IRA Legal Issues
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Learning Objectives
At the completion of this course you will be able to

• recognize power of attorney (POA) issues,
• understand the roles of a guardian/conservator for IRA transactions,
• identify and resolve abandoned property issues, and
• determine the correct process for paying IRA fees.
Handling Legal Issues

Financial organizations should not give tax or legal advice to IRA owners. This function should be left to tax advisors and attorneys, who play an important role in advising individuals about their retirement needs. As a practical matter, however, financial organizations often find themselves fielding legal questions. These questions may extend well beyond the bounds of IRA maintenance. At times, these legal issues need to be referred to the financial organization’s attorney. For issues that are likely to arise on a regular basis, the attorney may establish written guidelines to ensure that matters are properly handled. But financial organizations must always be alert to legal issues that may arise and to the laws that govern these issues.

For the most part, federal laws govern IRAs. But numerous state laws also may affect IRAs—including the following.

- Financial organization law (e.g., credit union charters or insurance company regulations)
- Tax law
- Property law
- Probate law
- Trust law
- Family law
- Contract law
Power of Attorney

A power of attorney (POA) is a written document authorizing one person (known as the attorney-in-fact or agent) to act on behalf of another person (known as a principal or grantor). POAs are often granted by individuals who will be unavailable to conduct their financial business for a limited period of time or who simply wish to give someone else the authority to act on their behalf. This may include authorizing someone to make contributions or take distributions from an IRA on behalf of the individual.

Often the authority to act is limited by the principal. It may be limited to a certain time period or it may be limited in scope.

<table>
<thead>
<tr>
<th>Durable POA</th>
<th>Nondurable POA</th>
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<tbody>
<tr>
<td>• Agent’s authority continues even if principle becomes legally incompetent</td>
<td>• Agent’s authority terminates if principle becomes legally incompetent</td>
</tr>
<tr>
<td>• Must contain a provision that POA will remain effective—or become effective—upon principle’s incapacity</td>
<td>• May confer broad authority to the agent</td>
</tr>
<tr>
<td>• May confer broad authority to the agent</td>
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</table>

State law governs the rules for determining whether a POA is valid and how it may be used. Any legally competent adult may execute a valid POA.

**NOTE:** The term “power of attorney” often describes both the POA document itself and the actual authority (power) given by the document.

Documentation

There are several types of documents that individuals can use to establish a POA.

**Fill-in-the-Blank**

Some financial organizations offer “fill-in-the-blank” POA forms, typically drafted by the financial organization’s attorney. This permits a client, such as an IRA owner, to grant authority to an agent with minimal effort. Often these forms are used to conduct routine IRA transactions, such as deposits or investment renewals.

Financial organizations offering fill-in-the-blank POA forms must be careful not to provide legal advice to the IRA owner completing the document. Because of this concern, some financial organizations do not provide this form, and insist that IRA owners have their own lawyers draft the POA document.
Statutory Short Form

Some state statutes also include a form that permits consumers to select which powers they are assigning to an agent. These “statutory short form” POAs make it easy for individuals to complete a valid POA without an attorney’s help. This may, however, cause even more reliance on financial organizations to understand the POA rules. Fortunately, state statutes that include a “pre-approved” form also spell out the specific scope of each power selected by the principal.

Attorney Drafted

Any competent adult may execute a valid POA document. As with wills, POA documents need not be drafted by a lawyer, but many individuals prefer to retain a lawyer to ensure that the POA document is properly drafted and executed.
**Revoking a POA**

There are several reasons that a principal may want to revoke a POA. For example, the agent may no longer be able to fulfill the functions outlined in the POA form or the principal and agent may have a disagreement about decisions made pursuant to the authority granted in the form.

Under various states laws, a POA can be revoked by writing, by act (destructive act together with intent to revoke), by presumption, or even orally. The attorney-in-fact must receive notice of the revocation. As a result, it is a good idea to have a written document as proof of the revocation.

