IRA FAQs

- What is the difference between a regular IRA and a self-directed IRA?
    - A self-directed IRA and a regular IRA are similar in many ways. The major difference is that with a self-directed IRA, you are allowed to make the investment choices versus a custodian who is in charge of your typical non-self-directed IRA. Often, the custodian of a non-self-directed IRA may say that you can invest as you wish but will impose restrictions when you attempt to make investments that will not benefit the custodian. With a self-directed IRA, the only restrictions are the ones you impose on yourself, except for prohibited transactions. For a discussion of prohibited transactions, see FAQ number 14 below.
- Is it legal to purchase non-traditional assets using my IRA?
    - Yes. The Employee Retirement Income Security Act (ERISA) of 1974 passed the responsibility of retirement saving from the employer to the employee. Created in 1975, IRAs provide individuals a chance to direct where their retirement funds are invested.
      The Internal Revenue Code, instead of distinguishing which investments are allowed, identifies which investments are not permitted under these laws. Under both ERISA and the Internal Revenue Code, there are only two types of investments excluded: life insurance contracts and collectibles such as works of art, rugs, jewelry, etc. Refer to Internal Revenue Code Section 401 (IRC § 408(a) (3)).
      To fully maximize your investment options, you need to have a retirement plan that allows you to select your own investments. A truly self-directed retirement plan allows you the freedom to invest in many types of assets--assets that are not prohibited by the Treasury Department regulations and the Internal Revenue Code.
- How come I haven't known about this?
    - It’s a common misconception that the only investments allowed in a retirement account are stocks, CD’s, and mutual funds. The truth is that broader investment options have been available to the public since the inception of the IRA in 1975.
      The retirement industry has been dominated by large transaction-driven custodians who have focused on a narrow universe of investments. While these kinds of accounts may be right for some, they don’t offer the kind of freedom that a self-directed qualified retirement plan offers.
- Are there a lot of people who have accounts?
    - The self-directed industry is growing at a rapid pace and is expected to see over $2 trillion enter the market in the next couple of years. There are over 45 million retirement account holders, and less than 4% of those funds are held in nontraditional assets. This number is expected to grow significantly over the next five years as more individuals and their financial advisers become more educated about self-directed IRAs.
- What types of retirement accounts can I place in my self-directed IRA accounts?
    - There are many different types of retirement accounts that you can place in your self-directed IRA accounts. These accounts include 401(k)s, educational IRAs, qualifiable annuities, Keoghs, traditional IRAs, 403(b)s, money purchase plans and eligible government deferred compensation plans. Additionally, to be completely sure whether your funds are eligible for a rollover, you will want to contact your current 401(k) provider.
- What are "IRA transfers" and "IRA rollovers"?
    - A "rollover" occurs when an individual requests a distribution from an IRA/QRP (Qualified Retirement Plan) and then "rolls" the assets into another IRA. An individual is limited to one rollover per year. A "transfer" is when IRA assets are moved directly from one financial institution to another without the IRA owner taking possession of the assets. Unlike rollovers, there is no limit on how many transfers can be executed in a year.

