RETIREMENT INDUSTRY TRUST ASSOCIATION

Voice of the Self-Directed IRA Industry

Retirement Industry Trust Association Explains 3 Rules on Self-directed IRA Investing into private equity and real estate

As the IRA market approaches $8 trillion, investors continue to seek new ways to increase returns and diversify beyond the stock market. *"Startup businesses and real estate investing not only help fuel the economy and create jobs; they are two popular asset choices for self-directed IRA investors,"* says Tom Anderson, President of the Retirement Industry Trust Association (RITA). However, there are three important rules to understand to prevent unintentional prohibited transactions and tax consequences.

Taking the Mystery out of self-directed IRAs

Many who become aware of the opportunities and mechanics of self-directed IRAs are intimidated by a wealth of information from providers and contrarians. "Self-directed" means that you are in charge. That means when selecting an investment, the IRA owner (you) need to perform due diligence on your investment selections, with or without the assistance of an investment advisor of your choice. Custodians do not perform due diligence, but execute your instructions. For example, just as you would when buying a personal home, you need to get personally involved and engaged when purchasing a rental property with your IRA. However, you need to remember that while you are able to inspect it before your purchase, as well as provide administrative support (e.g., selecting a tenant), you cannot provide material improvements through your own effort (for example, personally repainting it). Also, you cannot later live or vacation in it after the IRA owns it, nor can any of your direct relatives. The Government purposely chose to prevent IRA owners from using their IRA assets prior to retirement by imposing "self-dealing" and "prohibited transaction" rules. Violation of these rules can jeopardize the tax deferred or tax-free (Roth IRA) status of your IRA.

Three Ways to Avoid Prohibited Transactions-

In general, there are three major transactions that you need to avoid, to prevent your IRA from being deemed unqualified or taxable and no longer an IRA:

Do not engage in any transaction that:

1) Involves purchasing an asset you own or any direct ascendant or descendant or spouse owns more than 50%;
2) Involves a personal benefit beyond the benefit your IRA might achieve (e.g., a realtor buying real estate with his or her IRA where he or she will personally receive a commission or benefit because of the transaction);
3) Requires you or any direct ascendant, descendant or spouse to provide personal tangible services to maintain it (e.g. your son is a contractor and he puts a new roof on your IRA owned property).

While there are other rules that need to be considered in certain cases (particularly when you are funding a new company), these are the basics. Your custodian will assist you in understanding the rules and will generally have qualified attorneys and CPAs they can refer you to in more complex situations.

The majority of those using a self-directed IRA are doing so to diversify beyond Wall Street into certain non-traded assets to reduce their overall portfolio risk or to increase growth in their IRAs. They have no intention of engaging in self-dealing transactions. Fully explaining your intentions and approaches to your custodian when investing will help you to avoid becoming afoul of the rules.

Basically, just as you would when buying stocks through a self-directed brokerage firm, you are in charge. In addition, you need to avoid transactions that provide any additional benefit to you or any relative (other than to your IRA) or that are deemed to be self-dealing. Keeping those two aspects in mind, will enable you to make the most of your retirement investing!

More information can be seen on RITA's website(www.ritaus.org) and the websites of our member firms.