Thiessen v. Commissioner, 146 T. C. No. 7 (2016)

In Thiessen v. Commissioner, the U. S. Tax Court ruled that James and Judith Thiessen's guarantees of a loan related to their IRA-funded business acquisition were prohibited transactions under IRC § 4975(c)(1)(B). Consequently, their IRAs were deemed to have distributed their assets to the Thiessens on January 1, 2003, resulting in a significant taxable income inclusion. The case underscores the strict application of prohibited transaction rules to self-directed IRAs and extends the statute of limitations for assessment due to the unreported income.

Parties

James E. Thiessen and Judith T. Thiessen, Petitioners v. Commissioner of Internal Revenue, Respondent. The Thiessens were the taxpayers who challenged the Commissioner's determination of a tax deficiency for the tax year 2003.

Facts

In 2003, James and Judith Thiessen rolled over their tax-deferred retirement funds into newly established individual retirement accounts (IRAs). They then used these IRAs to acquire the initial stock of a newly formed corporation, Elsara Enterprises, Inc. (Elsara). Elsara subsequently purchased the assets of Ancona Job Shop, a metal fabrication business, from Polk Investments, Inc. (Polk). As part of the acquisition, the Thiessens personally guaranteed a $200,000 loan from Polk to Elsara. The Thiessens filed their 2003 joint federal income tax return reporting the IRA rollovers as nontaxable and did not disclose the loan guarantees. The Commissioner determined that the guarantees constituted prohibited transactions under IRC § 4975(c)(1)(B), causing the IRAs' assets to be deemed distributed to the Thiessens on January 1, 2003, and resulting in unreported taxable income.

Procedural History

The Commissioner issued a notice of deficiency on February 18, 2010, determining a $180,129 deficiency in the Thiessens' 2003 federal income tax, asserting that the Thiessens had unreported income from IRA distributions due to prohibited transactions. The Thiessens petitioned the U. S. Tax Court, contesting the deficiency. The Tax Court, applying a de novo standard of review, upheld the Commissioner's determination that the loan guarantees were prohibited transactions and that the six-year statute of limitations under IRC § 6501(e) applied.

Issue(s)

Whether the Thiessens' guarantees of a loan from Polk to Elsara constituted prohibited transactions under IRC § 4975(c)(1)(B), resulting in deemed distributions of their IRAs' assets on January 1, 2003, pursuant to IRC § 408(e)(2)?

Whether the six-year statute of limitations under IRC § 6501(e) applies to the

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Commissioner’s assessment of the 2003 tax deficiency?

Rule(s) of Law

IRC § 4975(c)(1)(B) prohibits any direct or indirect lending of money or other extension of credit between a plan and a disqualified person. An IRA ceases to be an IRA if the IRA owner engages in a prohibited transaction, and the assets of the IRA are deemed distributed to the IRA owner as of the first day of the taxable year in which the transaction occurs, per IRC § 408(e)(2). A disqualified person includes a fiduciary who exercises discretionary authority over the management of the plan or its assets, as defined in IRC § 4975(e)(2)(A) and (3)(A).

IRC § 6501(e) extends the statute of limitations for assessment to six years if the taxpayer omits from gross income an amount in excess of 25% of the amount of gross income stated in the return, unless the omitted amount is adequately disclosed in the return or an attached statement.

Holding

The Tax Court held that the Thiessens’ guarantees of the loan were prohibited transactions under IRC § 4975(c)(1)(B), resulting in deemed distributions of the IRAs’ assets to the Thiessens on January 1, 2003, pursuant to IRC § 408(e)(2). The Court further held that the six-year statute of limitations under IRC § 6501(e) applied because the Thiessens failed to adequately disclose the nature and amount of the unreported income on their 2003 tax return.

Reasoning

The Tax Court’s reasoning was grounded in the application of IRC § 4975 and the precedent set in Peek v. Commissioner, 140 T. C. 216 (2013). The Court found that the Thiessens, as IRA owners and fiduciaries, were disqualified persons under IRC § 4975(e)(2)(A) and (3)(A). Their guarantees of the loan were deemed an indirect extension of credit to their IRAs, constituting a prohibited transaction under IRC § 4975(c)(1)(B). The Court rejected the Thiessens’ arguments to distinguish or disregard Peek, emphasizing that statutory provisions are effective when enacted by Congress and not when first interpreted by the judiciary.

The Court also addressed the applicability of IRC § 4975(d)(23), which provides an exception to the prohibited transaction rules for certain transactions involving securities or commodities. The Court determined that the Thiessens’ guarantees were not connected to the acquisition, holding, or disposition of a security or commodity as defined in the statute, and thus the exception did not apply.

Regarding the statute of limitations, the Court applied IRC § 6501(e), finding that the Thiessens omitted gross income in excess of 25% of the amount reported on their return and did not adequately disclose the nature and amount of the omitted income. The Court reasoned that the Thiessens’ disclosure of the IRA rollovers as

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tax-free was insufficient to alert the Commissioner to the existence of the prohibited transactions or the resulting deemed distributions.

Disposition

The Tax Court entered a decision for the Commissioner, upholding the determination of the 2003 tax deficiency based on the deemed distributions from the Thiessens' IRAs due to prohibited transactions and affirming the application of the six-year statute of limitations.

Significance/Impact

Thiessen v. Commissioner reinforces the strict interpretation of prohibited transaction rules under IRC § 4975, particularly in the context of self-directed IRAs used for business acquisitions. The case highlights the potential tax consequences of personal guarantees related to IRA investments, including the deemed distribution of IRA assets and the resulting tax liability. Additionally, the decision clarifies the application of the extended statute of limitations under IRC § 6501(e) when taxpayers fail to report income from such transactions. The ruling serves as a cautionary precedent for taxpayers utilizing self-directed IRAs in complex investment structures and underscores the importance of full disclosure on tax returns to avoid extended assessment periods.

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