Following the revocation, the principal should

- notify all parties or institutions (e.g., banks, hospitals) where the form was being used that the POA no longer exists, and
- collect and destroy any copies of the revoked POA form.

**Sample POA Revocation**

To WHOM IT MAY CONCERN:

I ____________________________ (the “Principal”), revoke and declare null and void the POWER OF ATTORNEY I granted to ____________________________________________, which is dated _________________, 20____.

Please be advised that the above-named person no longer has power or authority to act as my attorney in-fact in any way.

Date: ______________________ ____________________________________________

(Principal)

The foregoing instrument was acknowledged before me this _________________ day of _________________, 20____, by ________________________________.

____________________________________________

(Notary Public)
Checking the POA

Before acting upon the direction of an individual with a POA document, a financial organization may wish to obtain a copy of the POA document and present it to its attorney, or ask the attorney to devise a set of guidelines to be followed when dealing with POAs. Consider the following items when determining whether the POA is valid.

Signatures

- Is the POA in writing?
- Are the principal and the attorney-in-fact identified?
- Is the POA signed and dated by the principal, is the document acknowledged (if necessary) by the attorney-in-fact, and is the document notarized (if necessary)?
- Are there any state-specific witnessing requirements beyond notarization?

Scope

- What is the nature and scope of the power granted? (Is there authority to conduct retirement plan transactions, such as changing beneficiaries?)
- What type of power is granted (durable or nondurable)?
- What is the document’s effective date? Has the power expired or terminated? Is there an event that must occur before the POA is effective?

Documentation

- Retain a copy of the POA in the principal’s file.
- Retain a copy of the identification presented by the attorney-in-fact.

Miscellaneous Concerns

- Does state law provide protection for a financial organization that acts upon a POA that appears to be valid?
- Does the financial organization need an attorney to review the POA?
- Are multiple attorneys-in-fact named and if so, can they act separately?
Financial Organization Responsibilities

Because attorneys-in-fact “step into the shoes” of the principal, financial organizations should follow the instructions of the attorney-in-fact, just as they would comply with requests by the principal. Provided that the agent does not exceed the scope of the authority conferred in the POA, the financial organization must treat the agent just like the principal. Many states give financial organizations protection from liability when they rely on a POA that appears to be valid.

Whether dealing with a principal or with an agent, financial organizations are obligated to ensure that investments are protected and that transactions are properly conducted. The surest way to guarantee that this is done is to obtain and follow the direction of legal counsel familiar with individual state requirements.

Before acting upon the direction of an individual with power of attorney, a financial organization generally should take the following steps.

1. **Obtain copy of written POA document**
2. **Present POA document to financial organization’s attorney or follow POA guidelines drafted by attorney**
3. **If financial organization agrees POA is valid, follow agent’s instructions**
POA Documents

Leslie, age 45, was in your financial organization yesterday and presented a POA document for her father Craig. Leslie believes that the POA allows her to take distributions from Craig’s Traditional IRA. The staff member who received the POA is asking you whether Leslie is allowed to take a distribution.

What is your process for handling this POA?
Guardianship/Conservatorship

Guardian

A guardian is an individual, appointed by a court, who is responsible for taking care of and managing the person and the property of an individual (sometimes called a ward) who, by reason of mental or physical health, is considered by the court to be incapable of administering her own affairs.

In its order appointing the guardian, a court generally will outline the responsibilities that the guardian will assume. A court may limit the guardian’s powers to handling only the property of an individual or may extend the powers to require the guardian to make decisions regarding the residence and care of the ward. An individual who has been granted less than full control over both the person and the property is sometimes called a “conservator.”

A guardianship relationship is very different from the relationship created by a power of attorney. Under a power of attorney, the principle decides who will make decisions regarding her property and the scope of the agent’s authority. The power of attorney generally will terminate if the individual becomes incapacitated, unless it is established as a durable power of attorney. A guardian, on the other hand, is appointed by a court, usually because an individual has become incapacitated. The court decides what powers the guardian will exercise.

