



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

U.I.L. 219.01-00

NOV 23 2004

SE: T: EP: RA: T 2

Attn.: *****

Legend:

- Company M = *****
- Portfolio A = *****
- Portfolio B = *****
- Portfolio C = *****
- Portfolio D = *****
- Portfolio E = *****

Dear *****

This letter is in response to a request for a private letter ruling dated January 25, 2001, as supplemented by correspondence dated August 16, 2002, submitted on your behalf by your authorized representative concerning the proper treatment of certain fees charged in connection with individual retirement arrangements (IRAs) as described in section 408(a) and section 408A of the Internal Revenue Code ("Code").

The following facts and representations have been submitted:

Company M is a securities broker-dealer and an investment advisor. It provides a variety of financial services to its clients, including investment banking, securities brokerage, trading, investment management, retirement planning,

estate planning, and trust services. Company M has instituted several programs that provide a combination of investment advisory services and securities trade execution services for various clients for their IRAs for which the clients pay a single fee (a "wrap fee"). In each of the programs, either Company M is the custodian over the account or one of Company M's affiliates is the custodian and has delegated investment and reporting responsibilities to Company M.

Company M will continue to focus its resources on its investment advisory service, a policy that is reflected in a wrap fee structure. Under Company M's wrap fee structure, fees are based on a percentage of assets under management and bear no relation to the number of trades an individual causes Company M to execute.

Following is a list and description of the programs Company M offers to its IRA clients:

a. Portfolio A

In Portfolio A's program, Company M selects certain senior financial advisors to provide discretionary investment advisory services. These senior financial advisors are both registered representatives and investor advisor agents. Through investment advisory agreements clients authorize Company M to act as a portfolio manager over their individual accounts, which entails managing investments on a discretionary basis and purchasing and redeeming securities on behalf of the IRA account in accordance with each client's specific goals. The portfolio manager manages all aspects of the account, including researching and selecting investments (based on research purchased from outside firms) and unilaterally purchasing the securities directly through Company M's trade desk. Other services include quarterly and annual performance appraisals, periodic reviews of objectives and progress and continued client consultations. Clients are not allowed access to the outside research firm or the individual trader; rather, the client generally communicates with a designated financial advisor. This portfolio uses a fee structure calculated as a percentage of the value of the assets held in the account.

b. Portfolio B

In Portfolio B's program, clients also authorize Company M to manage their investments on a discretionary basis. Company M's management is in accordance with a particular model Company M purchases from an independent research provider. The financial advisors work Portfolio B independently with clients to determine the approach that is most consistent with the client's objectives, including defining investment goals and risk tolerance. Other services include unilaterally executing trades with Company M's trade desk, taking custody of the securities, providing the client with quarterly and annual

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performance appraisals, reviewing objectives and progress periodically and consulting clients. This portfolio also uses a fee structure calculated as a percentage of the value of the assets held in the account.

c. Portfolio C

In Portfolio C's program, Company M provides IRA clients with an assortment of investment services, including asset allocation, portfolio management, custody of funds and securities, execution of transactions and monitoring portfolio manager performance. Portfolio C also has a fee structure whereby fees are calculated as a percentage of the value of the assets held in the account. As part of the Portfolio C's program, Company M assists clients in creating and developing an investment policy and selecting an adviser, a Portfolio Manager (who may or may not be affiliated with Company M) to manage the client's portfolio. When the Portfolio Manager and client agree on an investment policy, the Portfolio Manager places trades directly with Company M through Company M's trade desk. Company M will then periodically review the performance of the Portfolio Manager. Unlike a customary brokerage commission, Company M's fee does not vary with the frequency of the Portfolio Manager's trading or the type or amount of securities transacted. Rather, the fee is a quarterly expense, based on a percentage of assets under management, to maintain the account and to pay for the various services performed.

d. Portfolio D

In Portfolio D's program, Company M provides non-discretionary advisory services with respect to holdings or shares of mutual funds. However, based on specific information provided by each client, Company M assists clients with identifying objectives and risk tolerance, allocating assets and selecting mutual funds (which may or may not be affiliated with Company M) from a group of funds in which Company M has performed a due diligence review. The fee, also a percentage of assets under management, includes these and additional services, including taking custody of securities, reporting, monitoring of account performance and monitoring of individual funds. Company M purchases either no-load funds or funds that have waived the load for Portfolio D's accounts.

e. Portfolio E

Portfolio E is a nonadvisory program whereby Company M offers an alternative pricing strategy for full-service brokerage. Clients can choose to pay a fee based on a percentage of assets held on account in lieu of paying commissions on individual transactions. The service itself, however, is a traditional brokerage service in which Company M provides trade execution services, with broker

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advice being nondiscretionary and research and advice being solely incidental to the execution service. If the client chooses the Portfolio E program, he or she can make limitless trades without incurring additional fees.

You represent that each Portfolio includes a securities trading service, the cost of which is also included in the wrap fee. You further represent that Company M has calculated that trading costs for Portfolio A, B, C, and D total approximately fifteen percent of the overall wrap fees collected and that clients who participate in these Portfolios are predominantly paying for investment advisory, money management and other administrative services.