- Are there different tax rules for self-directed IRAs?
    - The unique thing with IRAs and 401(k)s are the tax advantages. Most contributions are either tax deductible, as in the case of a traditional IRA or 401(k), or the distributions are tax free, as in the case of a Roth IRA or Roth 401(k). There are no unique rules for self-directed IRAs.
- What are the different funds I can use to open a self-directed IRA account?
    - Most employer-sponsored plans, like 401(k) plans, do not let you roll your account into a new vehicle while you are still employed. Some employers, however, do allow you to roll a portion of your funds. To be certain, contact your current 401(k) provider.
      If you can roll your funds into a new account, the following is a list of the types of accounts that are eligible:
    - Traditional IRA
    - Roth IRA
    - SEP IRA
    - SIMPLE IRA
    - Solo(k) or Individual(k)
    - 401(k)
    - Health Savings Account
    - Coverdell Education Savings Account
- Can I use my 401(k) funds with my current employer to purchase non-standard assets?
    - Possibly. If the company has a self-directed 401(k), you may have the ability to self-direct your 401(k) into these types of investments. To be certain, contact your current 401(k) administrator.
- What is the deadline to contribute to an IRA or Qualified Plan?
    - Qualified plans must be established by the last day of your fiscal year if contributions are to be made for that year. If you have a calendar year end, you need to establish the plan on or before the last day to contribute for that year. The contributions may be made until your company tax year deadline, including extensions. 401(k) deferrals must be made no later than 30 days after the contributions are received.
      SEP IRA and SIMPLE IRA contributions may be made by the company tax deadline plus extensions, except for defaults, which follow the above rules.
      IRA contributions must be made by April 15 with no extensions.
- What kinds of investments can I make?
    - You may purchase real estate, secured or unsecured notes, options, private placement, accounts receivable, timber deeds, crops, cattle, stock, bonds, tax lien certificates, mutual funds, certificates of deposit, or anything that is not prohibited or collectible as defined by the Internal Revenue Code. Many other types of investments are permitted and thus the range of possible investment choices is nearly unlimited. Consequently, an IRA can purchase any form of real estate.
      Real estate IRA investing opens up a huge range of alternative investments for individuals who are knowledgeable about real estate investing or who work with knowledgeable advisors, sponsors, or brokers. Investing in real estate for your retirement may serve as a means to diversify your retirement portfolio to hedge against the cyclical changes in the stock market, economy, and bank and government-based investments.
      For many who are experienced with real estate investing, real estate investments hold the potential to protect against the loss of principal while generating better-than-market rate returns through income production and capital gains. When real estate investments are not leveraged, both income and capital gains can flow back to IRAs tax-deferred (or tax-free if the IRA is a Roth IRA).
      If you have your IRA purchase real estate from an unrelated party and pay cash for it and you do not use the real estate for personal reasons while it is in your IRA (i.e., you treat it strictly as an investment), there are no special issues.

- What are the limits to the investments I can make?
  - You cannot invest in life insurance contracts or collectibles. Collectibles include gems, antiques or rugs, stamps or coins, works of art, or alcoholic beverages.
    There are also certain transactions in which you cannot participate when using IRA funds. These transactions are referred to as "prohibited transactions." Prohibited Transactions are defined in IRC § 4975(c)(1) and IRS Publication 590. These transactions were established to maintain that everything the IRA engages in is for the exclusive benefit of the retirement plan. Sometimes, professionals refer to these as "self-dealing" transactions. Self-dealing happens when an IRA owner uses their individual retirement funds for their personal benefit instead of benefiting the IRA. If you violate these rules, your entire IRA could lose its tax-deferred or tax-free status.
    Lastly, a self-directed IRA cannot own share of stock in an S corporation.
- What is a prohibited transaction?
  - There are some transactions that are prohibited by the IRS and the Department of Labor. There are basic requirements and procedures needed to apply for exemptions from the prohibited transaction rules (includes ERISA and non-ERISA plans and Individual Retirement Arrangements).
    IRA transactions must be for the exclusive benefit of the retirement plan and must not directly or indirectly benefit the IRA owner. For example, the owner cannot:
    - Borrow money from his IRA
    - Buy property for personal use with his IRA funds
    - Use IRA assets to secure a loan
    - Sell property to his IRA
- Who makes the self-directed IRA's investment decisions?
  - You do. Your account is truly "self-directed," which means that you make the investment decisions for your retirement assets in much the same way as you invest outside of your retirement plan. But you don't invest alone.
- How are my assets managed?
  - Your assets are co-managed by you and your self-directed IRA custodian. You make all investment decisions, and the custodian generally takes care of all of the paperwork and reporting details. Once you make an investment, the custodian generally keeps your books and records, coordinates the custodianship of your assets, oversees the annual asset valuation, and files all required annual reports.
- How do I open a self-directed IRA?
  - You can open a self-directed IRA by contacting a custodian. You are generally asked a few questions regarding the type of account that you would like to open. Then, you are provided with the account application form. Simply fill out the form, sign it, and mail it to the custodian.
- How much should I have in my account to get started?
  - While there is generally no minimum amount, the amount you should start with depends on the nature of the deal or investment you plan to make. Keep in mind that if you make a cash contribution to your account, you should check the contribution limits for that account type.
- Can I transfer my current retirement funds to the custodian of my self-directed IRA?
  - Yes, most application kits contain documents that assist you in transferring or rolling over your funds to your custodian. To obtain an application kit, contact your custodian.
- Can I consolidate my IRAs?
  - Yes. You can consolidate the following:
    - Your traditional IRA and SEP IRA into a single traditional IRA
    - A SIMPLE IRA to a traditional IRA after two years
    - Multiple Roth IRAs to a single Roth IRA
- I have a 401(k) plan with my former employer. How can I self-direct the funds?

