

REAL ESTATE INVESTING IN SELF-DIRECTED IRAs

FREQUENTLY ASKED QUESTIONS

The following Questions and Answers reflect the applicable rules concerning prohibited transactions. They are not presented here as tax advice, but rather as examples of the types of issues (and opportunities) which can arise when investing in non-publicly traded alternative assets such as real estate. Any specific IRA investment may raise issues which should be discussed with your tax or legal professional.

Is it possible to purchase real estate using funds from my individual retirement account?

According to Section 408 of the U.S. Code, the only listed assets not permitted in an IRA are life insurance, collectibles and certain coins.

For years, many knowledgeable investors have chosen to add real estate to their retirement investing strategies as a way to further diversify their retirement portfolios in order to help grow retirement wealth or turn wealth into income during retirement. Millennium Trust has the knowledge and expertise to assist self-directed investors who decide to invest a portion of their IRA funds in real estate and other non-publicly traded alternative assets.

How does an IRA make a real estate investment?

With the assistance of a custodian who specializes in the custody and administration of real estate and other non-publicly traded alternative assets. When an investor decides to truly self-direct his or her retirement investing they are totally responsible for selecting the investment and performing the necessary due diligence. The custodian handles the transaction at the direction of the account owner and custodies and administers the real estate asset. Millennium Trust's Real Estate Investment Timeline and Real Estate Investment Checklist provide comprehensive step-by-step information investors need to establish and fund a self-directed retirement account and complete the transaction process with the assistance of their custodian.

Can I use my IRA funds to pay off my personal mortgage?

No, there are a number of Prohibited Transactions that must be avoided and they are described in detail in U.S. Code Section

4975 (Sec. 4975). In summary, a prohibited transaction is any improper use of a traditional IRA account by the account owner, its beneficiaries or any disqualified person. The following are examples of prohibited transactions.

- Borrowing money from your IRA.
- Selling your property to your IRA.
- Using your IRA as security for a loan.
- Buying property for personal use (present or future) using your IRA funds.

Can I use IRA funds to buy a condo in Florida and have my mother and father live in it?

No, you cannot use IRA funds to purchase real estate that would be used by any disqualified person.

Who exactly are disqualified persons?

Disqualified persons, also described in Sec. 4975 are summarized below:

- The account owner.
- A person providing services to the plan.
- An employer, any of whose employees are covered by the plan.
- An employee organization, any of whose members are covered by the plan (such as a trade association).
- A direct or indirect owner with 50% or more voting power.
- Direct member of the account owner's family (parents, spouse, children & their spouse).
- A corporation, partnership or trust with 50% or more voting power.
- An officer, director, a 10 percent or more shareholder or partner.

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Can Millennium Trust give me more detailed information on the rules and regulations surrounding self-directed investing in alternative assets such as real estate?

Millennium Trust Company provides online and in-person educational events discussing the rules and regulations surrounding self-directed investing in real estate and other non-publicly traded alternative assets. As a directed custodian Millennium Trust does not give tax, legal or investment advice and strongly encourages investors who wish to self-direct their retirement accounts to seek the advice of knowledgeable professionals who can help in the following ways.

- A financial advisor for investment and asset allocation strategies.
- A realtor for investment property identification.
- An attorney for contractual issues.
- A CPA for tax, accounting and reporting requirements.
- A property manager to manage income producing properties.
- A lender who offers non-recourse loans to IRAs for the purpose of leveraging an IRA real estate investment.
- A custodian who specializes in the custody and administration of real estate and other alternative assets.

What if my accountant, attorney or financial adviser has questions regarding investing in real estate in my retirement account?

The financial, legal and tax professionals you work with can learn more about Self-Directed Investing in several ways: by visiting our web site www.mtrustcompany.com, by requesting a one-on-one educational session, or by sending an email to RealEstateIRA@mtrustcompany.com. The Resource Page of our web site also provides links to numerous Government sources of information.

I'm ready to get started, so how do I go about investing in real estate using funds from my IRA?

Millennium Trust's Real Estate Investing Timeline and Checklist provide detailed information on the entire real estate investing process but here are some important points to consider.