Financial Organization Responsibilities Regarding Guardian

The requirements for guardianship proceedings and for the orders appointing the guardian differ from state to state. And the scope of the guardianship appointment differs from case to case. A financial organization’s attorney can point out any special concerns to watch for under a particular state’s laws.

If an IRA owner becomes subject to guardianship, the financial organization may be called upon to follow the guardian’s directions regarding the IRA owner’s IRA. If the financial organization learns that an IRA owner has become the subject of guardianship or conservatorship proceedings, the financial organization should take the following steps.

1. Obtain a copy of the order appointing the guardian so the financial organization can identify the individual who may now have authority to conduct IRA transactions.

2. Have the financial organization’s attorney review the guardianship order to determine whether the guardian has the power to direct contributions, distributions, or other transactions with respect to the IRA. As an alternative to submitting each order to an attorney for review, the financial organization’s legal counsel could draft guidelines that apply to guardianship orders.
## Power of Attorney vs. Guardian

<table>
<thead>
<tr>
<th></th>
<th>Power of Attorney</th>
<th>Guardian/Conservator</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>When effective:</strong></td>
<td>During IRA owner’s lifetime</td>
<td>During IRA owner’s lifetime</td>
</tr>
<tr>
<td><strong>Mental status:</strong></td>
<td>Competent or incapacitated</td>
<td>Incapacitated</td>
</tr>
<tr>
<td><strong>Scope:</strong></td>
<td>Individual defines</td>
<td>Court determines</td>
</tr>
<tr>
<td><strong>Duration:</strong></td>
<td>Individual defines</td>
<td>Court determines</td>
</tr>
<tr>
<td><strong>Creator of power:</strong></td>
<td>Individual</td>
<td>Court</td>
</tr>
</tbody>
</table>
A Note on Elder Financial Exploitation

One of the more significant issues currently facing IRA providers (and the financial services industry as a whole) is elder financial exploitation. A simple definition of elder financial exploitation, as provided by the GAO in a 2011 Report on Elder Justice, is “the Illegal or improper use of an older adult’s funds, property or assets.”

Due in part to an aging population, an increasing number of older Americans are experiencing diminished cognitive capacity. As a result, they are more susceptible to being taken advantage of by family members, caregivers, and unrelated fraudsters. Isolation, health issues, and disabilities can also be contributing factors. Because today’s elders typically hold a high proportion of their retirement savings in defined contribution plans and IRAs, it is particularly important that IRA providers are aware of both the changing regulatory landscape and the associated risks.

While no definitive statistics on the extent of elderly financial exploitation are available, several studies have indicated that nearly five percent of the elderly population may have experienced some form of financial exploitation. Some believe that this percentage may be a low estimate because such exploitation may be underreported.

See the summary of studies in the U.S. Securities and Exchange Commission, Office of the Investor Advocate, report entitled: “Elder Financial Exploitation, Why it is a concern, what regulators are doing about it, and looking ahead” (June 2018).

The Consumer Financial Protection Bureau’s (CFPB), Office for Older Americans is the primary federal office solely focused on the financial wellbeing of older Americans. In 2016, the CFPB published an advisory titled “Advisory for financial institutions on preventing and responding to elder financial exploitation.”

The Advisory concluded that financial institutions, including banks and credit unions, are “uniquely positioned to detect that an older account holder has been targeted or victimized, and to take action.” The CFPB identified the following six categories of best practices to help financial institutions prevent elder financial exploitation and effectively intervene when it occurs.

1. Develop and implement procedures to protect older account holders from financial exploitation.
2. Train management and staff to prevent, detect, and respond to suspicious events.
3. Use technology to detect elder financial exploitation.
4. Report cases of suspected exploitation to authorities.
5. Protect older account holders by complying with the Electronic Fund Transfer Act (EFTA) and Regulation E and by offering age-friendly services to enhance protections against financial exploitation.
6. Collaborate with law enforcement, adult protective services, and related service organizations.
In 2019, the CFPB updated the Advisory by issuing “Reporting of Suspected Elder Financial Exploitation by Financial Institutions,” which focused on the Advisory’s best practice #4 (reporting suspected elder exploitation).

