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A MUST-HAVE FOR EVERY RETIREMENT INVESTOR'S TOOLKIT

WHAT YOUR BROKER ISN'T TELLING YOU

FIRST EDITION

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Overview

When you think of saving for the future and investing for retirement, traditional investments and a 401k may come to mind. Under this school of thought, you work a full career, regularly contribute a portion of your earnings to a savings account / plan, and cash in on those investments when they have matured appropriately.

And while this method was a preferred means of planning for retirement, we now know that it isn't your only option. Enter the concept of alternative investments, and specifically the Self-Directed IRA.

The following ebook will help will open the eyes of the new investor and show the potential of investment outside of the traditional Stock Market. Education on this concept will give control to those who want to take it, and make the most of their investment dollars for the future.

Also for the experienced investor, who may be tired of the Stock Market, or who would like to diversify their portfolio into alternative investments (AI), it will help illuminate new possibilities and opportunities to self-direct your funds.

This ebook will help novice and knowledgeable investors alike, and can be used as a valuable teaching tool for anyone in between.

What is a Self-Directed IRA?

A Self-Directed IRA is an Individual Retirement Arrangement (IRA) that offers you, as the investor, complete control over your investment choices. These can include investments from the traditional Stock Market—such as stocks, bonds and mutual funds—as well as alternative options outside of the Stock Market—such as real estate, private notes, tax liens/deeds, private placements and even precious metals.

A Self-Direct IRA enhances (or expands) the options available to investors and are acceptable within the eyes of the the Internal Revenue Service (IRS).

In fact, the IRS specifically states that they don't prohibit investors from investing their funds in alternative investments (AI's), however they do not require IRA Trustees to offer AI's as investment options.

So what does this tell us? Large brokerage houses know and understand that this option exists; however, they chose to focus on the traditional Stock Market.

Why? Well, maybe there isn't enough financial gain for these institutions to offer AI's to their clients? Maybe it's too administratively burdensome. Or, maybe they would like to stick to what they know and have done over the last 100's of years.

In any event, through a Self-Direct IRA, you're able to invest your funds how you chose.

Alternative Investment (AI): An alternative investment is an asset with returns that have a low correlation with those of standard asset classes

Where Did Self-Direct IRAs Come From? (And Why Haven't You Heard About Them Before?)

In 1974, Congress passed the Employee Retirement Income Security Act (ERISA) that, among many other provisions, provided for the implementation of the IRA.

Initially, ERISA aimed to protect workers with benefit plans and IRA's were restricted to those who were not covered by employment-base retirement. The two goals of the IRA were to provide:

- A tax-advantaged retirement plan to employees of businesses that could not provide a pension plan; and
- A vehicle for preserving tax-deferred status of qualified plan assets at employment termination.

This changed in 1981—Under the Regan administration, the guidelines were modified as part of the Economic Recovery Tax Act (ERTA). With this adoption, anyone under the age of 70 ½ would be able to contribute to an IRA.

Types of Investment Accounts You Should Consider

IRS regulations require that a qualified trustee, or custodian, hold IRA assets on behalf of the IRA owner. The trustee/custodian provides custody of the assets, processes all transactions, maintains other records pertaining to them, files required IRS reports, issues client statements, helps clients understand the rules and regulations pertaining to certain prohibited transactions, and performs other administrative duties on behalf of the Self-Directed IRA owner.

Types of Investment Accounts

There are many variations of the retirement account, that span from a plan established for and by the individual investor, to plans designed for small business holders, and those supported and provided by the business itself.

Below is a list of the more common retirement accounts, and the tax environments in which they operate within:

Traditional IRA: Known as a tax-deferred or pre-tax account. When utilizing this account, taxes are deferred on contributions and earnings until funds are distributed from the account.

Roth IRA: Also known as tax-free or after-tax account. Taxes are paid on initial dollars contributed to the plan, while growth incurred thereafter is completely tax free.

