



Entrust New Direction

www.NewDirectionIRA.com

Using Your Retirement Plan To Invest in Real Estate



This book is for informational purposes only and does not serve as a substitute for tax or legal advice.

Table of Contents

INTRODUCTION	2
REAL ESTATE AS A RETIREMENT PLAN INVESTMENT	2
PURCHASING THE INVESTMENT.....	3
TYPES OF REAL ESTATE ALLOWED	3
FINANCING A REAL ESTATE PURCHASE	3
PURCHASE STRUCTURES	4
THE PROCESS: FLOW CHART	5
THE PROCESS: STEP-BY-STEP.....	5
OWNING REAL ESTATE IN AN IRA.....	7
INCOME AND EXPENSES	7
MANAGEMENT OF ASSET	8
CASH SHORTFALLS WITHIN THE IRA	8
RULES.....	9
PROHIBITED TRANSACTIONS & DISQUALIFIED PERSONS.....	9
CONSEQUENCES AND PENALTIES.....	10
SELLING IRA-OWNED REAL ESTATE.....	10
IMPORTANT THINGS TO KNOW AND REMEMBER.....	12
UTILIZING A PROPERTY MANAGEMENT COMPANY	13
UNRELATED BUSINESS INCOME TAX (UBIT).....	13
CASE STUDIES.....	14
CASE STUDY 1: UNDEVELOPED LAND	14
CASE STUDY 2: PARTNERING WITH IRA WITH CASH	16
CHOOSING THE SELF-DIRECTED PLAN THAT BEST FITS YOUR INVESTMENT STRATEGY.....	17
<i>Traditional or Roth - Which To Choose?</i>	17
TRADITIONAL IRA	17
ROTH IRA	18
SEP IRA	18
SIMPLE IRA.....	18
HEALTH SAVINGS ACCOUNTS (HSA).....	19
EDUCATION SAVINGS ACCOUNTS (ESA).....	19
INDIVIDUAL (K) PLANS	19
HOW TO CHOOSE A CUSTODIAN OR ADMINISTRATOR	19
ABOUT THE AUTHORS	21
<i>Catherine Wynne and Bill Humphrey Principals of Entrust New Direction IRA.....</i>	<i>21</i>
APPENDIX A – IRS CODE SECTION 4975 “PROHIBITED TRANSACTIONS”	23
APPENDIX B – INSTRUCTIONS FOR TITLE COMPANIES AND REAL ESTATE BROKERS..	31
APPENDIX C – IRA/401K PLAN CONTRIBUTION LIMITS	33
APPENDIX D – GLOSSARY	35

INTRODUCTION

Real Estate as a Retirement Plan Investment

The key to the self-directed retirement plan is the flexibility to place any legal investment in your Plan, including real estate. Purchasing real estate in your Plan provides investors a hard asset to counterbalance the retirement portfolio traditionally dominated by financial securities. It also allows real estate investors the ability to invest in an asset that they know and understand.

Self-directing retirement funds to real estate requires having a plan that allows true self-direction. Many financial institutions, while promoting self-direction, allow only financial securities to which the institution has easy access or from which it earns commissions. Truly self-directed plans allow you, the investor, to select the investment on your own. Self-directed plan administrators may be located easily via an Internet search. Entrust New Direction provides investors with education and hands-on assistance in self-directing their plan.

Once your Plan or Account is established, you may direct your plan administrator to purchase for your Plan whatever real estate property you choose, within IRS guidelines.

As with any IRS-related pronouncement, there are exceptions. When purchased, the property becomes an asset of your Plan or account. In addition:

- You do not personally own the property purchased by your Plan
- You must ensure that your intended purchase is not a prohibited transaction. A prohibited transaction involves the improper use of your IRA or Qualified Plan holdings by you or any disqualified person. A disqualified person is any member of your immediate family (except siblings), employers, certain partners, fiduciaries, and other categories specified in the IRS code. (See Appendix A)
- The property must be for investment purposes only.
- Neither you, your spouse, nor your family members, other than siblings, may have owned the property prior to its purchase by your Plan.
- Neither you nor your family members (other than siblings) may live in or lease the property while it's in your Plan.
- Your business may not lease or be located in or on any part of the property while it's in your Plan.

A more detailed examination of the IRS rules governing the purchase of real estate by an IRA or qualified plan is included in the Rules Chapter of this e-book.

PURCHASING THE INVESTMENT

Types of Real Estate Allowed

Nearly any kind of real estate is permissible as an IRA investment.

*The IRS code specifies **no restrictions** on:*

- Types of Real Estate
- How long the property is held
- Where the property is located
- The price and/or market value of the property

The following are all possible investments for your IRA or Qualified Plan:

- Single family homes
- Commercial Property
- Multi-unit homes
- Rental properties
- Apartment buildings
- Fix & Flips
- Condominiums
- Improved or unimproved land
- Co-ops
- Property held only for appreciation

Entrust will not provide investment advice regarding the purchase, they only perform the actions that you direct. As administrator, Entrust follows your instructions, reviews documents, and signs purchase and other documents on behalf of your Plan. Ultimately, both the IRA and investment control belong to you.

Financing a Real Estate Purchase

If your IRA does not have enough funds to purchase the property of choice, there are some options to consider for coming up with the balance for the investment. You may have your Plan partner with other plans or other individuals to make a purchase. You are allowed to finance a portion of the price if you wish. Your Plan may invest in a partnership or LLC that is purchasing real estate. The choice is yours. The ability to put your retirement funds into an investment that you can see, select, control and understand is the power of self-direction.

Purchase Structures

100% Cash

Property may be purchased with cash from the plan. This is the easiest way to purchase property with your IRA. In this case, the IRA owns 100% of the property.

Partnering

The IRA may partner with another person, entity, or IRA. In partnering, your IRA would own only a percentage of the property and the remaining portion would be owned by someone else. It is acceptable to partner your IRA with personal funds and/or disqualified persons, but one should take care in doing so.

When partnering with disqualified persons, the ownership percentage must be kept constant throughout the deal, and all expenses as well as income, must be split according to that ratio. It is also important that the dollar amounts be proportional to percentage of ownership when partnering with disqualified persons for the life of the investment. Managing the funds for this type of partnering is difficult, as it requires a third party property manager or bookkeeper to handle the monies of the property.

Mortgage

The IRA may use leverage (a mortgage loan) to purchase property. The loan must be a non-recourse loan, meaning that the IRA holder does not guarantee the loan, or pledge their personal assets and/or credit; the only security on the loan is the property itself. Non-recourse loans are typically made on income-producing properties and require between 35-40% down.

Profits from the leveraged portion of the investment may be subject to UBIT (Unrelated Business Income Tax). Please refer to our report on UBIT for more information.

LLCs

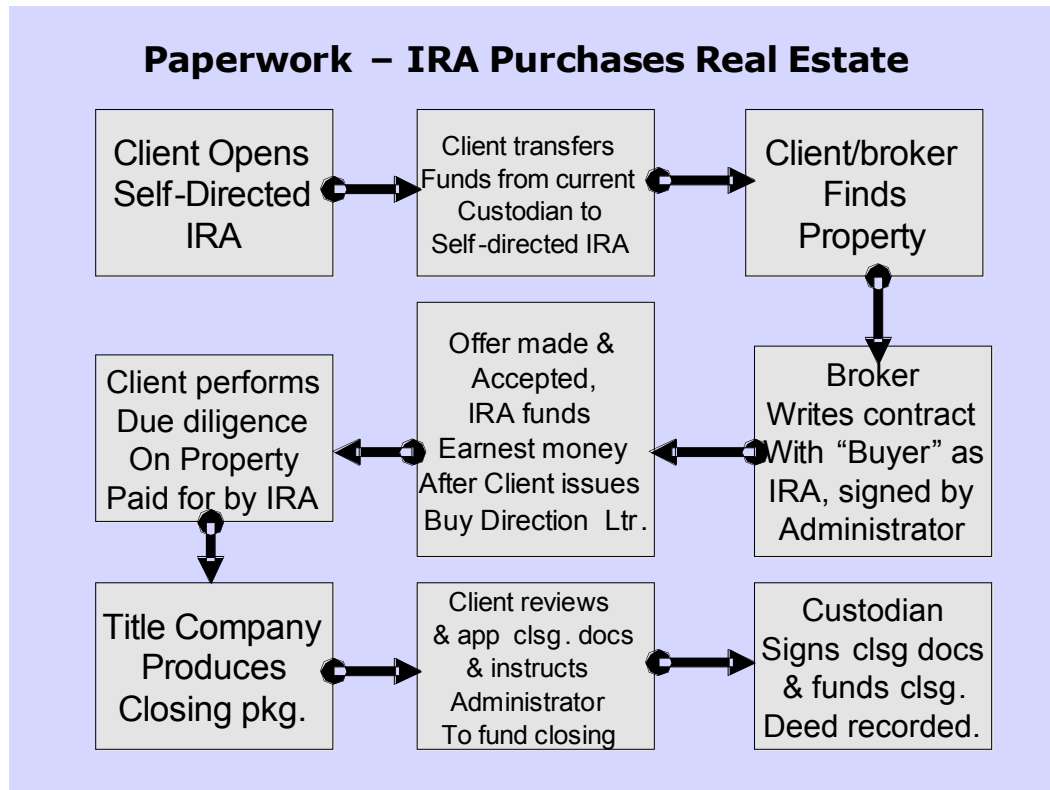
LLCs are not required to purchase real estate within an IRA – this is a common misconception. Although some clients do use LLCs to purchase real estate, a majority of IRA-held property is held directly in the IRA's name.