This update emphasized that “many financial institutions remain unsure of whether to report suspected financial exploitation due to privacy concerns.” As a result, the update targeted areas of the law that address those concerns, including the following.

**Federal Requirements/Developments**

- **The Senior Safe Act:** Section 303 of the Economic Growth, Regulatory Relief, and Consumer Protection Act (signed into law on May 24, 2018) addresses concerns that financial institutions and their employees have about reporting suspected elder financial exploitation to authorities. The Act shields “covered financial institutions” (including credit unions, depository institutions, investment advisers, broker-dealers, insurance companies, insurance agencies, and transfer agents—and their employees) from liability in civil/administrative proceedings for reporting potential exploitation of a senior citizen to a covered agency. Immunity is conditioned on 1) adequate employee training on identifying and reporting relevant activity of suspected exploitation, and 2) any potential exploitation being reported in good faith and with reasonable care.

- **FINRA Rule 4512 (Customer Account Information):** This rule requires FINRA members (generally broker/dealers and investment advisors) to make reasonable efforts to obtain name and contact information for a “trusted contact person” when opening or updating an account. Members are authorized to contact the trusted contact person to share account information to address or prevent suspected financial exploitation or to confirm the customer’s contact information, health status, identity of a legal guardian, executor, trustee, or holder of a power of attorney.

- **FINRA Rule 2165 (Financial Exploitation of Specified Adults):** This rule allows members to place a temporary hold (15 business days) on disbursements of funds or securities from an account of a person aged 65 or older if the member reasonably believes that financial exploitation has occurred, is occurring, or has been or will be attempted.
  - Financial exploitation includes the wrongful or unauthorized taking, withholding, appropriation, or use of funds or securities; or any act or omission, including through the use of a power of attorney, guardianship, or any other authority, to convert or obtain control, through deception, intimidation or undue influence, of money, assets or property.
  - Certain notice requirements (including notice to a trusted contact person(s)) and supervisory and record keeping requirements apply.
  - A temporary hold requires an immediate review of the underlying facts and circumstances.
  - The hold period may be extended by a state regulator, agency, or court order.
• **Interagency Guidance on Privacy Laws and Reporting Financial Abuse of Older Adults:** Issued by the Federal Reserve, CFTC, CFPB, FDIC, FTC, NCUA, OCC, and SEC in 2013, these eight federal agencies have authority to enforce the privacy provisions under the Graham-Leach-Bliley Act (GLBA). This guidance provides that the reporting of financial exploitation of an elderly person to appropriate authorities generally would not violate the privacy provisions under GLBA.


> If a financial institution knows, suspects, or has reason to suspect that a transaction has no business or apparent lawful purpose or is not the sort in which the particular customer would normally be expected to engage, and the financial institution knows of no reasonable explanation for the transaction after examining the available facts, including the background and possible purpose of the transaction, the financial institution should then file a Suspicious Activity Report.

• **FinCEN:** In 2013, FinCEN began using an electronic filing form for Suspicious Activity Reports (SARs) that includes a unique checkbox for suspected elder financial exploitation. Approximately 60,000 SARS filings made in 2017 reported suspected elderly financial exploitation.

**State Requirements**

The 2019 update from the CFPB indicated that approximately half of the 50 states specifically require financial institutions (or certain financial professionals) to report suspected elder financial exploitation to adult protective services (APS) or to law enforcement. Also, a number of states have added laws that permit certain financial institutions to delay disbursements of funds when there is a reasonable belief that financial exploitation may be present. A number of these state laws are based on the Model Act to Protect Vulnerable Adults from Financial Exploitation, which was adopted in 2016 by the North American Securities Administrators Association (NASAA).