Self Employed Pension Plan (SEP IRA): Known as a tax-deferred plan, this type of retirement account is typically used by small businesses with fewer than 25 employees. Under this plan, the business contributes on behalf of its employees.

Savings Incentive Match Plan for Employees (SIMPLE IRA): Know as a tax deferred, this type of plan is typically used by small businesses with less than 100 employees. It allows both the employee to contribute as well as an employer match the contribution of the employee of 1-3%

Individual Solo 401k: Both a tax deferred and tax free, this type of plan is established by small businesses with 1 employee and their spouse. It allows for both an after tax component on behalf of the business owner as an employee of their own business as well as a pre-tax component on behalf of the business itself)

401k/401A/403B/TSP/ESOP: Tax-deferred plans, established by the business and allow employees to contribute a portion of their earnings through salary deferrals.

What Can I Invest in with a Self-Directed IRA?

As a self-directed investor, you are able to broaden your investment options by incorporating AI's into the investment equation. These assets can include, but are not limited to, the following:

- Stocks/ Bonds / Mutual Funds
- Real Estate — Single family – Buy and Hold; or Fix and Flips
- Tax Liens/ Deeds
- Options
- Private Lending
- Private Mortgage Notes
- Precious Metals
- Oil and Gas
- Equipment Leasing
- Factoring

There are only a few items the IRS tells investors they CANNOT invest into. These assets would be insurance policies and collectibles, including:

- Artwork
- Rugs
- Antiques
- Metals (except for certain kinds of bullion)
- Gems
- Stamps
- Coins (except for certain kinds of coins)
- Alcoholic Beverages
- Certain types of tangible personal property

Can I get a loan for the purchase of assets using a Self-Directed Account?

Investors interested in using a Self-Directed IRA to purchase alternative assets, such as real estate, may not always have the necessary funds to make a purchase. In addition, they may not want to exhaust all the resources within the account for just one single asset.

The question becomes, “How do you get additional funds to make such a purchase? And, can an investor get a mortgage to leverage their account?” The answer is no, as most lenders will not lend to an IRA account. The reason for this is that lenders will want a personal guarantee for said mortgage, which the IRS does not allow when investing through a Self- Directed Account.

Enter the idea of the non-recourse loan. A non-recourse loan is the only form of debt an IRA can acquire. Non-recourse states that the account holder is not personally liable for the repayment of the loan. With this specific type of loan, the security instrument is the asset itself. Therefore, no recourse can be taken against the IRA holder in the event of default.

While this sounds like a great idea, non-recourse loans can be difficult to come by as there are only a few commercial lenders providing this specific type of loan to investors. In fact, there are only two national lenders that offer these types of loans, representing about 80 million in loans per year.

Investors are also able to explore the option of private money loans, while still operating under the idea of them being non-recourse. This can be an option; however, hard money loans can be quite expensive, taking away from the investors bottom line.

Lastly, there are companies that offer non-recourse financing as part of the property purchase itself. There is only one company that currently offers this type of arrangement to their clients nationwide; Growth Equity Group based out of Chicago, IL. This turn-key investment firm has set itself apart from its competitors by way of packaging these debt instruments with a fully managed, cash flowing asset to be held in the investor’s retirement account. This is extremely beneficial for those looking to invest in real estate, as leverage can be an investors best friend.

Who can I invest with?

When it comes to the IRS, they are very good at telling you what you cannot do, rather than what you can do. Below is a direct excerpt from the IRS code, describing who cannot invest directly with a Self-Directed IRA.

According to the Internal Revenue Code section IRC 4975(e)(2) the following people are considered disqualified persons (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 (A). 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 b. The capital interest or the profits interest of a partnership c. The beneficial interest of a trust or unincorporated enterprise Which is an employer or an employee organization described in subparagraph (C) or (D) 6 (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 (A). 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 b. The capital interest or profits interest of such partnership or c. 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, 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) (I) A 10 percent or more partner or joint venture of a person described in subparagraph (C), (D), (E), or (G).

