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Southern California's largest firm exclusively practicing employee benefits law

BRUCKER



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SELF DEALING

The Old Man and the Sea-based IRA

What happened:

He thought himself a man of the sea when he braved the winds and waves but he felt he had gone too many years spending good money to sail other men's boats. At first he sailed the sea with his wife and his boy. He thought that was the best form of lucky. Then he felt unlucky because he longed to be called captain and not faux-captain. He wanted to buy a boat but he wanted to get a deal because not getting a deal would cheapen his satisfaction and make it tawdry like buying the big fish at Gelson's and calling it his own. Then he knew how he could be lucky again. He would buy his boat with his IRA money!

He left the sea and went to the city. He found himself one day 22 stories above Wilshire Boulevard where he went at the suggestion of his pension plan administrator to lay out his idea to the pension lawyer.

"Alex," said the man after seeing the lawyer was comfortably positioned in a chair that denied its occupant the brilliant sun-lit vista of the City of the Angels from Westwood to LAX and beyond.

"I will make my boat a business," said the man who really thought of himself as not so old even though he had come to the lawyer to talk about his pension plan. "I will find a management company to lease my boat to other men when I am on land. I will buy it with my pre-tax IRA dollars. I will earn tax-advantaged income. I will feel lucky when other men sail it. I will feel lucky when I sail it."

"No you won't," the lawyer said. "That idea is wise and unwise. You can't be that lucky."

"How lucky can I be?" asked the not-so-old man.

"You can take the \$400,000 you need to buy the boat from the \$2 million in your IRA," the lawyer said.

"That's lucky,"

"You can have a management company lease your boat to other men of the sea," the lawyer continued.

"That's lucky," the not-so-old man said.

"You can make a good rate of return on your investment," the lawyer explained.

"That's lucky."

"You must pay taxes on the proceeds as unrelated business taxable income (UBTI)," the lawyer declared.

"That's unlucky."

"You may never sail your own boat," the lawyer said.

"That's very unlucky!"

"You may name your boat Ira."

"That's cute."

What we did:

Alex Brucker spoke politely to the not-so-old man who now seemed so downhearted and explained how the Internal Revenue Service is like the fish in the sea that surfaces to flash its gleaming skin and teases its human predators and raises their hopes and then never takes their bait. The IRS grants plan holders great latitude in directing investments while prohibiting investors from personally enjoying those tax-advantaged plan-owned assets because that is considered self-dealing.

"We will protect you from personal use of your retirement-plan assets by writing the contract between your IRA and the management

continued on other side

As experts in every tax and labor aspect of the Employee Retirement Income Security Act (ERISA), we at Brucker & Morra are challenged by our clients to devise creative solutions to a wide range of problems. People's lives, unlike pension law, can be imprecise and messy. We know that. Our job is to bring legal order to personal chaos.

In this newsletter, we open our files (while reserving the right to change names and facts to maintain confidentiality) to present cases and client predicaments that we find intriguing and, we admit, a little entertaining.

In fact, because we want you to learn from other people's experiences, we write our newsletter to reflect what the iconic American writer Ernest Hemingway once observed about all good books: "They are truer than if they had really happened."

If you find your clients or yourself enmeshed in a true pension or benefits quandary and could use our services, we invite you to contact us. The attorneys at Brucker & Morra are experts at skillfully applying pension law and common sense to achieve workable solutions. We pledge to resolve your issue in the most efficient and cost-effective manner. Even better, as you'll read here, we'll work with you to prevent problems from ever arising.

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continued from front side

company to promise that only paying customers may take Ira to sea," Alex said.

"We will eliminate any wording that permits you and your wife and your boy and anyone you know to sail Ira whenever the management company has no paying customers," he continued.

"We will promise that you will never try to sail Ira as a paying customer," he added.

"We will eliminate any possibility that the IRS will vie with the sun of the tropic sea in putting creases in your brow," Alex concluded.

"I'm lucky," the not-so-old man said.

Comment from Alex:

If the boat owner engaged in self-dealing, he faced the possibility of paying income taxes on the entire \$2 million in his IRA. He was a lucky man to have a TPA who sent him to us before he took Ira to sea. Even so, he is still required to file tax returns for his IRA and pay tax on the UBTI. There's just no tacking around that. —Alex Brucker, abrucker@pensionlawyers.com

TAXING ISSUES

A Farewell to Alms

What happened:

In the midsummer of his life one day he got up from his mahogany desk that was as vast as a soccer field and peered through his window beyond the traffic-clogged streets and boulevards to the tranquil marina where he saw boats in the main channel, sails white and glistening in the sun from the salt, crisscrossing the murky waters toward the open ocean. He envied their airy life even while knowing they sailed a putrid freeway toward a stinking guano-covered breakwater. Then feeling an attack of sudden office suffocation he ordered his accountant to establish a defined benefit plan for his thriving one-man business so one day he with his wife might enjoy the pleasures of vacations. The accountant followed the man's orders and directed actuaries who toil in the mystifying world of computer models and algorithms that is as dense as a black hole to calculate a hefty sum for annual contributions that would maximize the man's tax deductions and minimize the years that threatened to crawl like a tortoise in warm oozing mud from his present workaholic days to his future life of leisure even though everyone who knew the man scoffed at the idea of his having an asset account under the category of pension or retirement. All went like clockwork until another day when the man shook with the fervor of a religious awakening and yielded to his desires and his wife's entreaties and quietly began

snatching vacation time in chunks that grew increasingly larger until they stretched beyond multiple pages of the National Geographic month-at-a-glance Endangered Species calendar that hung on his office wall. Financial managers who were unaware of the man's penchant for playing hooky mechanically contributed the same hefty sum each year as authorized by the actuaries and after five years the man's pension plan had pleasantly ballooned to \$2.5 million. Now there was a problem because one day someone discovered the man was not at his desk and hadn't been for a long time and while he was out having his secret fun his latest required pension plan contribution of \$500,000 was not deductible because the man who was a sole proprietor had bumped into the Internal Revenue Code deduction ceiling for people like him who were self-employed.

When the man learned of the problem he became angry at the apparent lack of accounting and calendar keeping by his minions. He stormed because he knew the half-million was after-tax money when it went in and he was concerned it might be taxed again when it came out. He mourned the loss of a substantial sum of tax-advantaged money, not to mention having to pay a hefty income tax on the lost deduction. He steeled himself to bid a farewell to alms.

What we did:

Meredith Sesser knew she could save the money from the fate worse than death that is double taxation because she routinely works with pension plans containing errors as invisible as landmines in the ground and she is aware that the IRS has rules that are similarly invisible but constructive rather than destructive. Meredith has the skills of a demolition expert who knows the precise wire to snip to eliminate danger but she chose this time to blast away the problem. Terminate the entire pension plan, she advised the client. Roll over \$2 million — tax-free — into a safe and legal IRA and then take back \$500,000 as non-taxable under the IRS tax benefit rule. This statutory provision, she explained, mandates that if you made a payment that was not deductible, you never received a tax benefit from the payment so the returned money is not income. She then purged thoughts of multiple retribution lawsuits from the man's mind by admiring his golden tan.

Comment from Meredith:

When dealing with a sole proprietor be sure to get tax returns every year to prove earned income for deductibility and benefits purposes. To paraphrase Alex quoting "Under Siege 2," Assumptions are the mother of all you-know-whats. —Meredith J. Sesser, msesser@pensionlawyers.com

IRS regulations require us to notify you that information in this newsletter cannot be used by you as a taxpayer for the purpose of avoiding penalties that the IRS might impose on you for promoting, marketing or recommending to another party any tax-related matters contained in this communication.

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