When property is held directly by the IRA, paperwork flows through the hands of the Administrator, who ensures all paperwork is correct and transactions are clean from observable prohibited transactions. This benefit is lost in an LLC as transactions within the entity are invisible to the Administrator.

An LLC with IRA owners is still bound by IRS rules related to IRAs. It is the LLC manager's responsibility to avoid prohibited transactions which, if violated, can result in the distribution of the IRA plus other penalties. It is the client's

responsibility to ensure that the manager is familiar with IRS code section 4975, the 5305 disclosure document, and has competent legal advisors.

The Process: Flow Chart



The Process: Step-by-Step

1. Opening the account with the self-directed administrator is the first step because the administrator must be authorized by the client to sign the sales contract.
2. Funding the account should quickly follow account opening. Funds transfer may take as little as 3 weeks or up to several months depending on the client's custodian. Having the funds distributed to the client and rolled over into the new self-directed account is the fastest way to fund the account. However, there are restrictions on how often this can be done.

Opening and funding the self-directed IRA prior to making any offers on investment real estate will ensure that your purchase is completed quickly and with the least difficulty.

3. Finding the property is the next step. The broker must advise the client on suitability of the purchase based on the IRA account's ability to purchase and pay ongoing expenses, if necessary.
4. The IRA Administrator, "Entrust New Direction, Inc." must sign the contract on behalf of the client's plan. If the IRA holder is unable to get in touch with the Administrator on weekends or after hours, other arrangements will have to be made.

Writing the contract correctly (as always) is one of the most important steps in this purchase. An example of proper titling of the buyer: Entrust New Direction, Inc. FBO John Smith, IRA.

Note: there may be other titling options that are specific to certain custodians or administrators.

5. The earnest money check must be written from the IRA account. Always check with the administrator/custodian in order to find out what their guidelines are. Keep in mind that if funds transfer is an issue when needing quick earnest money, you can always make your current year IRA contribution in order to have funds available.
6. Due diligence is the responsibility of the client, the IRA holder and the broker, to the extent specified in agency law. Expenses incurred for inspections, surveys or other items are best paid at closing and shown on the settlement sheet. The expenses may also be paid for by a non-disqualified person. NOTE: The self-directed IRA administrator may NOT at any time issue a check to the IRA holder as that would be considered a distribution and therefore subject to taxes and possible penalties.

7. The IRA holder must coordinate the details of the real estate purchase. The title company will work closely with the IRA administrator, with assistance from the IRA holder, in order to correctly produce the documents for closing. Leave time for changes to documents. Make sure the title company has received instructions (see Appendix D) and that this closing will not be attended by the administrator for the IRA. This means that documents need to be ready at least 48 hours before the closing date because it will be a “mail out” closing.

8. The client/IRA holder must always review and approve the settlement documents prior to closing. An indication that the documents have been read and approved is required before the Administrator will fund the transaction. How is this indication made? The IRA account holder reads and approves the documents by signing and dating the documents and including the statement “read and approved” on the signature pages. The Administrator will always sign on the “buyer” line, not the IRA holder.

9. The Administrator reviews all documents for correct and consistent titling. The address of the Buyer is the address of the Administrator. The Taxpayer ID number is the Administrator’s trust account tax ID.

10. Closing and funding the transaction is done after the client has officially directed the Administrator in writing. Administrators will always have a form for this, called a Buy Direction Letter.

OWNING REAL ESTATE IN AN IRA

Income and Expenses

Once the purchase has been completed, all expenses and income will flow in or out of the IRA account. For example, the property tax for the property will be paid by the IRA. Any rental income would be made payable to the IRA and would be deposited into the IRA account as investment earnings. This arrangement is critical for protecting the tax advantages of the IRA-owned real estate.

If you personally pay an expense for the IRA, that expense becomes an over contribution to your plan. Taxes, as well as IRS penalties, may apply. It is the client's responsibility to ensure that all bills/invoices are mailed or faxed to Entrust.

Management of Asset

Following the closing, the client must have a plan in place that covers the ongoing management of the property. Since the client may not handle any monies associated with the property, a third party who is not a disqualified person must handle the day-to-day business. Options for this third party would include:

- Professional property manager using a trust account
- Bookkeeper with a business account set up for the property
- Accountant
- Self-directed Administrator to write checks only. NOTE: IRA holder may take possession of checks from the tenant if the checks are made out to the Administrator and if the IRA holder forwards them directly to the IRA account.
- Real Estate broker with business account
- Trusted Non-disqualified person

If there is a management contract, remember that the IRA is the client of the property manager and therefore the administrator must sign the management contract. Make sure the property manager understands that the IRA holder may not receive any funds from the IRA account under any circumstances. This concept is sometimes difficult to absorb at first exposure, so encourage the manager to contact the Administrator if there are any questions on the financial arrangements. The property manager is required to send current financial reports to the Administrator quarterly.

Cash Shortfalls within the IRA

Your IRA is responsible for all expenses related to your investments, including any emergency expenses like a new roof or new appliances. Even though you expect your tenants to pay rent, and you make sure to make a maximum contribution each year, it is possible for an unexpected expense to put you in a tight situation. You must plan for contingencies and maintain reserves of cash in your IRA account. Never use all of the cash in your account for the purchase of the asset; you will most likely need some later.

To cover some of those emergency purchases, IRAs may purchase hazard insurance, and, if used, the money paid out for claims must go into the Plan and

be paid to contractors. These funds may also be used as a withdrawal of an excess contribution.

Overall, the safest thing to do is to think ahead and keep enough liquid funds in your IRA to cover emergency expenses. Please be sure to call your IRA administrator if this becomes an issue.

RULES

The most frequently asked questions about self-directed retirement plans are about which kinds of transactions are permitted, and which are not. How much freedom do you have when it comes to investing with your tax-free or tax-deferred IRA?

The IRS tax code addresses this question by outlining and defining what is prohibited. Self-dealing transactions are prohibited. The terms "self-dealing" and "prohibited transaction" may be used interchangeably. There is little in the way of guidance or direction regarding what *is* allowed, in specific terms. Therefore it is important to understand the basic intent of your retirement plan, and the language that defines prohibited transactions.

Fundamentally, **your retirement plan is intended to benefit you when you retire, and not before** then. This simple concept is helpful in understanding the rules on permitted uses of your IRA. If you are planning any transaction which clearly appears to confer direct benefits to you prior to retirement, you should carefully examine the legality of such a transaction.

Prohibited Transactions & Disqualified Persons

IRS rules prohibit the IRA from dealing with certain people.

Disqualified persons to your Plan are:

- You
- Your spouse
- Your ascendants (parents)
- Your direct descendants (children)
- Your direct descendants' spouses
- Certain fiduciaries (CPAs, Attorneys, Financial Planners, etc.)
- Retirement Plans held by disqualified persons

- Entities owned or controlled by disqualified persons

A disqualified person CANNOT:

- Buy a property/asset from the Plan
- Sell a property/asset from the Plan
- Live in this property
- Rent this property (even if paying fair market rent)
- Use the property personally as a vacation home
- Pay expenses for the property
- Handle money related to this property
- Make improvements to this property
- Guarantee a loan or extend credit to the IRA
- Take a commission on the purchase or sale of this property
- Put personal property or sweat equity into this property

In other words, if the IRA directly or indirectly benefits OR is benefited by a disqualified person, that action is a Prohibited Transaction.

Consequences and Penalties

It's important to be aware that a violation of transaction rules may result in the distribution of this asset from your plan and may cause you to incur severe penalties. This rule is defined in IRS Code, Section 4975 (See Appendix A).

SELLING IRA-OWNED REAL ESTATE

Selling a property owned by an IRA may result in an increase in the IRA account value, which is tax-deferred when the entire transaction takes place within the account. Funds from a liquidated property may be invested in anything allowed by IRS Code section 408, including more real estate.

