures trading agreement for an individual retirement account (IRA), raising the question as to whether such indemnification arrangements would be nonexempt prohibited transactions. If the indemnity is considered a nonexempt prohibited transaction, then the mere provision of the indemnity could result in the IRA being disqualified and all of its assets being deemed distributed and subject to tax in the tax year in which the indemnity was provided. This follows AO 2009-03A,<sup>2</sup> which indicated that granting a broker a security interest in an individual's non-IRA accounts to support the IRA would be a prohibited extension of credit to the IRA.

Announcement 2011-81 states that the IRS will not consider an indemnification arrangement described in AO 2011-09A to be a prohibited transaction when determining the tax consequences to an IRA until further guidance from the DOL and IRS is issued. Specifically, the IRS will determine the tax consequences relating to an IRA without taking into account the consequences that might otherwise result from a prohibited transaction under Section 4975 of the Internal Revenue Code (the Code) resulting from entering into any indemnification agreement or any cross-collateralization agreement similar to the agreements described in the prior DOL advisory opinions, provided there has been no execution or other enforcement pursuant to the agreement against the assets of an IRA account. The IRS

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1. "DOL Calls into Question Whether Boilerplate Indemnification Language in an IRA Brokerage Agreement Constitutes a Nonexempt Prohibited Transaction" (Dec. 6, 2011), available at [http://www.morganlewis.com/pubs/EB\\_IM\\_LF\\_BoilerplateIndemnificationLanguage\\_06dec11.pdf](http://www.morganlewis.com/pubs/EB_IM_LF_BoilerplateIndemnificationLanguage_06dec11.pdf).

2. See our LawFlash on this subject, "DOL Holds: Security Interest Creates IRA Prohibited Transaction" (Nov. 16, 2009), available at [http://www.morganlewis.com/pubs/EB\\_IRAProhibitedTransaction\\_LF\\_16nov09.pdf](http://www.morganlewis.com/pubs/EB_IRAProhibitedTransaction_LF_16nov09.pdf).

added that no inference should be drawn with respect to the application of any Code section other than Section 4975.

Announcement 2011-81 also indicates that the DOL is considering a class exemption request “expected to be submitted to the DOL,” but does not indicate when to expect the DOL to issue the class exemption. This progression of events mirrors what occurred following the DOL’s issuance in July 1989 of AO 89-12A, which said that “relationship banking” arrangements could result in prohibited transactions. The IRS issued a similar no-enforcement policy for arrangements affected by that advisory opinion at the end of 1989, which was followed by a proposed DOL class exemption in February 1991 and a final class exemption in January 1993.

The IRS announcement provides assurance that an IRA will not be disqualified if it would otherwise be found to have engaged in a prohibited transaction based on the DOL advisory opinions. However, there are two important limitations that affect the scope of this relief.

First, the relief is not available if the indemnification or cross-collateralization provision was actually executed or enforced “against the assets” of the IRA. This generally should not be an issue under the type of indemnification arrangement described in the recent DOL advisory opinion, since that involved an obligation enforceable against non-IRA accounts rather than the IRAs themselves; it also was not an issue in the original request that prompted the 2009 advisory opinion on cross-collateralization, although the DOL raised it in its discussion. The narrow wording of the limitation demonstrates that the IRS has changed the focus to protecting the regulated entity—the IRA—against potential adverse effects, rather than prohibiting conduct that may in fact benefit the IRA.

Second, the IRS was careful to note that the relief is limited to the prohibited transaction rules of Section 4975; it has not addressed any other issue that could arise under the IRA rules as a result of such arrangements. This leaves open the question of whether a cross-collateralization obligation running from an individual’s IRA to the same individual’s non-IRA accounts, as discussed in the 2009 advisory opinion, could constitute a “pledge” that would result in the IRA assets being treated as distributed from the IRA for tax purposes under Section 408(e)(4) of the Code.

While the IRS announcement provides some level of assurance that the agency will not seek to disqualify IRAs based on the DOL positions, financial institutions should nevertheless consider evaluating any indemnification and cross-collateralization provisions in their IRA and non-IRA account agreements in light of the issues raised, to determine whether it is appropriate to make any changes pending further guidance.

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