According to the NASAA website, over half of the 50 states have adopted legislation based on this Model Act. The Model Act generally applies to broker dealers and investment advisers, but some states have also included banks and credit unions. The Model Act also includes a 15-day disbursement delay authority and immunity from civil and administrative liability for a financial institution reporting suspected financial exploitation if done so in good faith and with reasonable care.
This document does not cover the legal and regulatory requirements for reporting and reacting to suspected elder financial exploitation on a state-by-state basis. Financial institutions should consult with their legal counsel in order to understand the state rules applicable to its business and to monitor for potential updates. The previously referenced SEC report, CFPB Advisory, and CFPB update include detailed information on both federal and state requirements and provide a great reference as a starting point.

Conclusion

Given both the increasing regulatory focus and growing awareness of the extent of elder financial exploitation, IRA providers should work with legal counsel and risk- and compliance-professionals to understand both the overall issue and the regulatory landscape. Based on this, providers can maintain appropriate policies and procedures to help ensure that they meet regulatory requirements and that they adopt appropriate measures to protect aging clients.
Escheat Laws

Many financial organizations struggle with IRAs that are left unclaimed or abandoned. How must these IRAs or other assets be handled to satisfy both a financial organization’s duty as trustee or custodian and its desire to “clean up” inactive accounts?

In the United States, escheat laws grant individual states rights to abandoned property. Each state has its own laws setting procedures and timelines for reporting and remitting unclaimed or abandoned property to the state. Each financial organization should determine how relevant state law treats abandoned property. Competent legal counsel should be consulted to provide specific procedures to properly report and pay unclaimed accounts.

Identify Abandoned IRAs

Section 2 of the Uniform Unclaimed Property Act (i.e., the Act) provides guidance for IRAs (or other deposits at financial organizations) that are presumed abandoned. An update to the Act, entitled the Revised Uniform Unclaimed Property Act (“RUUPA”) was completed in late 2016. Most states have enacted a version of the Act. (Earlier revisions to the Act were in 1981 and 1995.)

In general, accounts are presumed abandoned if the IRA owner has not communicated an interest in the account after three years following the date that distributions are required to begin. IRAs can be more susceptible to escheatment because IRA owners often let their accounts grow without any regular activity. But because escheat laws are often applied at the individual level rather than the account level, if an IRA owner regularly contacts the financial organization regarding another account, investment, or loan, that individual’s IRA may be exempted from escheatment.

- Escheatment waiting periods differ by state (five or seven years is common).
- Some states do not start the escheatment waiting period until the required beginning date (i.e., April 1 following the year the IRA owner attains age 72).

State escheat laws normally do not distinguish between IRAs and other accounts. If a financial organization discovers this is true in its state, then it should apply the normal escheatment rules to IRAs.

Locating Missing IRA Owners

Each year, financial organizations must report to the state revenue administrator or treasurer those accounts or funds presumed to be abandoned under the Act. Before this is done, however, the financial organization must again attempt to inform the apparent IRA owner at her last known address that the financial organization holds the property.
Reporting Abandoned IRAs to the State

If reasonable locating efforts are fruitless, the Act requires that financial organizations file a report with the state. Individual state law prescribes what information must be included in the report. The report generally is due before November 1 of each year, reflecting property presumed abandoned as of June 30 of the same year. Later in the year the state will publish a notice titled Notice of Names of Persons Appearing to be Owners of Abandoned Property. This notice appears in a newspaper circulating in the specific county that contains the IRA owner’s last known address and reveals information about when and how property may be claimed. In addition, the state must again mail a notice to each missing IRA owner whose last known address is listed in the report.

Paying Unclaimed IRAs to the State

The Act states that within six months after the final date for filing the report, all abandoned property required to be reported must be paid or delivered to the proper state administrator. The financial organization should complete and retain a withdrawal statement, detailing the reason for the distribution.

In most states, the government takes custody, not title, of the property. Under the Act, the state waits three years, then sells the property (if other than cash) to the highest bidder at a public sale. If an apparent owner subsequently makes a proper claim to the IRA, the state generally will pay over or deliver the IRA assets to the claimant.

