

## Company Profile

Millennium Trust leads the industry in administrative and custodial services. Millennium custodies alternative and traditional assets in Self-Directed IRAs and Solo 401(k)s, creates customized Automatic Rollover programs, provides integrated Health Savings Account solutions, designs unique trading platforms for Investment Advisors and supplies valued Personal Trust Administration.



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## 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 alternative assets. Any specific IRA investment may raise issues which should be referred to your attorney or tax professions.

### Can I purchase real estate using funds from my IRA?

Yes. Since 1975, when IRAs were first available to individual investors, the only investments not allowed, according to IRS Publication 590, are collectibles, life insurance and certain coins. Investors over the years have found real estate to be a way to further diversify their retirement portfolios. It also can turn IRA wealth into retirement income.

### Is buying real estate in my IRA a good idea?

Millennium Trust Company as a custodian 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.

- An **attorney** for contractual issues and the pros and cons of setting up an entity
- A **CPA** for tax, accounting and reporting requirements
- A **realtor** for property identification and valuation
- A **financial advisor** for investment and asset re-allocation strategies
- A **property manager** for income producing properties
- A **lender** who offers non-recourse loans
- A **custodian** who specializes in the custody and administration of alternative assets

### If my accountant and my financial adviser have issues regarding investing in real estate through my IRA, where can they find more information on the subject?

The financial, tax and legal professionals you work with can learn more about Self-Directed Investing by attending one of Millennium Trust's seminars or by requesting more information regarding the IRS publications and Internal Revenue Code that address the issues that arise when investing in alternative assets such as real estate. There are rules and regulations that should be followed in order to avoid creating a prohibited transaction that can result in a distribution of IRA assets and subsequent taxes and penalties being incurred.

### How does a prohibited transaction happen?

According to IRS Publication 590, 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 property to your IRA
- Receiving unreasonable compensation for managing your IRA
- Using your IRA as security for a loan
- Buying property for personal use (present or future) using your IRA funds

### **What are the consequences of making a prohibited transaction?**

IRS Publication 590 states that if you or your beneficiary engage in a prohibited transaction in connection with your IRA account at any time during the year, the account stops being an IRA as of the first day of that year.

If your account stops being an IRA because you or your beneficiary engaged in a prohibited transaction, the account is treated as distributing all its assets to you at the fair market value on the first day of the year. Additionally, Section 4975 of the Internal Revenue Code specifies the taxes resulting from a prohibited transaction can equal 15 percent of the amount involved with respect to the prohibited transaction.

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

Refer to Millennium Trust's Real Estate Investing Guidelines document for detailed information on the entire real estate investing process and consider sharing it with your realtor and the other professionals working with you so that they are aware of the proper steps to take during the offer to purchase and closing.

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

- Before making an offer, make sure that your self-directed IRA account is open and funded since earnest money or a deposit must be made from IRA funds.
- You **cannot** use personal funds for the deposit.
- You **cannot** assign a real estate contract from yourself to your IRA.
- Your IRA **cannot** purchase a property owned by your parents, spouse, children or their spouses.
- The offer to purchase real estate should be made in the name of the custodian for the benefit of your IRA. Use the following language in the offer.

Millennium Trust Company LLC Custodian FBO (your name) IRA (specify if it is a Roth IRA)

- Any expense related to the purchase and any ongoing or future expense must be paid from IRA funds. Do the math first to make sure there are adequate funds to cover investment-related expenses.
- You **cannot** perform any work on the property, you **cannot** pay for an investment-related expense and reimburse yourself from IRA funds and you **cannot** deposit any income from the investment into a personal account.
- If the IRA has 100 percent direct ownership of the property, income, for example in the form of a rent check, would be payable to:

Millennium Trust Company LLC Custodian FBO (your name) IRA (specify if it is a Roth IRA)



### **Can I use my IRA funds to pay off the mortgage on my house?**

No. Internal Revenue Code Section 4975, states that the plan owner (in this case the self-directed IRA account owner) cannot use plan assets (IRA funds) for the benefit of a disqualified person (the IRA account owner). According to current Code you cannot use your self-directed IRA funds to pay off the mortgage on the real estate that you personally own.

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

No, According to the IRS, you cannot use IRA funds to purchase real estate that would be used by a disqualified person. Internal Revenue Code 4975 identifies disqualified persons to be you, your parents, your spouse, your children and the spouses of your children, therefore, Mom and Dad are considered disqualified persons.

### **Can I use my IRA to help my daughter buy her first home?**

No. Once again, your daughter would be considered a disqualified person therefore using your IRA funds to help with her real estate investment would be considered a prohibited transaction.

### **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.

### **Can I 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.

### **Can I use my IRA to lend money to my brother for a real estate development project he's working on?**

The IRS does not list siblings as disqualified persons, therefore you should be able to use IRA funds to invest in your brother's real estate development project. You may want to have your tax professional review IRS Bulletin 2004-4 before making the 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? 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 considering 'enabling' by the IRS meaning the IRA investment is enabling the IRA account owner.

**I want to buy properties that need repairs and do the work myself. I'm an electrician and I'm capable of doing all of the electrical work on the properties. 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 Internal Revenue Code Section 4975 which states that 'any direct or indirect furnishing of goods, services, or facilities between a plan (IRA) and disqualified person (IRA owner)' is a prohibited transaction. Industry experts may have their own interpretation of the Internal Revenue Code but may not be able to defend themselves 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.

**Can I take ownership of my IRA-owned vacation 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 all at once 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 over a 5 year period. However, 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.



**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 personally cannot guarantee a loan on behalf of your IRA; but it is possible that your IRA could obtain a non-recourse loan if the investment and amount of IRA funds available meet the lender's criteria. 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.

**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 70-1/2. Roth IRAs, however, do not have a mandatory distribution requirement.

**How do I find knowledgeable professionals?**

Local organizations such as your state real estate lawyers association, CPA Society, and real estate associations are a good place to start. Also consider attending local real estate investor association meetings and educational seminars organized by experienced industry experts such as Millennium Trust Company

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 are your assets 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.

