REAL ESTATE INVESTING GUIDE

Combine IRA tax advantages with real estate investment opportunities.

New Direction TRUST COMPANY

Real Estate IRA

Introduction

The IRS allows an IRA, Solo 401(k), or HSA to acquire real estate as an asset without penalty and while keeping the tax benefits associated with that account type.

An IRA can purchase any type of real estate, including residential, commercial, raw land, agricultural, and more. The IRA can buy the property outright, meaning the IRA is the title holder. If the IRA does not have the full purchase price, the IRA can partner with a person, company/entity, or another IRA. It can also secure a non-recourse loan (see below) to buy real estate.

Real estate in an IRA provides the opportunity to generate income from rent, appreciation, fixing and flipping, and more.

It has been possible to participate in real estate as an asset since the inception of IRAs. What has not always been easy is finding an IRA provider who was willing to service this type of investment. The IRS requires an authorized IRA provider for all IRAs. Not all IRA providers handle real estate, but New Direction Trust Company does.

You, the IRA holder, along with your financial professional, select the property and negotiate the terms. New Direction Trust Company makes sure that the paperwork substantiates that the asset is part of your IRA and, thus, deserves the tax benefits associated with the account type.

This report will give you detailed information on Self-Directed IRA real estate investing.

Eligible Account Types

- Traditional IRA
- Roth IRA
- SEP IRA
- SIMPLE IRA
- Solo 401(k)
- HSA

Benefits of Real Estate IRA

- Real estate is a tangible asset and one that you understand.
- Investment properties can potentially yield rental return as well as market appreciation.
- You have strategic control over the properties that your retirement account owns.
- You can buy, sell, and exchange properties without tax consequence.

Important Things to Know

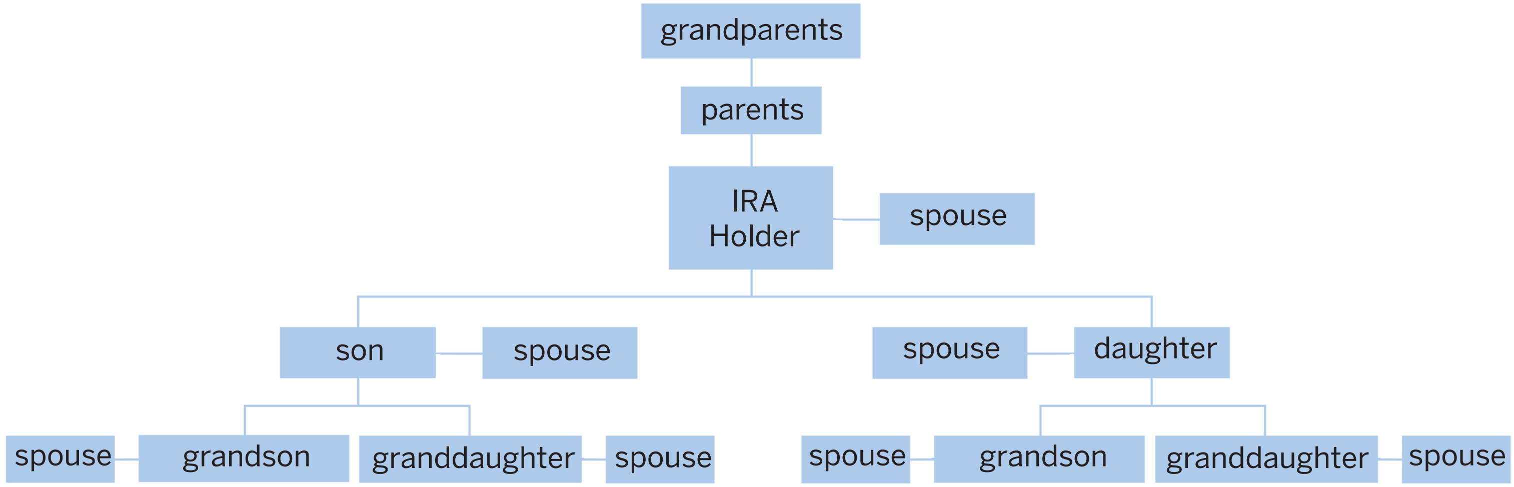
- An IRA is its own financial and legal entity, separate from your personal finances.
- As a separate legal entity, your IRA has its own name: NDTCO as custodian FBO *Client Name* IRA.
- The IRA is the owner of the real estate, not the IRA holder. Therefore, purchase and maintenance costs are paid by the IRA and all income (e.g. rent) goes back to the IRA.
- All legal documents (offer, closing documents, leases, etc.) related to an IRA-owned asset must be in the name of the IRA, not your personal name.
- Documents associated with your IRA's real estate acquisition need to be signed by New Direction Trust Company (as the custodian for that account) to be legal.