Based upon the aforementioned facts and representations, you request the following rulings:

1. Under section 408(a) of the Code for IRA clients and section 408A of the Code for Roth IRA clients, payments of wrap fees by clients that participate in Company M's Portfolio A program will not be treated as deemed contributions to such clients' respective IRA and/or Roth IRAs if the clients pay the wrap fees with funds that are not part of the clients' respective IRAs and/or Roth IRAs.
2. Under section 408(a) the Code for IRA clients and section 408A of the Code for Roth IRA clients, payments of wrap fees by clients that participate in Company M's Portfolio B program will not be treated as deemed contributions to such clients' respective IRA and/or Roth IRAs if the client pays the wrap fees with funds that are not part of the clients' respective IRAs and/or Roth IRAs.
3. Under section 408(a) of the Code for IRA clients and section 408A of the Code for Roth IRA clients, payments of wrap fees by clients that participate in Company M's Portfolio C program will not be treated as deemed contributions to such clients' respective IRA and/or Roth IRAs if the clients pay the wrap fees with funds that are not part of the clients' respective IRAs and/or Roth IRAs.
4. Under section 408(a) of the Code for IRA clients and section 408A of the Code for Roth IRA clients, payments of wrap fees by clients that participate in Company M's Portfolio D program will not be treated as deemed contributions to such clients' respective IRAs or Roth IRAs if the clients pay the wrap fees with funds that are not part of the client's respective IRAs and/or Roth IRAs.
5. Under section 408(a) of the Code for IRA clients and section 408A of the Code for Roth IRA clients, payments of wrap fees by clients that participate in Company A's Portfolio E program will not be treated as deemed contributions to such clients' respective IRA and/or Roth IRAs if the clients pay the wrap

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fees with funds that are not part of the clients' respective IRAs and/or Roth IRAs.

Section 162 of the Code allows a deduction for the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.

Section 212 of the Code provides that in the case of an individual, there shall be allowed as a deduction of all the ordinary and necessary expenses paid or incurred during the taxable year (1) for the production or collection of income, (2) for the management, conservation, or maintenance of property held for the production of income, or (3) in connection with the determination, collection or refund of any tax. Section 1.212-(e) of the Income Tax Regulations provides, in part, that section 212 does not allow the deduction of any expenses which are disallowed by any of the provisions of Subtitle A of the Code (relating to income taxes) even though such expenses may be paid or incurred for one of the purposes specified in section 212.

Section 219(a) of the Code provides that there shall be allowed as a deduction an amount equal to the qualified retirement contributions of the individual for the taxable year. Section 219(e)(1) provides that such contributions include amounts paid by or on behalf of an individual to an IRA.

Section 1.404(a)-3(d) of the regulations provides that any expenses incurred by the employer in connection with a qualified employees' plan, such as trustee's and actuary's fees, which are not provided for by contributions under the plan are deductible by the employer under section 162 of the Code (relating to trade or business expenses), or section 212 (relating to expenses for production of income), to the extent that such expenses are ordinary and necessary. Amounts that are not ordinary and necessary expenses are not deductible under section 162.

Rev. Rul. 84-146, 1984-2 C.B. 61, discusses the deductibility of trustee's fees with respect to IRAs. It holds that, consistent with the rules governing deductions in connection with qualified plans, amounts paid by the IRA owner for such fees in connection with an IRA are deductible under section 212 of the Code to the extent they satisfy the requirements of that section, but that the amounts paid that are not ordinary and necessary expenses, such as capital expenditures and disguised IRA contributions, are not deductible under section 212.

Rev. Rul. 86-142, 1986-2 C.B. 61, considered the deductibility of broker's commissions charged in connection with the purchase and sale of securities for a qualified employee's trust or an IRA. It notes that broker's fees are not recurring administrative or overhead expenses incurred in connection with the maintenance of the trust or IRA. Rather, brokers' commissions are intrinsic to the value of the trust's or account's assets; buying commissions are part of the cost of securities purchased and selling commissions are an offset against the

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sales price. Based on this analysis, IRA contributions to pay broker's commissions on transactions involving IRA assets are not deductible under section 162 or 212. Such contributions (and payments treated as IRA contributions) are deductible subject to the limits of section 219.

With respect to each portfolio offered by Company M, the services provided to its clients include managing investments, purchasing, redeeming, and taking custody of securities and funds, researching, and selecting investments, including mutual funds on which Company M has performed a diligent review, unilaterally purchasing and executing securities through Company M's trade desk, conducting quarterly and annual performance appraisals, conducting periodic reviews of objectives and progress, client consultations to determine the investment approach that is most consistent with the client's account objectives, consulting clients with identifying objectives and risk tolerance, allocating assets and selecting mutual funds.

The fees assessed by Company M for services it provides with respect to Portfolio A, B, C, and D are based on a fee structure calculated as a percentage of the value of the assets held in the respective account and the fees do not vary with the frequency of the transactions performed and are distinct from the cost or volume of any assets purchased or sold. Even though Portfolio E provides mainly brokerage services, the fee charged is still calculated as a percentage of the total assets under management, paid annually and clients participating in Portfolio E can make an unlimited number and amount of trades without incurring additional fees. Such fees assessed by Company M for its services with respect to Portfolios A, B, C, D, and E are recurring administrative or overhead expenses incurred in connection with the maintenance of clients' respective IRAs and/or Roth IRAs.

With respect to rulings number one through five, we conclude that payments of wrap fees by clients that participate in Portfolio A, Portfolio B, Portfolio C, Portfolio D and/or Portfolio E will not be deemed contributions to such clients' IRAs under section 408(a) of the Code and/or Roth IRAs under section 408A of the Code if the clients pay the wrap fees with funds that are not part of the clients' respective IRAs and/or Roth IRAs.

No opinion is expressed as to the tax treatment of the transaction described herein under the provisions of any other section of either the Code or regulations which may be applicable thereto.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

A copy of this letter is being sent to your authorized representative in accordance with a power of attorney (Form 2848) on file in this office.

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If you have any questions concerning this ruling, please contact
*****SE:T:EP:RA:T2.

Sincerely yours,

(signed) JOYCE E. FLOYD
Joyce E. Floyd, Manager
Employee Plans Technical Group 2

Enclosures:
Deleted copy of letter ruling
Form 437