When selling a property that is owned by an IRA, the process is very similar to initially purchasing the property. The process:

1. Listing Contract is with the IRA, not the owner of the IRA. The "Seller" line should read exactly the same as the Deed. Although the beneficial owner of the IRA should acknowledge that they have read and approved the listing agreement, it will need to be ultimately signed by the IRA Administrator.
2. The IRA holder AND the Administrator should sign other documents such as the Lead Based Paint Disclosure, Property Disclosure, Square

Footage Addendum and others. The Administrator's signature on these documents is for acknowledgment of the document only, and is not meant to convey any knowledge or responsibility for the property condition.

3. Once the property is under contract, the Sales Contract and any addendums or amendments need to be signed by both the IRA holder as "read and approved" and by the Administrator on behalf of the IRA.
4. If there is a loan on the property, the IRA holder or the IRA administrator should provide information to the title company on the mortgage payoff.
5. Title work should be sent to both the IRA holder and the IRA administrator although it is the IRA that is the owner of the property.
6. Once the property is under contract and the Buyer's due diligence has been performed, the broker needs to work with the title company in preparation for the closing, ensuring that all documents have the correct vesting of title.
7. The IRA holder needs to review anything that is signed by the Administrator, ideally at least 48 hours prior to the day of closing. Since the Deed is the most important document in the closing, the buyer's broker and the Administrator need to examine this document to ensure that the entity shown as conveying the property is correct. Do not hesitate to seek competent legal advice if there are any questions about the conveyance. The Deed will need to have the Administrator's signature notarized; therefore, it will be a "mail out" closing, and the document should be reviewed by the Administrator prior to sending in order to avoid delays.
8. At the time of the closing, the proceeds of the sale must go back to the IRA. The IRA Administrator needs to account for the sale of the asset on the books. If there is a lender and there are funds in the lender's escrow for real estate taxes or insurance, the lender will need to be reminded that those funds MUST be sent to the IRA administrator and NOT be sent or made payable to the IRA holder.
9. If there are any escrow agreements or holdbacks for work on the property, they need to be signed by the IRA Administrator.
10. If the property had a mortgage, there is likely to be UBIT generated on the sale of the property. Just like when the investment is initially made, care should be taken when deciding when to sell a property, taking into consideration the affect of UBIT on the proceeds of the sale. Note: although not covered here, it is possible to perform a 1031 exchange on the debt-leveraged portion of the sale in order to avoid the tax.

In order to avoid self-dealing or other prohibited transactions, the following also needs to be observed:

- No cash from the sale may go back to the IRA holder
- A Broker who owns a property in his/her IRA may not earn a commission from the sale of the property.
- No “Disqualified Person” may purchase the property. This includes an “indirect” purchase that involves sale to a third party and quitclaim or quick sale to the IRA holder. The sales transaction must be a “real transaction”, not merely a change in title for the purposes of getting the property out of or into the IRA.

IMPORTANT THINGS TO KNOW AND REMEMBER

IRAs require special treatment and have to follow specific rules. The first investment will be on a learning curve, and the administrator expects to answer a lot of your questions.

Please remember:

1. You and your IRA are NOT the same thing.
 - a. Your IRA is a completely separate entity from you - think of it as your Uncle IRA.
 - b. You cannot sign on behalf of your IRA - If something needs a signature, write “Read and Approved” and sign IN THE MARGINS; then, email/fax to us to sign as the buyer or investor.
2. You may NOT pay any of the IRAs expenses.
 - a. The IRA cannot reimburse you.
 - b. Any expense of the IRA’s that you pay becomes a taxable and penalized distribution from the plan - this INCLUDES earnest money.
3. UBI Tax applies to profits made as a result of using leverage (loans).
 - a. It is the client’s responsibility to calculate, report, and pay this tax.
4. Any violation of IRS rules that results in a Prohibited Transaction will result in the distribution of related funds plus penalties.

Utilizing a Property Management Company

If you choose to use property managers to make the process of paying bills and collecting rent quicker and easier, please note these requirements.

- The property management account must be in the name of the IRA.
- The property managers must provide the IRA administrator an accounting of the income and expense on a quarterly basis.
- Any excess cash would be sent from the property manager back to the IRA.
- Property managers must not be disqualified persons.

Unrelated Business Income Tax (UBIT)

If you elect to take advantage of debt financing to make the purchase, you should be aware of Unrelated Business Income Tax (UBIT). Basically, UBIT is tax on the income produced by the debt-financed portion of your investment. Your plan administrator will be able to direct you to appropriate information regarding the UBIT calculation for your proposed purchase.

Once the property is purchased, all the expenses and debt service payments will have to be paid through your Plan. You must make sure that there are sufficient funds available in the Plan on an ongoing basis. If you prefer, you may hire a management company to receive the rents and pay the bills, or you can arrange for those functions to be handled by the Plan administrator.

If you decide to sell the property, once again you direct the administrator to complete the transaction upon your direction. The proceeds from the sale are put back into your Plan. The administrator can also be directed to distribute the property to you, in part or in whole as a distribution from the plan. This option is a favorite for investors who wish to personally use property in the Plan, such as a retirement home, once they reach the age of 59 1/2.

Real estate in retirement accounts is not a new idea; Entrust has been providing self-directed IRAs since 1981. IRAs have been promoted primarily by financial services companies who do not have the expertise to provide truly self-directed plans and who are not financially motivated to develop such programs. Today, the advent of the Internet is making companies like Entrust more accessible to the average investor and the idea is spreading quickly.

CASE STUDIES

Case Study 1: Undeveloped Land

**10 acres with privacy, views and amenities in mountain resort community
IRA makes cash purchase of property**

2010 price: \$50k

Jake is a successful rancher in rural Wyoming. His dream is to pass the ranch and all the operations to his sons a few years after his 60th birthday and retire to a mountain resort community. While vacationing in Whitefish, Montana Jake finds the perfect spot. He knows he's found the property of his dreams in this secluded acreage with a bubbling spring, gorgeous mountain views and a short drive from town. This year has been tough on Jake's savings. He has already borrowed as much as he can this year on emergency equipment purchase this spring. He simply does not have the personal resources to buy the property this summer. He considers giving up until he gets a call from the selling Realtor, Joe, saying the seller really needs to sell the property and has reduced the price an additional \$25,000! Luckily, Joe has a helpful suggestion. Has Jake considered buying the property using his retirement savings?

Joe explains that Jake cannot use the property until he retires, but the investment would grow tax-deferred until that point. Jake doesn't care about not using the property until retirement, because he would continue to live in Wyoming until retirement anyway. Jake and Joe begin by carefully analyzing the projected costs together to determine if the investment is worth considering.

Jake is 40 years old this year. Joe projects that the property will be worth \$100,000 in 2029 when Jake reaches age 59 ½ and can begin taking ownership of the property. Because Jake would like to retire on the acreage, Jake plans to distribute ownership in lieu of cash distributions from the retirement plan for his first few years in retirement.

Option 1: Take 100% distribution of ownership in 2029. Pay income tax on the \$100,000 value of the distribution.

Jake plans to continue working and live on income from his ranch of \$60,000/year in 2029. Adding the \$100,000 distribution to the ranch income puts Jake and his wife in the 28% tax bracket for 2029. Total income tax paid on the distribution comes to \$28,000. Initially, Jake balks at that figure, but Joe reminds him that he would have to grow the \$50,000 in his IRA to \$100,000 in order to make a cash purchase of the acreage in 2029 and chances are that by 2029 properties like this acreage will not even be available anymore. The development in the area is growing at a steady rate. Joe also points out that

including the income tax on the property ownership, total costs to acquire the property (\$78,000) are still well below the projected property value in 2029.

Jake agrees they should continue the analysis, but more questions are growing in his mind. Jake wonders aloud, “What if I don’t have \$28,000 to pay the taxes in 2029? What if the area gets so crowded that I don’t want to live here anymore once I retire? ”.

“Whoa!” grins Joe, “one question at a time!”

Then Joe complements Jake on his forward thinking. He is planning ahead and thinking critically, which are important when making any investment.

Joe begins supplying the answers Jake needs, “In planning for the tax, it will be a good idea to consult with your CPA. I know there are options to spread that out, so ask how to do that. Either way, you will want to save for that expense as part of your retirement planning.”

Joe also reminds Jake that he always has the option to sell the acreage instead. Let’s look at what Jake would earn on the land as an investment.

Purchase price 2009: \$50,000

Projected sale price 2029: \$100,000

Costs associated with the property: \$100/year tax plus 8% commission on the sale = \$10000

Total profit = \$40,000

Annualized Rate of Return = 4%

Jake considered, “Well, a few years ago I would have laughed all the way home at those numbers, but given that it means I know that land is mine after I retire, it might be worth it to me. Besides, I like the thought of having that beautiful piece of land to show for my hard work. Some of the junk I bought from my broker 3 years ago isn’t worth the pig’s slop bucket today.”