Real Estate IRA

Disqualified Persons & Prohibited Transactions

All IRAs have a list of people who are disqualified from having certain interactions with that account. Below is a graphic that delineates which persons are disqualified. Keep in mind that any entity that is owned or controlled by a Disqualified Person is also disqualified.

Disqualified Persons Include:



- Neither the IRA holder nor any other Disqualified Person to that IRA may live in or use the property.
- Disqualified Persons cannot work on the property, for free or for pay. "Sweat equity" is not allowed. Any remodeling, repair, improvement, and even maintenance must be performed by a non-disqualified person or entity.
- Your IRA cannot purchase a property from you or any Disqualified Person, nor can your IRA sell a property to a disqualified person.
- Neither you nor a Disqualified Person can guarantee a loan for an IRA property.
- Disqualified Persons are not allowed to be paid by the IRA.

Getting Started

Complete Account Application

Fund Account (transfer, rollover, or contribution)

Make an Investment

Real Estate IRA

Possible Structures for your IRA to Participate in Real Estate

Hold title to Real Estate: A real estate contract is written between the IRA and the seller. Funds from the IRA are sent to closing for the purchase and the IRA takes title to the property directly.

Tenants-in-Common with a partner entity: This is one of the ways an IRA can participate in a real estate asset without necessarily having the entire purchase price. The partner can be a person (even a disqualified person), an IRA, a company, or other entity.

Private Equity in an entity (like an LLC, LP, C-corp., etc.) that then invests in real estate: The asset in your IRA in this case is shares of a private company or percentage ownership in that company.

Loan money to a borrower who uses Real Estate as collateral: You can think of your IRA as a private lender. Your IRA can lend money to non-disqualified persons and secure the note with real estate holdings and/or other assets if you like. You and the borrower decide on the term, collateral, and the rate.

Using an LLc in your Purchase Structure

Your IRA can use an LLC or entity in its ownership structure, but it is not required. An IRA can have direct ownership in a real estate asset, or it can participate in an entity that then owns real estate. LLCs are commonly used for real estate investments outside of an IRA to achieve a level of liability protection. So, it is common for investors to think that they automatically need this same setup in their IRA. The account holder decides what the structure of the investment will be. The legal boundary inherent in an IRA may or may not satisfy the IRA holder's risk tolerance. And, of course, not all LLCs are created equally when it comes to liability protection. Strategies to mitigate risk certainly include liability insurance purchased by the IRA for its asset(s) as well as having the IRA own an LLC which owns the property.

Leveraging Real Estate in an IRA

An IRA may secure a loan to purchase property. According to the IRS, it must be a non-recourse loan (the lender is acknowledging, in the case of default, their only avenue for remuneration is the property itself). Not all lending institutions and banks offer these types of loans, but several do exist. Also, a non-recourse loan can come from a private lender.

When an IRA purchases real estate using a non-recourse loan, the debt financed portion of the property's profits may be subject to Unrelated Business Income Tax (UBIT). Similarly, if an IRA-owned property is sold while a percentage of ownership is still debt-financed, the profits derived from the debt financed percentage may be subject to UBIT. UBIT is calculated on a form 990-T and is paid by the IRA. It does not affect the IRA holder's personal taxes.

