
Folks:

Take-Away: An IRA cannot invest in collectibles. The IRS has recently expanded the concept of what constitutes a collectible as a prohibited IRA investment.

Background: I spent 8 hours a few months ago driving a U-Haul, listening to AM radio, trying to ignore the pain in my back. A repeating radio commercial every 15 minutes was the need to buy gold in an IRA, the announcer trading on the fears of inflation, recession, and war. [The only fear not played upon was Armageddon!] Listening to that commercial I was reminded that the IRS recently issued a Notice that advised that the investment of collectibles in an IRA was prohibited.

As a generalization, IRAs are subject to severe prohibited transaction rules that include the type of investments that can be held in an IRA. For example, an IRA cannot invest in life insurance or S-corporation stock. In addition, IRAs are not permitted to invest in *collectibles*. The investment in a prohibited asset results in an immediate 'deemed distribution' to the IRA owner of the amount paid for the prohibited investment.

Collectibles: The Tax Code provides the following list of **prohibited collectibles** that cannot be held in an IRA. What **cannot be held** in an IRA are **any-**

- Works of art
- Rugs
- Antiques
- Metals
- Gems
- Stamps
- Coins [but an IRA can invest in certain U.S. gold coins or silver coins that are minted by the Treasury]

Alcoholic Beverages

- Other tangible personal property that is identified by the IRS.

[IRC 408(m)(2).]

Bullion: An IRA can, however, invest in gold, silver, platinum, or palladium bullion. Nevertheless, that bullion must be held by a *qualified* IRA custodian; the bullion cannot be held by the IRA owner in a lock box. By way of example, in the fairly recent case *McNulty v. Commissioner*, 157 Tax Court 10 (November 18, 2021), the Tax Court held that a self-directed IRA owner who held U.S. gold coins in her home safe had incurred a ‘taxable distribution’ that resulted in over \$300,000 in taxes and penalties. Accordingly, while an IRA can invest in gold bullion, but it must be held by the qualified IRA custodian, no doubt for a custodial fee (which the radio advertiser failed to mention.)

IRS Notice 2023-27: This Notice was covered earlier this year after it was first released. In this Notice the IRS stated that if an IRA holds a nonfungible token, that too might result in a ‘deemed distribution’, since the nonfungible token (NFT) would be treated by the IRS, *in some cases*, as a *collectible*. An NFT will be treated as a prohibited *collectible* if the NFT is “associated with a prohibited *collectible*.” This will be the result if the NFT either confers on the NFT holder a right to a prohibited *collectible* or it certifies ownership of a *collectible*.

Example: Bart invests \$60,000 of his IRA assets in 2023 in an NFT that certifies ownership of a rare gem. The NFT certifies ownership of the gem. A gem is a *collectible*. Hence, Bart’s NFT is *associated* with a prohibited *collectible* and therefore, Bart’s NFT will be treated as a prohibited *collectible*. Because Bart’s investment in the NFT is a prohibited investment for his IRA, that results in Bart having an immediate taxable ‘deemed distribution’ of the \$60,000. In addition, since Bart is age 54, he will also pay a \$6,000 early distribution excise tax. Even if Bart’s NFT drops in value by the time that he pays his income taxes in 2024, he is deemed to have taken a distribution from his IRA equal to the cost of the NFT that he paid in 2023.

Deemed Distributions: Things get a bit more complicated when there is a

'deemed distribution' from an IRA arising from a prohibited investment. Following the Bart example just provided, assume that Bart's \$60,000 investment in the NFT proves to be an excellent investment, and its value balloons to \$130,000 by 2025. When Bart distributes the NFT investment from his IRA (he is planning to sell it) he will have to report taxable income for 2025 of \$70,000 (\$130,000 price paid, less \$60,000 cost/basis = \$70,000.) Bart's basis in the NFT is \$60,000. Bart will also owe a penalty for the NFT distribution in 2025 since he is still under the age of 59 ½.

Prohibited Transaction: Finally, it is important to remember that not only is there the risk of a 'deemed distribution' if a prohibited investment is held in an IRA, there is also a prohibited transaction risk if there is self-dealing associated with IRA assets, if there is a personal gain that results from the use of an IRA asset that constitutes a prohibited transaction.

Back to Bart. Assume that Bart lends the NFT *associated* gem to a museum and he receives compensation from the museum for its display of the gem. That, too, is a prohibited transaction since Bart is using the gem to advance his own self-interest. As a generalization, whenever there is self-dealing with an IRA the *entire* IRA is disqualified and the IRA owner will owe income taxes on the entire balance of the IRA which will be 'deemed to be distributed', not to mention the early distribution 10% excise tax.

SECURE Act 2.0: This disqualification rule was altered somewhat with the SECURE Act 2.0, where a disqualified asset held in a IRA will not cause the entire IRA to lose its tax qualified status, just that asset/portion that was prohibited. It is not clear, though, if this rule change applies when there is an act of self-dealing with the IRA. We will have to await the Proposed Regulations that implement the SECURE Act 2.0 to find out if an act of self-dealing disqualifies the entire IRA or only that part of the IRA where there was an element of self-dealing.

Conclusion: The risk of investing in a prohibited asset in an IRA is greatest when the IRA is self-directed. Otherwise most IRA custodians are alert to what is a permissible IRA investment and what is not. If an individual wants to invest in

an NFT using their IRA, and they believe that the NFT is not *associated* with a collectible, then it would be wise to use a separate, stand-alone, IRA to hold that NFT. I wonder if former President Donald Trump, who is selling MARVEL-like 'cards' with his likeness and a small piece of the business suit that he was wearing when he had his 'mug shot' taken, now being pitched by him on TV, are NFTs associated with a collectible (as he promises?)

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