    - You can self-direct the funds by rolling over your account into a traditional IRA or a qualified plan (if you are eligible to have a qualified plan) that permits complete self-direction. Contact your former employer's plan administrator or benefits department to determine what, if any, special procedures may be required. Use your custodian's funding form to carry out the rollover from your former employer's plan, as well as any other special forms required.
    - You may roll over the assets you have in your old plan to your self-directed IRA "in kind." "In kind" means that the assets you held in your old qualified plan, 401(k), or other plan are rolled "as is" into your self-directed IRA. There may be restrictions from the fund provider, broker, or annuity company about "in kind" rollovers or transfers. Your former employer will advise you about any restrictions.
    - If you are still employed, check with your current plan administrator to determine if self-direction is currently allowed within your plan or if this option can be added.
- How do I determine which retirement plan is best for me?
    - The factors to consider are:
        - Your age
        - Your contribution and deferral capability
        - Whether you have common-law employees
        - When you wish to retire
        - Your tax situation
        - Most people seek to make the highest contribution to their retirement plan that they can. Then they choose the plan that gives them the most flexibility.
- How do I fund my new self-directed IRA?
    - You may initially fund your self-directed IRA in one of several ways. At the same time you submit your application, you should indicate how you plan on funding your new IRA. Because the time it takes for your custodian to receive funds can vary greatly, take this waiting period into consideration when planning your investment timeline. Your self-directed IRA cannot make a purchase before funds reach the custodian and have cleared the banking system.
        - Funding Via Transfer. If you have decided to transfer other IRA funds into your new self-directed IRA, you generally will complete a transfer request form and your custodian will forward the completed transfer request form(s) to your current custodian(s) to initiate the transfer(s). You should expect this method to take anywhere between a week and a month, depending on your current custodian. Most take approximately 3-4 weeks to process this request.
        - Funding Via Direct Rollover. If you have decided to roll over funds from a previous 401(k) or other qualified plan, you will typically submit an application to your custodian in order to open your new self-directed IRA and contact your current plan administrator. Ask them what you need to do to initiate a "Direct Rollover" to an IRA. Once you have requested this "direct rollover," you should expect this method to take anywhere between a week and a month, depending on your current retirement plan administrator. Most take approximately 3-4 weeks to process your request. In some rare cases, they will want your new custodian to send a "letter of acceptance."
        - Funding Via Cash Rollover. Another way to move IRA funds from your current custodian to your new self-directed IRA custodian is a cash rollover. If you are in a hurry, this is most likely the fastest method of moving cash between accounts. You will need to request a taxable distribution from your current custodian. If possible, ask them not to withhold taxes (because you are going to cancel out the taxable event). You will then endorse that check over to your new IRA account by signing the back and making it payable to "ABC Trust Company Custodian F.B.O. "Your Full Name" IRA". To avoid tax and/or penalty, you must deposit this check into your new self-directed IRA within 60 days. Note: You are only

allowed to use this method once every 12 calendar months per IRA. This method takes only as long as it takes you to get a distribution and mail it in with the necessary paperwork.