Step-by-Step Instructions

1. Open your self-directed IRA and fund it with a rollover, transfer, and/or contribution.
2. Work with your real estate agent to find a property. Make sure the offer/contract reflects the IRA as the buyer. Purchase contracts in the name of disqualified persons cannot be assigned to the IRA via an assignment, amendment, etc. Do NOT put the contract in your name or personally pay the earnest money.

Real Estate IRA

Please complete all investment documents using the following guidelines:

Buyer/Owner Name: NDTCO as custodian FBO *John A. Smith* IRA
OR
NDTCO as custodian FBO Account No. 12345678
OR
NDTCO as custodian FBO *John A. Smith* IRA, Account No. 12345678

If you partner your IRA with a disqualified person/IRA/entity, you must establish the percentage of ownership at the beginning of the investment. Those percentages will be used to divide up the incoming revenue and pay all expenses, including earnest money.

For example, the vesting would be shown as follows, assuming a 60/40 split (the percentages can be anything from 50/50 to 99/1):

NDTCO as custodian FBO *John A. Smith* IRA, as to an undivided 60% interest, and John A. Smith, as to an undivided 40% interest

OR

NDTCO as custodian FBO *John A. Smith* IRA, as to an undivided 60% interest, and NDTCO as custodian FBO *Joseph B. Smith* IRA, as to an undivided 40% interest

Earnest money must be paid from the IRA or by a non-disqualified person who may then be reimbursed by the IRA.

Property Management of Rental Real Estate in an IRA

After your IRA has successfully purchased real estate, the IRA holder is the decision-maker for that property. That may include the hiring of a property manager (or other non-disqualified person or entity) to handle the day-to-day cash flow and operations, or you may choose to work directly with New Direction Trust Company to pay vendors and other bills out of your account. Income generated by the IRA-owned real estate must go back into the IRA. Rent checks are made out to the IRA (or the management company if there is one), not the IRA holder. As the IRA holder, you have the ability to choose the vendors for your IRA-owned property. Maintenance and improvements cannot be performed by the IRA holder or any disqualified person. You may not pay for any property related expenses with your personal funds on behalf of the IRA. All expenses are paid from the IRA. Because neither the IRS nor NDTCO researches nor endorses any investments, the IRA holder is responsible for performing due diligence on all investments. Visit our website for more information on due diligence and ways to protect yourself from investment scams. A competent professional in the legal, financial advice, or accounting fields can also be engaged if you need additional help. Any of these legal professionals can assist in deciding if the investment being considered is legitimate, meets your risk tolerance parameters, and is right for your investment goals.

Real Estate IRA

Real Estate Distribution Strategy Considerations

- An IRA holder may begin taking distributions from their plan at 59.5 years of age without penalty.
- Distributions made prior to age 59.5 will result in an early distribution penalty of 10%.
- A distribution can be taken in cash or in-kind.
- With a cash distribution, the IRA holder liquidates real estate asset(s) within the account and then requests a "cash" distribution (in the form of a check or wire) from the account.
- With an in-kind distribution, the asset itself (or some percentage of the asset) is distributed to the account holder.
- If the distribution is taken from a Traditional IRA, tax is due on the value of the distribution, cash or in-kind.
- Similar to the way that an account holder can distribute a percentage of the cash in their IRA over a number of years to spread out the tax burden, an in-kind distribution can take place over a number of years.
- Valuation prior to distribution of a real estate asset generally needs to be in the form of a formal appraisal.

Real Estate IRA Frequently Asked Questions

Can I buy real estate in my Retirement Plan?
Yes! The IRS has had this question so many times they answer it directly on their website (www.irs.gov). In their retirement Q & A section they say "IRA law does not prohibit investing in real estate but trustees are not required to offer real estate as an option". Therefore, to invest in real estate your IRA custodian must allow it. New Direction Trust Company handles real estate and many more alternative assets.