Joe got an even better idea, “If you give this guy a call, we might be able to sweeten this deal.” He handed Jake a business card with his CPA’s name on it. “If you can qualify for a Roth IRA you won’t have to pay any tax on the property distribution at all.”

Option 2: Convert the \$50,000 IRA to a Roth IRA. Take 100% distribution of ownership in 2029. Pay no income tax on the \$100,000 value of the distribution.

Joe explained to Jake that if he converted the \$50,000 in his IRA to a \$50,000 Roth IRA by paying the 28% tax (\$14,000), he wouldn't have to pay any additional tax on the property when he took it as a distribution in the future.

"Now you're talking!" said Jake. He called up Joe's CPA, Jim, to see if he could qualify. Jim was able to pass along some good news and also explain a little bit about how Roth IRA conversions work. Jake was ready to roll. "Joe, it's time to write a contract."

Jake was glad that Joe understood IRA purchases so well, the purchasing process went very smoothly. Thanks to Joe, Jake now knows his retirement is going to be as sweet as he's always dreamed.

Case Study 2: Partnering With IRA With Cash

One couple found a rental property that was, in their estimation, an incredible deal. This property in Texas was affordable, unlike just about anything in their home state of New York. The problem was they had a total of \$25,000 in their combined Roth IRAs, \$25,000 short of the \$50,000 purchase price of the property. What could they do? Talking with lenders revealed that there would be no Non-Recourse loan available to them. The solution?

This is what they did:

1. \$25,000 from the Roth IRAs
2. \$25,000 cash from a refinance of their personal residence in New York
3. Property deeded to the couple, as individuals, at 25% each (total of 50%)
4. Property deeded to Roth IRAs as 50% ownership

Result: The couple reports 50% of the net operating income from the property, less the interest deduction for the \$25,000 they borrowed with a home equity loan.

IRA: the IRA receives 50% of the net cash flow from the property. NOTE: IRA must pay its proportionate share of the expenses; therefore the bookkeeping must be done correctly to avoid IRS issues.

Upon sale, 50% of the net proceeds go back to the IRA; the 50% personally owned by the couple personally goes either to the couple or to a 1031 exchange accommodator.

What makes this a win-win situation is that the couple has 100% leverage on their 50% share of this property as well as the interest deduction and

depreciation. The IRA, although not leveraged, has a real estate investment and the opportunity for both cash flow and appreciation at the sale of the property.

CHOOSING THE SELF-DIRECTED PLAN THAT BEST FITS YOUR INVESTMENT STRATEGY

Traditional or Roth - Which To Choose?

An Individual Retirement Account is a personal retirement savings plan available to anyone who receives taxable compensation during the year. For IRA contribution purposes, compensation includes wages, salaries, fees, tips, bonuses, commissions, taxable alimony, and separate maintenance payments.

Husbands and wives may each have an IRA, even if one person in the marriage is not employed. There are several different kinds of IRAs to meet specific individuals' needs:

Traditional IRA

A Traditional IRA may be opened by any individual who has earned income and wants to set aside a portion for retirement on a tax-deferred basis. Contributions to traditional IRAs may not be made for the year in which you reach age 70 1/2, or any later year.

If you are eligible to contribute to an IRA, the amount of the contribution for which you may take a tax deduction will depend upon whether you (or, in some cases, your spouse) are an active participant in an employer-maintained retirement plan and the amount of income you make.

- If you (and your spouse, if you are married) are not an active participant in an employer-maintained plan, your whole IRA contribution will be deductible.
- If you are an active participant (or are married to an active participant in an employer-maintained plan), the deductibility of your contribution will depend on your adjusted gross income (AGI) and your tax filing status for the tax year for which the contribution was made. AGI is determined on your income tax return using your adjusted gross income but disregarding any deductible IRA contribution.

Generally, a Traditional IRA is appropriate for those who expect their tax rates during retirement to be lower than their current tax rate, or whose tax strategy is to defer taxes to a later time in their lives. Distributions are taxable and may be

subject to penalties if there is an early withdrawal. There may be exceptions for distributions used for a first home purchase or college tuition.

Roth IRA

A Roth IRA differs from a Traditional IRA in the sense that your contributions are made with after-tax dollars. This means that eventual distributions from a Roth IRA may be tax free. By contrast, with a Traditional IRA you pay no taxes upfront, but pay them when you withdraw the money during your retirement. Moreover, contributions can be made to a Roth IRA even after you attain age 70 1/2, and unlike a Traditional IRA, you are not forced to take distributions.

A Roth IRA is appropriate for those who expect their tax rates during retirement to remain the same or be higher than their current tax rate. You can contribute to a Roth IRA if you have taxable compensation and your modified adjusted gross income is less than:

Married individuals filing jointly:

- \$176,000 for 2009

Single or head of household:

- \$120,000 for 2009

Married filing separate returns:

- \$10,000

Compensation includes wages, salaries, tips, professional fees, bonuses, and other amounts received for providing personal services. It also includes commissions, self-employment income, and taxable alimony.

SEP IRA

A Simplified Employee Pension (SEP) IRA is a plan that allows an employer, including self-employed individuals, to make contributions toward his or her own and their employees' retirement plans without becoming involved in administrative complexities.

SIMPLE IRA

Under a SIMPLE IRA plan, employees may choose to make tax-deferred contributions out of their salary while the employer makes a matching contribution of 3 percent each year, or, alternatively, a non-elective contribution of 2 percent of compensation. Employers must make either one or the other type of contribution, and must notify the employee before the beginning of each year which contribution type will be made. A Savings Incentive Match Plan for

Employees (SIMPLE) IRA, is well suited to small businesses. Generally, the attraction of a SIMPLE IRA is its ease of administration.

Health Savings Accounts (HSA)

Health Savings Accounts (HSAs) are designed to help individuals save for future qualified medical and retiree health expenses on a tax-free basis. And unlike a Medical Savings Account (MSA), an HSA is not a "use it or lose it" account.

Education Savings Accounts (ESA)

An Education Savings Account, or ESA, is a trust or custodial account that is designed exclusively for paying the qualified higher education expenses of the designated beneficiary of the account. The account must be designated as a Coverdell Educational Savings Account when it is created to be treated as a Coverdell (ESA) for tax purposes.

Individual (k) Plans

An Individual(k) plan is a cost-effective 401(k)/profit sharing plan for small business owners. The Individual(k) has 401(k)-like options for sole proprietors or small business owners. The plan offers the highest contribution amounts and lower administration fees of all plans.

HOW TO CHOOSE A CUSTODIAN OR ADMINISTRATOR

When you rely on an IRA custodian to handle your IRA account, you make the assumption that they know and understand the basic rules regarding prohibited transactions and disqualified persons. IRS § 4975, "Prohibited Transactions", gives both you and your IRA all the information necessary to manage your account legally and ensure that the rules are followed. For the purpose of this article, we are using the terms "trustee", "custodian" and "administrator" synonymously.

While ultimately you are responsible for following the IRS rules, what you might not know is that when using a custodian, they may be inadvertently violating the rules. The outcome is this - it is not just the administrator that will get in trouble, it is you and your IRA account as well. You could be subject to distribution, taxes and penalties as a result.

How do you know if your IRA administrator knows what they are doing? There are certain types of transactions which a custodian can never be involved in. If your IRA custodian allows any of the following, consider looking elsewhere for custodial services:

- Lending to your IRA
- Allowing you to transfer or sell anything you already own to your IRA
- Funding a transaction which involves a disqualified person such as a spouse, child or parent.

The first example above, lending to the IRA, is unfortunately being done by bank custodians who do not understand the rules. What do you need to know about these types of transactions? If a bank is your IRA custodian, that bank may not make a loan to your IRA. IRS § 4975 clearly states the following:

For purposes of this section, the term “prohibited transaction” means any direct or indirect—

4975(c)(1)(B) lending of money or other extension of credit between a plan and a disqualified person;

4975(c)(1)(C) furnishing of goods, services, or facilities between a plan and a disqualified person;

What is a disqualified person? Specific to the bank custodian, 4975(e)(2) delineates the list of disqualified persons, among them:

4975(e)(2)(B) a person providing services to the plan;

In plain English, any IRA custodian who provides services to your IRA, such as custodial services, is automatically a *disqualified person* with regards to the law. Banks who lend money to IRAs for which they are the custodian or provide investments directly to the plan, are participating in a prohibited transaction and, because it is your IRA, you are too.

It may be asserted that the bank Trustee department that provides the custodial services is set up as a separate entity. If so, this entity must pass the same tests as your IRA when examining disqualified persons and the ownership of the entity providing the trust services. If the bank trustee entity is owned by the same companies or individuals as the bank providing the loan, it is still disqualified.

Recent state and federal bank audits have revealed and terminated the IRA custodial services of banks who are involved in lending to their IRA accounts, mainly because of the types of transactions listed above. Many banks have decided that if they are not fully versed in the rules, they should not be in the business of providing custodial services.