1. Understand the total cost of real estate ownership as any expense related to the investment must come from retirement funds. Do the math first.
2. You might want to discuss your investment objectives with your financial advisor so that you may uncover any potential issues by performing some 'what if' scenarios.

3. Find a real estate professional that specializes in investment properties as they usually have the knowledge and expertise to thoroughly analyze the target investment.
4. Have your attorney review any transaction-related documents such as purchase and sale agreements or condominium by-laws.
5. Determine how the investment will be made: direct, with other investors, through an entity such as an LLC or leveraged with a non-recourse loan.
6. Depending on the investment structure, you may want to speak with your tax professional regarding any potential Unrelated Business Income Tax (UBIT) issues on either Unrelated Business Taxable Income (UBTI) or Unrelated Debt Financed Income (UDFI).
7. Select your 'alternative asset custodian' and spend time learning their process and procedures.
8. Establish and fund your self-directed retirement account. This process usually takes 2 to 4 weeks to complete.
9. The process of identifying a suitable investment property should start once your account is established and funded as the escrow funds/down payment must come from the IRA.

How do I make the offer to purchase real estate if my IRA is making the investment?

To avoid prohibited transactions and their tax consequences remember the following important points.

- You cannot assign a real estate contract from yourself to your IRA so before making an offer, make sure your self-directed IRA account is open and funded.
- Any expense related to the investment must come from the retirement account including escrow/deposit funds. You cannot use personal funds.
- The offer to purchase real estate should be made in the name of the custodian for the benefit of your IRA. When you have selected Millennium as your custodian, use the following language in the offer.

*Millennium Trust Company LLC Custodian FBO
(your name) IRA (specify if Roth IRA)*

- If the IRA has 100 percent direct ownership of the property and the investment produces income then the rent checks must be made payable to:

*Millennium Trust Company LLC Custodian FBO
(your name) IRA (specify if Roth IRA)*

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I don't have enough money in my IRA to buy a property outright. Can I use my IRA funds as a down payment and get a mortgage for the rest?

You cannot personally guarantee a loan on behalf of your IRA; but it is possible that your IRA could obtain a non-recourse loan if the non-recourse lender's current criteria are met. However, debt-financing an IRA funded real estate investment could trigger Unrelated Business Income Tax (UBIT) based on Unrelated Debt Financed Income (UDFI). Seek out a CPA to review IRS Publication 598 providing details on UBIT, UDFI and reporting requirements. Leveraging an IRA investment may require the IRA to pay UBIT tax; therefore, it is important to do the analysis up front to determine if the proposed investment scenario makes financial sense. There are a few lenders who offer non-recourse loans to IRAs and an Internet search on 'non-recourse lending' should provide a list of those financial institutions.

FAQs ON SPECIFIC INVESTMENT SCENARIOS

I want to use my IRA funds to buy a medical complex and rent out space to fellow physicians and therapists. Is it legal for me to do so?

Yes, providing you do not rent any of the space out to yourself, which would be considered a prohibited transaction.

Can I use my IRA to buy a co-op in New York City?

Yes, but by the nature of a cooperative your IRA would be investing in an entity. The ownership in the entity would entitle the IRA to a unit within the co-op. The ownership in the cooperative should be for investment purposes and not personal use.

Is it possible to use IRA funds to buy a foreclosed property?

Yes, but you must be aware of the foreclosure purchase process including payment timeframe which is usually very short. If planning to use IRA funds for the foreclosure process, it may be necessary to identify an escrow agent to hold funds until the day of purchase. Working with a knowledgeable real estate attorney or CPA would be beneficial in this scenario.

Is it prohibited for me to use some of my IRA funds to lend money to my brother for a real estate development project he's working on?

Sec. 4975 does not list siblings as disqualified persons therefore

you may be able to use IRA funds to invest in your brother's real estate development project. It is wise to consult with a tax or legal professional to discuss your specific intentions prior to directing this type of investment.

Can I use my IRA to buy an apartment building? Who collects the rent checks and how do I pay for ongoing maintenance and repairs of the building?