The Act protects financial organizations that pay over abandoned property in good faith; it also provides for criminal penalties for persons who willfully violate the Act. Failure to report abandoned property is punishable as a misdemeanor offense. Failure to pay or deliver the property to the state is a gross misdemeanor offense.

Reporting and Withholding for Abandoned IRAs

In May 2018, the IRS released Revenue Ruling (Rev. Rul.) 2018-17, which addresses how financial organizations should report IRAs that they escheat to the state. Rev. Rul. 2018-17 verifies that a financial organization must report these payments on the applicable year’s Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit Sharing Plans, IRAs, Insurance Contract, etc., identifying the IRA owner as the recipient. The revenue ruling also states that these payments are treated as taxable distributions subject to the federal IRA withholding rules. The IRS did not specifically address how a financial organization should satisfy the withholding notice requirement. But informal IRS guidance suggests that financial organizations may satisfy this requirement by giving the state the withholding notice. Based on Rev. Rul. 2018-17, it appears that the state may not waive withholding on the IRA owner’s behalf.

Rev. Rul. 2018-17 did not address reporting for beneficiary IRAs. Conservatively, the financial organization should use code 4 to report the distribution on Form 1099-R in the beneficiary’s name and Social Security number. If you do not have the beneficiary’s Social Security number, leave the “Recipient’s identification number” box blank on Form 1099-R.
The revenue ruling states that financial organizations will not be treated as failing to comply with the withholding and reporting requirements for payments made before the earlier of January 1, 2019, or the date it becomes reasonably practicable to comply with those requirements. In January 2019, the IRS issued Rev. Rul. 2018-90, extending this deadline to the earlier of January 1, 2020, or the date it becomes reasonably practicable to comply.

**Escheat Laws**

Gloria, age 83, had a Traditional IRA at your financial organization. On June 12, 2015, Gloria died. Her brother, Bryan Carlson, is the beneficiary of her IRA but has not made an election to receive the IRA assets. According to your state law, you may escheat the assets to the state. Gloria’s Traditional IRA currently has a balance of $83,984.25. You must report this transaction to the IRS.

**Complete IRS Form 1099-R to report the transaction.**

![Form 1099-R](image)
IRA Fees

All IRA personnel should be familiar with how IRA fees and other charges are categorized and accordingly, how the expense is settled. IRA expenses can be split into two groups.

- Expenses that can be paid out-of-pocket or out of the IRA
- Expenses that must be paid out of the IRA

Expenses That Can Be Paid Either Out-of-Pocket or Out of the IRA

Fees that are ordinary and necessary expenses for the administration of the IRA can be paid either out-of-pocket or out of the IRA. For example, many financial organizations assess an annual fee for maintaining an IRA. In addition, fees for transactions such as rollovers, transfers, required minimum distribution calculations, terminations, and distributions are becoming more common. If an IRA owner engages an investment manager for the IRA, an investment management fee typically will be assessed. All of these fees are considered to be “trustee fees.”

IRA owners may either pay trustee fees out-of-pocket to the financial organization or have the fees debited from the IRA, if the IRA documents so permit (Treas. Reg. 1.404(a)-3(d), Rev. Rul. 84-146). Some financial organizations, through their plan documents, will dictate the method for fee payment. If the financial organization allows fees to be paid separately by the IRA owner, the financial organization generally will retain the right to charge the IRA for unpaid fees.

Trustee Fees Paid Out-of-Pocket

Before 2018, if the IRA owner was allowed to pay the trustee fees out-of-pocket, he may have been able to take a deduction for the fees. IRA trustee fees generally are considered to be an ordinary and necessary expense incurred in connection with the maintenance of the IRA. Therefore, the IRA owner generally was entitled to a deduction under IRC Sec. 212 for the IRA administrative fee if the IRA owner itemized deductions exceeding two percent of adjusted gross income.

The Tax Cuts and Jobs Act of 2017 amended IRC Sec. 67 by adding a new subsection (g), which states “no miscellaneous deduction shall be allowed” for taxable years 2018 through 2025. This amendment effectively removes the ability to deduct trustee fees charged in connection with income producing investments and IRAs.