Before selecting a custodian for your IRA, know what their level of expertise is. Custodians who specialize in the area of self-directed IRAs are the best selection. Having a track record, experience with a variety of transactions and competent ERISA-based legal council are a must.

Remember, your custodian's error will become your error in the event of an IRS inquiry. Ask your custodian the right questions in order to ensure you are getting the most experienced custodian for your IRA and know the Prohibited Transaction yourself in order to stay in compliance.

ABOUT THE AUTHORS

Catherine Wynne and Bill Humphrey
Principals of Entrust New Direction IRA



Catherine Wynne is best known as a dynamic speaker and expert on self-directed retirement investing. Her teaching credentials include the University of Denver Law School's Graduate Tax Program, Lorman Education and multiple CE certified courses for real estate brokers and CPAs. She has extensive personal experience as a real estate investor and syndicator and is recognized regionally as an expert in the IRS rules for IRA investment. She is an author of industry articles and courses on the subject of non-traditional IRA investment and has an instructional book currently in the works. She understands that paying attention to the details of investments as well as the IRS rules is what makes self-direction work. Working primarily in client asset acquisition, she is well acquainted with the IRA purchase of a wide variety of assets such as mortgages, notes, real estate, private placements and LLCs. Catherine has a BS in Structural Engineering from the University of Pittsburgh and spent the first part of her career in oil and gas production, later moving into nuclear power plant design with Westinghouse.



Bill Humphrey is recognized by professional advisors as an expert in the self-direction of IRAs and other tax-advantaged accounts as well as the associated IRS codes pertaining to these investments. Bill is also an experienced Certified Public Accountant who, over the past 20 years, has specialized in tax-

related property issues and forensic accounting. He received his BS in Business from the University of North Carolina, Chapel Hill. Bill's graduate work included a concentration in finance and economics. He knows the ins-and-outs of IRA law and stays current with all legislation governing tax-deferred or tax-free retirement arrangements. Bill has also been a consultant to the HSA Insider, one of the largest clearinghouses of Health Savings Account information on the web. He became involved in real estate investing with his associate, Catherine Wynne, and assisted in developing the framework for debt-leveraged IRA real estate investment.

Appendix A – IRS Code Section 4975 “Prohibited Transactions”

IRS Regulations

Sec. 4975. Tax on prohibited transactions

US Code as of: 01/05/99

- (a) Initial taxes on disqualified person There is hereby imposed a tax on each prohibited transaction. The rate of tax shall be equal to 15 percent of the amount involved with respect to the prohibited transaction for each year (or part thereof) in the taxable period. The tax imposed by this subsection shall be paid by any disqualified person who participates in the prohibited transaction (other than a fiduciary acting only as such).
- (b) Additional taxes on disqualified person In any case in which an initial tax is imposed by subsection (a) on a prohibited transaction and the transaction is not corrected within the taxable period, there is hereby imposed a tax equal to 100 percent of the amount involved. The tax imposed by this subsection shall be paid by any disqualified person who participated in the prohibited transaction (other than a fiduciary acting only as such).
- (c) Prohibited transaction
 - (1) General rule For purposes of this section, the term "prohibited transaction" means any direct or indirect -
 - (A) sale or exchange, or leasing, of any property between a plan and a disqualified person;
 - (B) lending of money or other extension of credit between a plan and a disqualified person;
 - (C) furnishing of goods, services, or facilities between a plan and a disqualified person;
 - (D) transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a plan;
 - (E) act by a disqualified person who is a fiduciary whereby he deals with the income or assets of a plan in his own interests or for his own account; or
 - (F) receipt of any consideration for his own personal account by any disqualified person who is a fiduciary from any party dealing with the plan in connection with a transaction involving the income or assets of the plan.
 - (2) Special exemption The Secretary shall establish an exemption procedure for purposes of this subsection. Pursuant to such procedure, he may grant a conditional or unconditional exemption of any disqualified person or transaction, orders of disqualified persons or transactions, from all or part of the restrictions imposed by paragraph (1) of this subsection. Action under this subparagraph may be taken only after consultation and coordination with the Secretary of Labor. The Secretary may not grant an exemption under this paragraph unless he finds that such exemption is -
 - (A) administratively feasible,
 - (B) in the interests of the plan and of its participants and beneficiaries, and
 - (C) protective of the rights of participants and beneficiaries of the plan. Before granting an exemption under this paragraph, the Secretary shall require adequate notice to be given to interested persons and shall

publish notice in the Federal Register of the pendency of such exemption and shall afford interested persons an opportunity to present views. No exemption may be granted under this paragraph with respect to a transaction described in subparagraph (E) or (F) of paragraph (1) unless the Secretary affords an opportunity for a hearing and makes a determination on the record with respect to the findings required under subparagraphs (A), (B), and (C) of this paragraph, except that in lieu of such hearing the Secretary may accept any record made by the Secretary of Labor with respect to an application for exemption under section 408(a) of title I of the Employee Retirement Income Security Act of 1974.

- (3) Special rule for individual retirement accounts An individual for whose benefit an individual retirement account is established and his beneficiaries shall be exempt from the tax imposed by this section with respect to any transaction concerning such account (which would otherwise be taxable under this section) if, with respect to such transaction, the account ceases to be an individual retirement account by reason of the application of section 408(e)(2)(A) or if section 408(e)(4) applies to such account.
 - (4) Special rule for medical savings accounts An individual for whose benefit a medical savings account (within the meaning of section 220(d)) is established shall be exempt from the tax imposed by this section with respect to any transaction concerning such account (which would otherwise be taxable under this section) if section 220(e)(2) applies to such transaction.
 - (5) Special rule for education individual retirement accounts An individual for whose benefit an education individual retirement account is established and any contributor to such account shall be exempt from the tax imposed by this section with respect to any transaction concerning such account (which would otherwise be taxable under this section) if section 530(d) applies with respect to such transaction.
- (d) Exemptions Except as provided in subsection (f)(6), the prohibitions provided in subsection (c) shall not apply to -
 - (1) any loan made by the plan to a disqualified person who is a participant or beneficiary of the plan if such loan -
 - (A) is available to all such participants or beneficiaries on a reasonably equivalent basis,
 - (B) is not made available to highly compensated employees (within the meaning of section 414(q)) in an amount greater than the amount made available to other employees,
 - (C) is made in accordance with specific provisions regarding such loans set forth in the plan,
 - (D) bears a reasonable rate of interest, and (E) is adequately secured;
 - (2) any contract, or reasonable arrangement, made with a disqualified person for office space, or legal, accounting, or other services necessary for the establishment or operation of the plan, if no more than reasonable compensation is paid therefore;
 - (3) any loan to an ^[1] leveraged employee stock ownership plan (as defined in subsection (e)(7)), if - ^[1] So in original. Probably should be "a".
 - (A) such loan is primarily for the benefit of participants and beneficiaries of the plan, and (B) such loan is at a reasonable rate of interest, and any collateral which is given to a disqualified person by the plan consists only of qualifying employer securities (as defined in subsection (e)(8));
 - (4) the investment of all or part of a plan's assets in deposits which bear a reasonable interest rate in a bank or similar financial institution supervised by the United States or a State, if such bank or other institution is a fiduciary of such plan and if -

- (A) the plan covers only employees of such bank or other institution and employees of affiliates of such bank or other institution, or
 - (B) such investment is expressly authorized by a provision of the plan or by a fiduciary (other than such bank or institution or affiliates thereof) who is expressly empowered by the plan to so instruct the trustee with respect to such investment;
- (5) any contract for life insurance, health insurance, or annuities with one or more insurers which are qualified to do business in a State if the plan pays no more than adequate consideration, and if each such insurer or insurers is -
 - (A) the employer maintaining the plan, or
 - (B) a disqualified person which is wholly owned (directly or indirectly) by the employer establishing the plan, or by any person which is a disqualified person with respect to the plan, but only if the total premiums and annuity considerations written by such insurers for life insurance, health insurance, or annuities for all plans (and their employers) with respect to which such insurers are disqualified persons (not including premiums or annuity considerations written by the employer maintaining the plan) do not exceed 5 percent of the total premiums and annuity considerations written for all lines of insurance in that year by such insurers (not including premiums or annuity considerations written by the employer maintaining the plan);
- (6) the provision of any ancillary service by a bank or similar financial institution supervised by the United States or a State, if such service is provided at not more than reasonable compensation, if such bank or other institution is a fiduciary of such plan, and if -
 - (A) such bank or similar financial institution has adopted adequate internal safeguards which assure that the provision of such ancillary service is consistent with sound banking and financial practice, as determined by Federal or State supervisory authority, and (B) the extent to which such ancillary service is provided is subject to specific guidelines issued by such bank or similar financial institution (as determined by the Secretary after consultation with Federal and State supervisory authority), and under such guidelines the bank or similar financial institution does not provide such ancillary service -
 - (i) in an excessive or unreasonable manner, and (ii) in a manner that would be inconsistent with the best interests of participants and beneficiaries of employee benefit plans;
- (7) the exercise of a privilege to convert securities, to the extent provided in regulations of the Secretary but only if the plan receives no less than adequate consideration pursuant to such conversion;
- (8) any transaction between a plan and a common or collective trust fund or pooled investment fund maintained by a disqualified person which is a bank or trust company supervised by a State or Federal agency or between a plan and a pooled investment fund of an insurance company qualified to do business in a State if -
 - (A) the transaction is a sale or purchase of an interest in the fund,
 - (B) the bank, trust company, or insurance company receives not more than a reasonable compensation, and (C) such transaction is expressly permitted by the instrument under which the plan is maintained, or by a fiduciary (other than the bank, trust company, or insurance company, or an affiliate thereof) who has authority to manage and control the assets of the plan;
- (9) receipt by a disqualified person of any benefit to which he may be entitled as a participant or beneficiary in the plan, so long as the benefit is computed and paid on a basis which is consistent with the terms of the plan as applied to all other participants and beneficiaries;