In layman's terms, this means the following people are consider disqualified from benefiting or interacting with your IRA:

- You (covered in section describing fiduciaries)
- Anyone providing services to the plan
- Descendants of IRA owners/Spouse
- Ancestors of IRA owners/Spouse
- Spouse
- Businesses owned by disqualified people (if the business is owned by you, your wife, etc.)

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After reviewing this list, there are typically two common responses.

The first is that the family member list is limited and aunts, uncles, brothers, sisters and other family members are not on the list. While the IRS currently allows transactions with these people that does not mean they always will.

Also, keep in mind that while these transactions are not prohibited, you probably want to avoid them if possible, as they could draw unnecessary IRS attention.

The other common line of thought you may have had is a “quid pro quo” arrangement. Example: Kristina and Jim each have an IRA with vacation properties in Tampa Bay, Florida in their IRAs. A quid pro quo arrangement would be that if Kristina stays at Jim’s house, then Jim can stay at Kristina’s house for free. This is considered illegal, because both Jim and Kristina are gaining indirect benefit from the IRA.

Prohibited Transactions or Investments

Again, following the theme of who you cannot invest with, the IRS also tells us specifically what we cannot invest in. Below is the direct code from the IRS:

Internal Revenue Code 4975(c)(1): For purpose 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 asset 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 Please note the words "any direct or indirect"; meaning the scope of prohibited transaction is very broad. Additionally, please note items C and D.

In this passage, the IRS states the we cannot gain personal benefit from IRA transactions. You cannot receive any benefit, goods and services from your IRA.

But it goes both ways.

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The IRA cannot benefit from investments or changes made possible by funds allocated outside of the account. This means you can't manage the tenants, vacancies or do repairs on the property with personal resources.

The following are additional detailed descriptions of the assets you (or other disqualified persons) cannot invest in with a Self-Directed IRA:

- Buy a property in your IRA that you currently own.
- Live in a property that your IRA owns.
- Use your IRA property as your personal vacation home.
- Buy a house in your IRA and lease it to your son/daughter to use as a college house.
- Buy a house in the IRA and personally guarantee the loan.
- Do work (such as repairs or property management activities) on a property owned by your IRA.
- Be a customer of the assets owned by your IRA.
- You cannot gain any benefit from the IRA or have the IRA gain benefit from you.
- IRA owns a rental and the rent check is paid to you.
- Disqualified persons cannot co-mingle personal money on an IRA property.

The best way to avoid prohibited transactions is to keep everything at arm's length distance from yourself.

When can I access these Retirement Funds for Personal Use?

The great thing about the Self-Direct IRA is that it follows all the same rules and guidelines established by the IRS for any other retirement account. Distributions start at the retirement age of 59 ½, and may or may not be subject to taxes depending on the tax environment the account sits in (i.e. tax-deferred vs. tax-free).

In some instances, (tax-deferred) if a distribution is taken before the rightful age of 59 ½, then a 10% penalty would be added to the normal tax assessed.

Furthermore, tax-deferred plans with mandate that you begin to take distributions from your retirement plan starting at the age of 70 ½.

How does the Self-Directed IRA Help Me?

At the end of the day, all investors have the same goal—financial freedom!

While the traditional market believes this is enabled through reliance on a financial advisor (and associated management fees), we argue that individuals can take control of their financial assets and reap larger rewards, with greater flexibility. This is achieved through development of a savings and investment plan, as well as the proper education and channels through which to make your investments.

Employing this investment strategy using a Self-Directed IRA into assets—i.e. Real Estate and other alternative investment options—you are able to better control the outcome, achieving the freedom you are seeking.

Next Steps: How Do I Move Forward with a Self-Directed IRA?

Speak with an expert when researching the various strategies and investment vehicles available to handle your investment funds.

Consult with an individual or company you trust to help discuss your financial situation, identify your retirement goals and help steer you toward the best vehicle for your money and investing knowledge.