Yes, you could use IRA funds to invest in an income producing apartment building. When the IRA directly owns the income producing real estate, rent checks would be made out to the IRA custodian. The IRA account owner should consider hiring a property manager to manage the real estate including collecting rent and handling maintenance issues. Also consider consulting with an attorney to discuss liability issues and options for creating some level of liability protection around you and your IRA's investment.

If I use IRA funds to buy a condo, can I use my personal funds to purchase the golf membership that is available to condo owners? I know I can't use the condo, but I do want to be able to use the golf course and the only way to obtain a golf membership is through condo ownership.

You cannot use personal funds to purchase a golf membership that is available because your IRA owns a unit in the golf community. This could be considered 'enabling', meaning the IRA investment is enabling the IRA account owner to purchase the golf membership.



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I want to buy properties that need repairs and I want to do the work myself. I'm an electrician and I'm capable of doing all of the electrical work on the properties. Is this okay?

If my IRA owns a property and it needs minor work, say replacing a broken glass window, can't I do that myself? I've heard from industry experts that I can do that small amount of work.

Performing any work on an IRA real estate asset would be considered a prohibited transaction according to Sec. 4975 which states that 'any direct or indirect furnishing of goods, services, or facilities between a plan (IRA) and disqualified person (IRA owner)' is considered a prohibited transaction. Industry experts may have their own interpretation of the Internal Revenue Code but may not be able to defend you and their position in tax court if and when a prohibited transaction is detected.

If I buy a vacation property using my IRA, is it considered a second home and can I use it two weeks out of the year without causing any problems with the IRS?

When considering a real estate investment within an IRA, the account owner should view the real estate as just that – an investment for the purpose of growing IRA wealth. Unlike the tax laws that revolve around vacation property, Internal Revenue Code Section 4975 states that the IRA account cannot personally use or benefit from the IRA-owned investment.

What happens when I need to take mandatory distributions from my IRA and my only asset is real estate?

You would have to liquidate (sell) the real estate asset in order to have cash available for the mandatory distribution. You should contact your CPA to discuss how you will handle required minimum distributions well before the required timeframe. IRS Publication 590 states that you must start receiving distributions from your IRA by April 1 of the year following the year in which you reach age 70½. Roth IRAs, however, do not have a mandatory distribution requirement.

Can I take ownership of my IRA-owned property when I'm ready to retire? If yes, how do I do that and are there any tax implications?

The only way an IRA account owner can use or take ownership of an IRA-owned property is by taking a distribution in kind of the real estate. This can be done by taking a 100% distribution in kind or spreading out the distributions over a period of time, for example, taking 20% ownership as a distribution in kind for each year over a 5 year period. Each time a distribution is taken a formal appraisal of the property would be required to determine current value and if the real estate asset is held in a Traditional IRA, then that amount distributed would be reported as income for that tax year. The IRA account owner can only use the property once 100% ownership of the property is achieved. The type of IRA (traditional or Roth), length of time the asset is held, age and current tax bracket of the IRA account owner must be factored into the equation to determine what, if any, taxes will be due on the distribution. A discussion with your tax professional will help you better understand the options and implications of taking a property as a distribution in kind.

How do I find knowledgeable tax, legal, investment or real estate professionals?

Local organizations such as your state CPA society, realtor board, Bar association or financial planning association are a good place to start. It is prudent to select your professional partners based on credentials, experience and knowledge. Are they regulated? What type and how much insurance coverage do they have? What is their core business practice? Have any sanctions been filed against them? Are they up front in answering questions about administration fees and how and where your assets are held in custody? If you have trusted professionals who are not yet knowledgeable about self-directed IRA investments, share this document with them or have them contact Millennium Trust to discuss specific questions in detail.



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COMPANY PROFILE

Millennium Trust Company is an industry leader in administrative and custodial services. Millennium custodies alternative and traditional assets in IRAs, Solo 401(k)s and custody accounts, offers private fund custody services, creates customized Automatic Rollover programs, provides integrated Health Savings Account solutions and designs unique trading platforms for Investment Advisors.