- (10) receipt by a disqualified person of any reasonable compensation for services rendered, or for the reimbursement of expenses properly and actually incurred, in the performance of his duties with the plan, but no person so serving who already receives full-time pay from an employer or an association of employers, whose employees are participants in the plan or from an employee organization whose members are participants in such plan shall receive compensation from such fund, except for reimbursement of expenses properly and actually incurred;
 - (11) service by a disqualified person as a fiduciary in addition to being an officer, employee, agent, or other representative of a disqualified person;
 - (12) the making by a fiduciary of a distribution of the assets of the trust in accordance with the terms of the plan if such assets are distributed in the same manner as provided under section 4044 of title IV of the Employee Retirement Income Security Act of 1974 (relating to allocation of assets);
 - (13) any transaction which is exempt from section 406 of such Act by reason of section 408(e) of such Act (or which would be so exempt if such section 406 applied to such transaction) or which is exempt from section 406 of such Act by reason of section 408(b)(12) of such Act;
 - (14) any transaction required or permitted under part 1 of subtitle E of title IV or section 4223 of the Employee Retirement Income Security Act of 1974, but this paragraph shall not apply with respect to the application of subsection (c)(1) (E) or (F); or
 - (15) a merger of multiemployer plans, or the transfer of assets or liabilities between multiemployer plans, determined by the Pension Benefit Guaranty Corporation to meet the requirements of section 4231 of such Act, but this paragraph shall not apply with respect to the application of subsection (c)(1) (E) or (F).
- (e) Definitions
 - (1) Plan For purposes of this section, the term "plan" means -
 - (A) a trust described in section 401(a) which forms a part of a plan, or a plan described in section 403(a), which trust or plan is exempt from tax under section 501(a),
 - (B) an individual retirement account described in section 408(a),
 - (C) an individual retirement annuity described in section 408(b),
 - (D) a medical savings account described in section 220(d),
 - (E) an education individual retirement account described in section 530, or
 - (F) a trust, plan, account, or annuity which, at any time, has been determined by the Secretary to be described in any preceding subparagraph of this paragraph.
 - (2) Disqualified person For purposes of this section, the term "disqualified person" means a person who is -
 - (A) a fiduciary;
 - (B) a person providing services to the plan;
 - (C) an employer any of whose employees are covered by the plan;
 - (D) an employee organization any of whose members are covered by the plan;
 - (E) an owner, direct or indirect, of 50 percent or more of -
 - (i) the combined voting power of all classes of stock entitled to vote or the total value of shares of all classes of stock of a corporation,
 - (ii) the capital interest or the profits interest of a partnership, or
 - (iii) the beneficial interest of a trust or unincorporated enterprise, which is an employer or an employee organization described in subparagraph (C) or (D);

- (F) a member of the family (as defined in paragraph (6)) of any individual described in subparagraph (A), (B), (C), or (E);
- (G) a corporation, partnership, or trust or estate of which (or in which) 50 percent or more of -
 - (i) the combined voting power of all classes of stock entitled to vote or the total value of shares of all classes of stock of such corporation,
 - (ii) the capital interest or profits interest of such partnership, or
 - (iii) the beneficial interest of such trust or estate, is owned directly or indirectly, or held by persons described in subparagraph (A), (B), (C), (D), or (E);
- (H) an officer, director (or an individual having powers or responsibilities similar to those of officers or directors), a 10 percent or more shareholder, or a highly compensated employee (earning 10 percent or more of the yearly wages of an employer) of a person described in subparagraph (C), (D), (E), or (G); or
- (I) a 10 percent or more (in capital or profits) partner or joint venturer of a person described in subparagraph (C), (D),
 - () a 10 percent or more (in capital or profits) partner or The Secretary, after consultation and coordination with the Secretary of Labor or his delegate, may by regulation prescribe a percentage lower than 50 percent for subparagraphs (E) and (G) and lower than 10 percent for subparagraphs (H) and (I).
- (3) Fiduciary For purposes of this section, the term "fiduciary" means any person who -
 - (A) exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets,
 - (B) renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or
 - (C) has any discretionary authority or discretionary responsibility in the administration of such plan. Such term includes any person designated under section 405(c)(1)(B) of the Employee Retirement Income Security Act of 1974.
- (4) Stockholdings For purposes of paragraphs (2)(E)(i) and (G)(i) there shall be taken into account indirect stockholdings which would be taken into account under section 267(c), except that, for purposes of this paragraph, section 267(c)(4) shall be treated as providing that the members of the family of an individual are the members within the meaning of paragraph (6).
- (5) Partnerships; trusts For purposes of paragraphs (2)(E)(ii) and (iii), (G)(ii) and (iii), and (I) the ownership of profits or beneficial interests shall be determined in accordance with the rules for constructive ownership of stock provided in section 267(c) (other than paragraph (3) thereof), except that section 267(c)(4) shall be treated as providing that the members of the family of an individual are the members within the meaning of paragraph (6).
- (6) Member of family For purposes of paragraph (2)(F), the family of any individual shall include his spouse, ancestor, lineal descendant, and any spouse of a lineal descendant.
- (7) Employee stock ownership plan The term "employee stock ownership plan" means a defined contribution plan -
 - (A) which is a stock bonus plan which is qualified, or a stock bonus and a Money Purchase Pension Plan both of which are qualified under section 401(a), and which are designed to invest

primarily in qualifying employer securities; and (B) which is otherwise defined in regulations prescribed by the Secretary. A plan shall not be treated as an employee stock ownership plan unless it meets the requirements of section 409(h), section 409(o), and, if applicable, section 409(n) and section 664(g) and, if the employer has a registration-type class of securities (as defined in section 409(e)(4)), it meets the requirements of section 409(e).

- (8) Qualifying employer security The term "qualifying employer security" means any employer security within the meaning of section 409(l). If any moneys or other property of a plan are invested in shares of an investment company registered under the Investment Company Act of 1940, the investment shall not cause that investment company or that investment company's investment adviser or principal underwriter to be treated as a fiduciary or a disqualified person for purposes of this section, except when an investment company or its investment adviser or principal underwriter acts in connection with a plan covering employees of the investment company, its investment adviser, or its principal underwriter.
- (9) Section made applicable to withdrawal liability payment funds For purposes of this section -
 - (A) In general The term "plan" includes a trust described in section 501(c)(22).
 - (B) Disqualified person In the case of any trust to which this section applies by reason of subparagraph (A), the term "disqualified person" includes any person who is a disqualified person with respect to any plan to which such trust is permitted to make payments under section 4223 of the Employee Retirement Income Security Act of 1974.
- (f) Other definitions and special rules For purposes of this section -
 - (1) Joint and several liability If more than one person is liable under subsection (a) or (b) with respect to any one prohibited transaction, all such persons shall be jointly and severally liable under such subsection with respect to such transaction.
 - (2) Taxable period The term "taxable period" means, with respect to any prohibited transaction, the period beginning with the date on which the prohibited transaction occurs and ending on the earliest of -
 - (A) the date of mailing a notice of deficiency with respect to the tax imposed by subsection (a) under section 6212,
 - (B) the date on which the tax imposed by subsection (a) is assessed, or
 - (C) the date on which correction of the prohibited transaction is completed.
 - (3) Sale or exchange; encumbered property A transfer of real or personal property by a disqualified person to a plan shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien which the plan assumes or if it is subject to a mortgage or similar lien which a disqualified person placed on the property within the 10-year period ending on the date of the transfer.
 - (4) Amount involved The term "amount involved" means, with respect to a prohibited transaction, the greater of the amount of money and the fair market value of the other property given or the amount of money and the fair market value of the other property received; except that, in the case of services described in paragraphs (2) and (10) of subsection (d) the amount involved shall be only the excess compensation. For purposes of the preceding sentence, the fair market value -

service, or insurance organization merely because of its issuance of such policy;

- (2) to a governmental plan (within the meaning of section 414(d)); or
 - (3) to a church plan (within the meaning of section 414(e)) with respect to which the election provided by section 410(d) has not been made. In the case of a plan which invests in any security issued by an investment company registered under the Investment Company Act of 1940, the assets of such plan shall be deemed to include such security but shall not, by reason of such investment, be deemed to include any assets of such company.
- (h) Notification of Secretary of Labor Before sending a notice of deficiency with respect to the tax imposed by subsection (a) or (b), the Secretary shall notify the Secretary of Labor and provide him a reasonable opportunity to obtain a correction of the prohibited transaction or to comment on the imposition of such tax.