The IRA owner may not be reimbursed from the IRA for trustee fees paid directly by the IRA owner. Any such reimbursement to the IRA owner is considered a reportable distribution to the IRA owner.
Trustee Fees Paid by the IRA

As an alternative to paying trustee fees separately, the fees may be debited from the IRA. If the IRA owner chooses to have the trustee fees paid from the IRA assets, the IRA owner is prohibited from reimbursing the IRA for the fees. Any attempted reimbursement is considered an IRA contribution, reportable on IRS Form 5498, *IRA Contribution Information*. If the IRA owner has already contributed the maximum amount for the year in which the reimbursement occurs, an excess contribution will occur.

Expenses That Must Be Paid out of the IRA

Fees that are not ordinary and necessary expenses for the administration of the IRA, including asset fees or capital expenditures, must be paid out of the IRA. All of these fees are considered to be “nontrustee fees.” Asset fees and capital expenditures tend to arise when an IRA invests in alternative investments (e.g., real property, promissory notes).

Likewise, commissions and sales charges resulting from certain investments, such as stock and mutual funds, are common in IRAs. The IRS has ruled that brokers’ commissions are not recurring administrative or overhead expenses relating to the maintenance of the IRA. Rather, brokers’ commissions are incurred when the IRA assets are actually invested and relate to the IRA’s growth.

IRS Rev. Rul. 86-142 established that brokers’ fees for requested transactions are not to be considered recurring administrative expenses for the maintenance of the IRA. Because IRA owners may pay only recurring administrative expenses out-of-pocket, broker’s transaction charges generally must be deducted from the IRA balance. Any attempt to pay the broker directly or to reimburse the IRA for the commission or sales charge amount is considered a contribution to the IRA, reportable on IRS Form 5498. If the IRA owner has already made the maximum IRA contribution allowed for the year, any such amount paid to the IRA or to the broker directly will be treated as an excess IRA contribution.

Commission and sales charges are not deductible under IRC Sec. 212.
Combination Fees

Under some fee arrangements, various types of fees are combined and charged to the IRA as one sum. For example, it is not uncommon for the asset manager’s fee, the brokerage firm’s fee, and the broker’s commission to be combined and charged to the IRA as one fee. Such combined fees are sometimes referred to as “wrap fees.”

The IRS has reviewed wrap fees in the qualified retirement plan context but has not issued official guidance on the payment and deductibility of these fees for IRAs. Presumably, combined IRA fees would be treated in the same manner as qualified plan wrap fees. In qualified plans, if the plan administrator can identify the portion of the combined fee attributable to commissions and sales charges and the portion that reflects trustee fees, the different portions of the fee may be paid separately.

But in Private Letter Ruling (PLR) 200507021, issued in November 2004, the IRS makes a distinction in defining when brokerage-related IRA fees may be paid outside an IRA rather than deducted from the IRA assets. In four investment portfolios cited in the PLR, clients each pay an annual single fee based on an asset-based formula, independent of the number or kind of investment transactions.

Clients who participate are predominantly paying for investment advisory, money management, and other trustee services. One other portfolio cited in the PLR allows investors to decide whether they would pay investment fees on a transaction-by-transaction basis, or by an annual asset-based formula. The IRS ruled that, if the IRA fee is asset based—varying by asset size, and not by the number of transactions—such fees may be considered recurring trustee expenses, and thus may be paid out-of-pocket. This allows retention of more tax-deferred assets in the IRA. See also PLR 201104061, issued November 2010.

NOTE: A PLR may be relied upon only by the person (or persons) requesting the ruling.

Liquidating Assets to Pay Fees

Because the payment of fees is an ongoing concern, most financial organizations have language in the IRA plan agreement allowing the financial organization the right to liquidate assets, if necessary, to pay fees. Another alternative for financial organizations with fee concerns is to require that the IRA owner maintain a certain amount of liquidity in the IRA to be used to pay fees or other IRA expenses.