McNulty v. Commissioner, 157 T. C. No. 10 (2021)

In McNulty v. Commissioner, the U. S. Tax Court ruled that an IRA owner's physical possession of American Eagle coins purchased through a self-directed IRA's LLC investment constituted taxable distributions. The court also upheld accuracy-related penalties for unreported IRA distributions, emphasizing the necessity of fiduciary oversight for IRA assets. This decision clarifies that IRA owners cannot take unfettered control over IRA assets without tax consequences, reinforcing the importance of fiduciary and custodial requirements in retirement savings schemes.

Parties

Andrew McNulty and Donna McNulty, Petitioners, v. Commissioner of Internal Revenue, Respondent. The McNultys were the petitioners at both the trial and appeal levels, with the Commissioner of Internal Revenue as the respondent throughout the litigation.

Facts

Andrew and Donna McNulty established self-directed IRAs and directed the assets to invest in a single-member LLC. Donna McNulty managed the LLC and used IRA funds to purchase American Eagle (AE) coins, which she took physical possession of at her residence. The Commissioner determined that Donna McNulty received taxable distributions equal to the cost of the AE coins in the year she received them. Andrew McNulty directed his IRA to invest in AE coins and a condominium through an LLC, conceding taxable distributions but contesting accuracy-related penalties for failure to report these distributions.

Procedural History

The case was submitted for decision without trial under Tax Court Rule 122. The Commissioner determined income tax deficiencies and accuracy-related penalties for the years 2015 and 2016. The McNultys timely filed their petition and resided in Rhode Island during the relevant years. The parties settled issues related to Andrew McNulty's IRA distributions, except for the penalties. The remaining issues for Donna McNulty were whether she received taxable distributions from her IRA and whether both McNultys were liable for accuracy-related penalties.

Issue(s)

Whether Donna McNulty received taxable distributions from her self-directed IRA upon her receipt of American Eagle coins purchased through an LLC owned by the IRA?

Whether Andrew and Donna McNulty are liable for accuracy-related penalties under I. R. C. section 6662(a) for substantial understatements of income tax attributable to their failure to report taxable distributions from their IRAs?

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Rule(s) of Law

I. R. C. section 408(a) requires that an IRA be administered by a trustee acting as a fiduciary, and the IRA assets must be kept separate from other property except in a common trust or investment fund. I. R. C. section 408(d)(1) includes the value of assets distributed from an IRA in the distributee's gross income. I. R. C. section 6662(a) and (b)(2) impose accuracy-related penalties for substantial understatements of income tax, unless the taxpayer can show reasonable cause and good faith.

Holding

The Tax Court held that Donna McNulty received taxable distributions from her self-directed IRA equal to the cost of the AE coins upon her receipt of the coins. The court also held that both McNultys were liable for I. R. C. section 6662(a) accuracy-related penalties for substantial understatements of income tax attributable to their failure to report taxable distributions from their IRAs.

Reasoning

The court's reasoning focused on the fundamental requirement that IRA assets be under the oversight of a qualified custodian or trustee to ensure compliance with the statutory scheme of IRAs. Donna McNulty's physical possession of the AE coins allowed her complete and unfettered control over them, which is inconsistent with the fiduciary requirements of section 408(a). The court rejected the argument that the flush text of section 408(m)(3) allowed for an exception to custodial requirements, emphasizing that no such exception exists without clear statutory text. The court also noted that the McNultys failed to establish a reasonable cause defense for the penalties, as they did not seek or receive professional advice and did not disclose relevant information to their CPA.

Disposition

The Tax Court's decision will be entered under Rule 155, affirming the Commissioner's determination of taxable distributions and accuracy-related penalties.

Significance/Impact

This case clarifies that IRA owners cannot take physical possession of IRA assets without incurring tax consequences, reinforcing the importance of fiduciary oversight in the administration of IRAs. It also underscores the necessity for taxpayers to report IRA distributions accurately and seek professional advice when engaging in complex investment structures. The decision may impact the structuring of self-directed IRAs and LLCs, particularly in investments involving physical assets like coins, and serves as a reminder of the strict application of accuracy-related penalties for substantial understatements of income tax.

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