(i) Cross reference For provisions concerning coordination procedures between Secretary of Labor and Secretary of the Treasury with respect to application of tax imposed by this section and for authority to waive imposition of the tax imposed by subsection (b), see section 3003 of the Employee Retirement Income Security Act of 1974.

Appendix B – Instructions for Title Companies and Real Estate Brokers

Broker, Closer, Title Company Checklist

These instructions apply for **all investments real estate related or not*
(Closing documents may be different for other investment types)*

- **The client must have an account opened and funded prior to placing a contract on a property in order that the administrator may sign on behalf of the IRA on Sales Contracts and fund earnest money deposits.**
- **Requirements for Real Estate Purchases With Your IRA**

The following instructions apply to any self-directed IRA/Qualified Plan Administrator for individuals who wish to invest their IRAs in non-traditional investments such as real estate and real estate-related instruments. Clients always direct the transaction by instructing both the Broker and the Title/Escrow agent to purchase the subject real estate asset on behalf of their Plan. From your perspective as the Broker/Closer/Title company you will need to provide and understand the following in order to ensure that the asset has been purchased by the client's Plan and the tax-deferred or tax-free status of the account has been preserved.

- **The Buyer of the property is:**

“NAME OF ADMINISTRATOR/CUSTODIAN FBO Client Name, IRA”

- **All documents associated with the purchase and closing must be signed by the administrator/custodian.**

This entity will appear on all of the following documents.
Wherever a signature is required it is to be signed by the IRA administrator

The address of the entity on all documents shall be the address of the administrator/custodian

- All documents must be signed as “Read and Approved” by the IRA owner prior to our signature.
- **Documents Required to fund:**

1. Sales Contract and all Addendums and Amendments to Contract
2. The deed *
3. Title Insurance *
4. Settlement Sheet *
5. Property Management Contract
6. Hazard Insurance as with IRA as loss payee

*These documents are required before funding and must be received at least **48 hours prior to closing**. A \$35 late fee is applied for documents received less than 48 hours, and \$100 late fee for documents received less than 36 hours prior to closing.

- Any earnest money deposit funded from the client's personal account will be replaced by IRA money at closing. The earnest money shall be refunded to the client by the title company.
- All bills associated with the acquisition of this asset must be paid by the client's IRA, including your fees, legal fees, filing and recording fees, and ongoing expenses such as real estate taxes and hazard insurance. To set up automatic payment of periodic bills, fill out the **Authorization for Periodic Payments**. This form is on our website.
- Please furnish wire instructions, including street addresses, for wiring closing funds. We will not fund a closing without the **Buy Direction Letter – Real Estate** signed and executed by the client. This form is on our website.
- All of the items described above must be observed in order to preserve the tax-deferred status of our client's account. The IRS has established rules governing this type of transaction.

I have provided these instructions to my broker and the title company and understand that I am responsible for follow-up and ensuring that all documents are in the possession of the IRA administrator a minimum of 48 hours prior to closing.

Investment Address or Reference

Client Signature

Date

Appendix C – IRA/401k Plan Contribution Limits

2010 MAXIMUM CONTRIBUTIONS

Why wait until April 15th to deposit to your IRA? Time is on your side when you put tax-deferred money to work now rather than later. Also, the contribution you miss making for any tax year cannot be “made up” in subsequent years. Contribution limits on the various plan types follow. Remember: April 15th is the deadline for 2007 contributions. Use the deposit form in this mailing for contributions.

TRADITIONAL/ROTH IRA CONTRIBUTION LIMITS

The contribution limit for both Traditional and Roth IRAs is \$5,000 in 2010. The chart below shows the contribution limits for both the Traditional and Roth IRA. The amount you may contribute to a Roth IRA is reduced by contributions you make to a Traditional IRA. The amount you may contribute to a Roth IRA also may not exceed your taxable compensation. You may continue to make contributions to your Roth IRA after reaching age 70 1/2.

ROTH IRAs

You may contribute to a Roth IRA if you have taxable compensation and your modified adjusted gross income (MAGI) is less than \$120,000 (\$167,000 if you are married and file a joint return, and \$10,000 if you are married, lived with your spouse and file a separate return). The amount you may contribute to a Roth IRA is gradually reduced if your modified adjusted gross income is between \$105,000 and \$120,000 (between \$167,000 and \$177,000 if you are married and file a joint return, and between \$0 and \$10,000 if you are married, lived with your spouse and file a separate return).

SEP IRA CONTRIBUTION LIMITS

A SEP IRA owner may contribute up to 25% of compensation, as much as \$49,000 for 2010. However, the maximum compensation upon which SEP contributions can be based is \$245,000. The term "compensation" for self-employed individuals refers to earned income.

HEALTH SAVINGS ACCOUNT CONTRIBUTION LIMITS

An individual may contribute the lesser of his/her health plan deductible or \$3,050 in 2010 into a Health Savings Account, and a family may contribute the lesser of their health plan deductible or \$6,150 in 2010 annually.

INDIVIDUAL 401(k) CONTRIBUTION LIMITS

Two components comprise the maximum Individual(k) plan contribution: an employee salary deferral contribution and an employer profit sharing contribution. More information can be found on our website.

The employee may contribute up to \$16,500 for 2010 through salary deferral, however this amount may not exceed 100% of pay. The employer profit sharing contribution limit is up to 25% of pay, or 20% for self-employed. There is a total contribution limit, from both sources, of \$49,000 in 2010, but only income up to \$245,000 can be considered. The “catch up” provision for individuals age 50+ is an additional \$5,000 in salary deferrals beyond the \$16,500, allowing for a total contribution limit of \$54,000 in 2010.

SUMMARY TABLE

Year	Traditional/Roth	Traditional/ Roth (if over 50)	SEP Max	SIMPLE	SIMPLE (if over 50)	401(k) 403(b)	401(k) 403(b) (if over 50)
2010	\$5,000	\$6,000	\$49,000	\$11,500	\$14,000	\$16,500	\$22,000

Appendix D – Glossary

401(k) Plan	A defined contribution plan offered by a corporation to its employees, which allows employees to set aside tax-deferred income for retirement purposes, and in some cases employers will match their contribution dollar-for-dollar. Taking a distribution of the funds before a certain specified age will trigger a penalty tax. The name 401(k) comes from the IRS section describing the program.
addendum to contract	Additions to a contract which are to become part of the original contract.
AGI	Adjusted gross income.
appreciation	Increase in value of an asset.
Asset	Items of value owned by an individual. Assets that can be quickly converted into cash are considered "liquid assets." These include bank accounts, stocks, bonds, mutual funds, and so on. Other assets include real estate, personal property, and debts owed to an individual by others.
assignment of contract	The act of transferring a contract from one person to another who will assume all rights to the contract.
Balloon payment/mortgage	A mortgage loan that requires the remaining principal balance be paid at a specific point in time. For example, a loan may be amortized as if it would be paid over a thirty year period, but requires that at the end of the tenth year the entire remaining balance must be paid.
beneficiary	An individual, institution, trustee, or estate which receives, or may become eligible to receive, benefits under a will, insurance policy, retirement plan, annuity, trust, or other contract.
Bridge Loan	Bridge loans are obtained by those who have not yet sold their previous property, but must close on a purchase property. The bridge loan becomes the source of their funds for the down payment. One reason for their fall from favor is that there are more and more

second mortgage lenders now that will lend at a high loan to value. In addition, sellers often prefer to accept offers from buyers who have already sold their property.

Buy Direction Letter

Instructions to an IRA administrator or custodian from an account holder requesting the purchase of an asset for the account.

closing costs

Fees and expenses, over and above the price of the property, incurred by the buyer and/or the seller in the property ownership transfer.