- Once I have decided to open a self-directed IRA account to invest directly in real estate and have chosen a custodian, what are the practical steps that happen?
    - Open and fund your self-directed IRA with your chosen custodian and make sure the IRA will have cash in it in time to make your investment. Before looking around for your investment, if you haven't already established and funded your self-directed IRA, you will want to begin there. Before moving any further, you will, at the very least, need to open an account so that you have your IRA's "name" to work with. Always remember, it is your IRA that is making the investment--not you. Generally, once the custodian receives your application for a self-directed IRA, the application is processed and you will receive your new account number. The form of your self-directed IRA's legal "name" is generally "ABC Trust Company Custodian F.B.O. 'Your Full Name' 'IRA' (or SEP IRA, Roth IRA, etc.)'Account #'". For example: "ABC Trust Company F.B.O. Jane M. Investor, IRA, Acct. MQ148". With this new name, you may begin to search for your real estate investment.
      You must draw up all offers and/or contracts so that the buyer is listed as your IRA, not you. Your self-directed IRA should be treated as an investor separate from you, and the name of your IRA--not yours--should be used anywhere on the offer that describes the portion it is buying. Whether it is the sole buyer, or buying as a tenant in common, the documents should be vested correctly. Your IRA's title is usually "ABC Trust Company Custodian F.B.O. 'IRA Owner's Full Name' IRA 'Account Number'". You are not allowed to transfer a contract drawn up in your name into your IRA's name. When your IRA purchases property, your IRA must fund any deposit or earnest funds necessary. To authorize your custodian to put down a deposit from your self-directed IRA, you typically complete an investment authorization form and provide a copy of the purchase contract.
      At closing, you, the IRA owner, must read, approve, and sign all documents before sending them to your custodian for the final custodial signature. After checking for your signature of approval, an officer of your custodian will finalize the sale by signing the documents on your IRA's behalf. The signed documents will then be returned to the closing agent, along with funds, for processing. All documents must be vested correctly.
- What happens to the money that isn't invested in assets?
    - Because all plans are self-directed, you may direct your money anywhere you wish. Most custodians hold all your uninvested money for your benefit in FDIC-insured accounts. Alternatively, you can direct your custodian to deposit the funds in any financial institution.
- How fast will my custodian respond to an investment opportunity?
    - Once you send most custodians documentation regarding your proposed transaction and the persons to whom funds are to be sent, the custodian will send checks overnight or wire funds for you within hours of your call. Check with your custodian for their particular requirements.
- Is real estate investing an option for my self-directed IRA?
    - Yes. Real estate is one of the options that can truly add value to your investments. The arena of real estate is expansive when it comes to choices to add to your self-directed IRA. Some of the more popular choices are single family homes, duplex residential rentals, commercial properties, mortgage loans, mortgages, condominiums, raw land in both domestic and foreign countries, manufactured homes, apartment buildings, and more.
- What can you do in an IRA with real estate?
    - Buying real estate from an unrelated party (i.e., one who is not a disqualified person) with cash is the simplest way of investing in real estate with your IRA. Your IRA can buy raw land, commercial property, residential (e.g., rental) property, real estate options, as well as extend loans (e.g., first and second mortgages) secured by real estate with your IRA to unrelated parties.

As discussed below, your IRA can also buy property through leveraging, provided the loan is not guaranteed by the IRA owner (or any other disqualified person) and that the IRA has enough liquidity to support the mortgage and expenses. Most custodians have limits on the amount of leverage they will permit. Also, as mentioned below, leveraging can result in income taxes on unrelated debt-financed income (UDFI) that must be paid by the IRA. Generally, these taxes are higher than would be paid on income generated from a property that you buy and finance personally. In addition, the UDFI taxes must be paid from funds from the IRA and, therefore, there has to be enough liquidity in the IRA to cover these taxes. See IRS Form 990T and its accompanying instructions for details.

There are a variety of ways, however, that an IRA can participate in a real estate investment without a full cash capital investment. For example, your IRA can co-invest with other parties. You could also have your IRA and other parties participate in real estate investing by becoming members of an LLC that buys and sells property.

- Are there restrictions on where my IRA can purchase real estate?
    - No. Your IRA can purchase real estate anywhere