Why haven't I heard about real estate investment in IRAs before?
Retirement investing has been dominated by the securities industry since 1974, but real estate has always been available to IRAs. Investing IRA funds directly in real estate is an option that many people are just learning about.

I have a 401(k). Can I invest that in real estate?
Your 401(k) plan may, at your direction, be invested in real estate if the investment provisions of the plan permit it. The employer establishes the plan for the benefit of the employees, and that employer will have language incorporated in the plan document which states what investment options are available to the employee. If you have a 401(k) from an employer for whom you no longer work, those funds can be rolled over to a Traditional IRA with no tax consequence. From there, you can invest in real estate.

What about borrowing? Can my IRA get a mortgage?
Yes, the IRS requires that the loan be a non-recourse loan. The lender can be a bank or a private lender. IRA non-recourse loans tend to require a higher down payment than those for personally guaranteed loans.

What are the restrictions for the purchase?
The primary requirement is that the purchase be for investment purposes only. The IRA owner, certain family members, and plan fiduciaries cannot use the property while the IRA owns it. Your IRA is not allowed to buy property you already own personally.

What can I invest my IRA and qualified plans in?
There are two broad asset categories that are not allowed: life insurance and collectables. Beyond that, the IRS does not approve any specific investments. Usually limitations on asset types are a result of the IRA provider's business model, not IRS regulations.

What are "alternative" investments?
Assets that are not publicly traded securities; almost anything you can invest in can be purchased inside your IRA.

Real Estate IRA

Do I need an LLC to purchase real estate with my IRA?
An LLC may be used to purchase real estate, but it is not required. See above.

Where do I find an investment property?
It's up to you and your real estate agent to find the property. There are no limitations or restrictions other than the property cannot be something you or any disqualified person currently own.

Do I need to use a special broker and title company?
No special broker or title company are required, you can use the same ones you used to buy your current home.

Can I repair the property myself?
You may not personally do any work on the property and neither can any other disqualified persons or any company you or they own. Work can be done by anyone else and you still have control over what you want them to do. Basically, you can't personally put the paint on the walls but you can choose the painter and the paint.

Can I partner my IRA with my personal funds? Who else can I partner with?
If you cannot afford the investment property you are interested in you have many options. One option is to partner with yourself. For example your IRA can own 50% and you can personally own 50% (note: even if you personally own 99% of the property you are still prohibited from living in it or using the property.) You may also partner with someone else's personal or IRA funds. The disqualified persons rule does not apply here so you may partner with your spouse, parent, child, friend, or whomever. There is no limit to how many people you can partner with.

How are the expenses paid on an IRA-owned property handled?
Expenses are to be paid directly from the IRA. If the IRA owns 100% of the property it is responsible for 100% of the expenses. If your IRA is a partner, it is responsible for its portion of the expenses. Because the IRA must pay the expenses it is important to make sure there are sufficient funds in the IRA to cover the expenses. When purchasing the property don't forget to take expenses into account.

Where does rent income go?
Rental income from the investment goes directly into the IRA.

How long must my IRA own a property before selling it?
There are no time restrictions or limitations on buying or selling a property.

Do I have to pay capital gains taxes if I sell the property?
Because the property is owned within a tax deferred (Traditional IRA) or tax free (ROTH IRA) plan, no capital gains taxes need to be paid as long as there is no outstanding debt leverage for 12 months prior to the sale. If there is outstanding debt leverage, UBIT may apply to the percentage of that leverage.

Can I take property as a distribution and then live in it?
Yes, after you reach 59.5 years of age you may choose to take the property as a distribution from your IRA. Once the property is 100% distributed, it is in your possession and you are free to use the property as you wish.

What exactly is UBIT?
Unrelated Business Income Tax applies to debt financed property in IRAs and also applies to operating income received from companies owned by IRAs and qualified plans. Typically the debt financed income is taxable under UBIT rules for the percentage of property that is debt-financed.