Compensation

Payment for personal services. Salaries, wages, fees, commissions, tips, bonuses and specialized forms of compensation such as director's fees and jury's fees fall into this category. However, certain fringe benefits and some foreign-earned income are not taxed.

contract sale

Refers to a situation where one party has a ratified contract on a property and sells the right to assume that contract to another.

contribution

Specifically referring to tax advantaged accounts: the contribution of cash to the account as provided for by the IRS within the limits established in the code.

Coverdell ESA

An investment vehicle designed to help parents fund their child's education. The Coverdell Education Savings Account has replaced the Education IRA. Contributions to the account are taxed, but earnings used to pay education expenses are not. The account is transferable among family members.

custodian

An agent, bank, trust company, or other organization which holds and safeguards an individual's, mutual fund's, or investment company's assets for them.

deed

The legal document conveying title to a property. May be also called a warranty deed, special deed or tax deed depending upon the quality of the deed being conveyed and the state in which the transaction occurs.

Deed of Trust	A legal document that pledges a property to the lender as security for payment of a debt. Instead of mortgages, some states use First Trust Deeds. Some states do not record mortgages. Instead, they record a deed of trust which is essentially the same thing.
deferred earnings	Methods of compensating employees based upon their current service where the benefits are deferred until future periods (for example, a pension plan).
depreciation	A non-cash expense that reduces the value of an asset as a result of wear and tear, age, or obsolescence. For residential rental property the amount of time that an asset can be depreciated is 27.5 years.
disqualified entity	An entity in which controlling interest is held by disqualified person as defined in IRSC 4975. See "disqualified person"
disqualified person	According to IRSC 4975, those individuals or entities with which an retirement plan owner cannot do business. Typical examples are the plan holder his/her self, lineal ascendants and descendants.
distribution	When an individual removes and funds from their retirement plan for their personal use. May result in taxes for traditional IRAs and penalties if taken prior to 59 1/2 years of age.
due diligence	The process of investigation, performed by investors, into the details of a potential investment, such as an examination of operations and management and the verification of material facts.
earnest money	A deposit made by the potential home buyer to show that he or she is serious about buying the house.
equity	A homeowner's financial interest in a property. Equity is the difference between the fair market value of the property and the amount still owed on its mortgage and other liens.
ERISA	Employee Retirement Income Security Act. Enacted to protect employees' retirement plans from misuse by

employers.

excess contribution	Contributing funds to a tax-advantaged retirement plan that exceed the legal contribution limits for that type of plan.
hazard insurance	Insurance coverage that in the event of physical damage to a property from fire, wind, vandalism, liability or other hazards.
Health Savings Account	Established by law in 2004, allowed for pre-tax money to be placed into a savings account for payment of qualified medical expenses. Requires that individual have a high deductible health insurance plan in place in order to qualify.
home equity line of credit (HELOC)	A mortgage loan, usually in second position, that allows the borrower to obtain cash drawn against the equity of his home, up to a predetermined amount.
Individual 401(k)	A 401(k) that is meant for individuals and partners in a business with no employees, thus gaining the advantages of a qualified plan while eliminating the need for ERISA testing.
IRA Administrator	Company which provides administrative and bookkeeping services for IRA/401(k) plans in conjunction with a relationship with a custodial bank, who acts as the trustee/custodian for the plan.
legal description	Unique description of a piece of real estate, of public record, exclusive of the street address, which identifies the property exclusively.
Leverage	The degree to which an investor or business is utilizing borrowed money. Using a mortgage can increase the real estate purchaser's return on their investment and often there are tax advantages associated with borrowing.

LLC	Limited Liability Company, A corporation that is generally taxed under the partnership rules. Although similar to an S corporation, there is no limit to (1) the number of shareholders, (2) the number of classes of stock, or (3) the types of investments in related entities.
mortgage	A legal document that pledges a property to the lender as security for payment of a debt. Instead of mortgages, some states use First Trust Deeds.
non-recourse loan	A loan where there is no personal guarantee and the lender's sole recourse is the asset securing the loan.
note	A legal document that obligates a borrower to repay a mortgage loan at a stated interest rate during a specified period of time.
operating income	When referring to an investment in rental real estate, the net income is defined as the gross rental income less all operating expenses such as utilities, maintenance, repairs, real estate taxes, insurance and management. Operating expense does not include either capital improvement or interest expense from purchase money loans.
option, real estate	A contract which gives a purchaser the right to purchase the property at a certain price within a certain window of time. Purchaser is not bound by any obligation to exercise the option.
overcontribution	Making a cash contribution to a tax-advantaged plan which is in excess of the legally established contribution limits.
owner financing	Also called an "owner carryback". A property purchase transaction in which the property seller provides all or part of the financing.
prohibited transaction	Violation either directly or indirectly, by the account holder or any disqualified person any provision of IRSC 4975.
promissory note	A written promise to repay a specified amount over a specified period of time.

qualified plan	A plan that meets the requirements of Internal Revenue Code Section 401(a) and the Employee Retirement Income Security Act of 1974 (ERISA) and is thus eligible for favorable tax treatment.
quit claim deed	A deed that transfers without warranty whatever interest or title a grantor may have at the time the conveyance is made.
Realtor®	A real estate agent, broker or an associate who holds active membership in a local real estate board that is affiliated with the National Association of Realtors.
rollover	A tax-free reinvestment of a distribution from a qualified retirement plan into an IRA or other qualified plan within a specific time frame, usually 60 days. These transfers can happen when leaving a job at an employer who offered a retirement plan such as a 401(k).
Roth 401(k)	Since 2005, a provision within 401(k) plans which allows for the individual to contribute to a tax-free account for retirement.
Roth IRA	Reference IRSC 408(a), a tax-free retirement account which is funded with post-tax money. Although no tax deduction is available for contributions, the account is allowed to grow tax-free until retirement. Eligibility for this type of account is based on certain maximum income restrictions.
SEC	Securities and Exchange Commission: A federal agency established by the Securities Exchange Act of 1934 that regulates the issuance of securities in the primary market and the trading of securities in the secondary market.
securities	1) A contract that proves ownership of stocks, bonds, and other investments, can be assigned value, and can be traded. 2) A legal representation of the right to receive future benefits under stated conditions. Commonly, a protection granted providing a lender the right to claim a borrower's property if the borrower defaults in making payments.

security	1) Something of value pledged in exchange for a loan or 2) An investment instrument, other than an insurance policy or fixed annuity, issued by a corporation, government, or other organization which offers evidence of debt or equity.
self-dealing	According to the IRS, either the IRA owner or any disqualified person receiving a benefit from an IRA investment that does not come to the IRA holder as a taxable distribution.
self-directed IRA	An individual retirement account where the IRA owner makes investment choices from all investments allowed by the code.
self-direction	When referring to IRA/qualified plan administration, this means having the ability to make any investment allowed by law.
SEP	Simplified Employee Pension plan. Inexpensive retirement plan for employees and self-employed individuals which follow the same rules as IRA accounts administratively.
servicing, loan	The collection of mortgage payments from borrowers and related responsibilities of a loan servicer.
Tenancy in common	As opposed to joint tenancy, when there are two or more individuals on title to a piece of property, this type of ownership does not pass ownership to the others in the event of death.
TIC	Stands for "tenants in common" but more specifically refers to a way of holding direct title to real estate where each has an undivided interest in the property by deed.
title	A legal document evidencing a person's right to or ownership of a property. A Deed.

title company	A company that specializes in examining and insuring titles to real estate, frequently acting as escrow agent for closings.
title insurance	Insurance that protects the lender (lender's policy) or the buyer (owner's policy) against loss arising from disputes over ownership of a property.
Traditional IRA	An individual retirement account according to IRS Code Section 408 where the IRA owner funds the account using pre-tax money for which a tax deduction, in most cases can be claimed.
Traditional to Roth conversion	When the traditional IRA holder takes funds in the IRA and moves them to a Roth IRA. This results in a tax liability equivalent to the total amount moved. This may only be done for individuals falling beneath adjusted gross income guidelines. See IRS Publication 590 for more information.
transfer	When referring to IRA/qualified plan administration, this means moving funds from one custodian to another without the individual taking possession of or having access to the funds.
trustee	see "custodian"
UBIT	Unrelated Business Income Tax: for IRA or other tax deferred plans, a tax levied either 1) on the debt-leveraged portion of the net income of an asset or 2) on an operating business within an IRA, Qualified Plan or other tax-advantaged account.
UDFI	Unrelated Debt Financed Income: See UBIT, refers specifically to the use of debt in an IRA

unimproved land	Raw land with no structures, utilities or other additions.
vested	Having the right to use a portion of a fund such as an individual retirement fund. For example, individuals who are 100 percent vested can withdraw all of the funds that are set aside for them in a retirement fund. However, taxes may be due on any funds that are actually withdrawn.
vesting of title	How an asset is legally titled.
warranty deed	see "Deed"
wire	The transfer of funds from one financial institution to another which is instantaneous and is considered "good funds" or available immediately.