

# *USING YOUR IRA TO BUY REAL ESTATE*



(a.k.a. **Self Directed IRA**)  
Frequently Ask Questions



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## **How do I use my IRA to buy Real Estate?**

You can use your IRA to invest in Real Estate. To do this you will need to set up a Self-Directed IRA (with check-book control). The process and guidelines are discussed in more detail below.

## **What is a Self-Directed IRA?**

A Self-Directed IRA is technically the same as the traditional IRA. It is governed by the same rules and conditions as a traditional IRA. What makes a self directed IRA attractive to many people is the availability of additional investment options.

Typically an IRA from a bank or brokerage firm only suggests approved stocks, bonds, mutual funds and CDs. A Self-Directed IRA, when set up properly, allows those types of investments to be made in addition to real estate, notes, private placements, tax lien certificates and much more.

## **Why haven't I heard of a Self-Directed IRA before?**

Actually, you have had a Self-Directed IRA for years with your traditional IRA from a bank or brokerage firm. You have always had to instruct the institution (Self-Directed) where and how much to invest for your traditional IRA. Your investment options are normally limited to mutual funds, stock, CDs, and a few more variations. Banks and brokerage firms focus on mutual funds, stocks, and CDs because they have vested financial interests in you selecting those investments from them.

Self-Directed IRA's put the decision making, control, and execution in your hands. As such, you eliminate many of the fees that are associated with those services and products.

## **What are the benefits of a Self-Directed IRA?**

In addition to the same traditional IRA benefits, you will be able to invest in tax-deferred investments as well, (tax is applicable upon distribution as in traditional IRAs) such as real estate, notes, private placements, tax lien certificates and much more.

## **What are the different types of Self-Directed IRA's?**

There are different variations:

- 1) Active IRA custodian: These firms will complete all your IRA reporting to the IRS and invest your IRAs at your direction to the additional investments options that are discussed above. They charge annual fees, service fees and / or a percentage of the holding or both to perform these services. All investment decision must be submitted to the active IRA

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custodian. As such, processing time might be a factor in certain investment opportunities.

- 2) **Passive IRA custodian:** These firms will do all your IRA reporting to the IRS but are not responsible for executing your investments. You will be required to create a special purpose entity with an unique Operating Agreement LLC (Limited Liability Company) for the passive IRA custodian to invest your IRA funds into. From the LLC, with you being its manager, all the investments will be made. Since you have the check book writing authority for the LLC, any investment decision can be made very quickly to capture the opportunities.

Our law firm works with a well known IRA custodian (IRAServices) to create your Self-Directed IRA and your LLC (with check writing capability) to enable you to expand and control your IRA investment options.

## **How do I report income, expenses?**

All income and expenses is contained within the LLC structure. Since it is an IRA, you do not need to report the details. However, you must:

- 1) Pay the state applicable LLC tax (\$800/year to the State of California Franchise tax board. Higher if the gross income is \$250,00.00 or more).
- 2) Year-end report of the LLC asset cash position to the IRA custodian so they can file required paperwork with the IRS.
- 3) Pay the custodian an annual fee to administer your IRA account reporting to the IRS.

## **Can I be assured that Self-Directed IRAs are allowed under IRA rules?**

There are specific rules regarding IRAs, and in particular, Self-Directed IRAs that you should be familiar with to ensure compliance. There are certain types of transactions that you cannot perform through an IRA. Most importantly, the IRS prohibits “self dealing,” which are investments in which you or your family members of lineal descent have prior ownership.

Your custom LLC Operating Agreement will specify these rules and conditions.

## **Are my Self-Directed IRA investments guaranteed?**

Your IRA, when deposited with the IRA custodian (IRA services) is held in a US bank and insured by the FDIC. Your IRA, when invested into the LLC, is deposited into a bank of your choice and therefore is protected by the FDIC-insured deposits as well.

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However, when the LLC funds are invested by you, there are always inherent risks and there are no guarantees. Self-Directed investing is not for everyone but successful investors feel that the investment risk in assets they know and understand is much less than that associated with investing solely in conventional IRAs.

## **Can I use my Self-Directed IRA to buy a vacation property?**

The purpose of the IRA is to provide for your retirement in the future. It's not intended to benefit you now. It's considered an "indirect benefit" if your IRA is engaged in transactions that, in some way, can benefit you personally—and this is NOT allowed.

### **Indirect Benefit Examples:**

The following are just a few types of indirect benefit transactions that are NOT allowed in an IRA:

- Personally using IRA property —such as using real estate purchased through your IRA—as an office, personal residence, vacation home, retirement home, or office space.
- Receiving personal benefits from your IRA —such as lending yourself money from your IRA or paying yourself, or a company that you own, to do work on a home purchased by your IRA
- Using your IRA funds to buy a vacation home that you or your family will use

## **Can I use my Self-Directed IRA to buy a rental property?**

Yes, buying a property for rental income (as most people do) is an acceptable purchase within the IRS guideline. All title, income, expenses, profit, and loss must be accounted through the LLC and reported with the yearend evaluation to the IRAServices.

## **How do I withdraw funds from my Self-Directed IRA?**

Just like a traditional IRA, all the applicable rules and conditions concerning the distribution of funds apply to Self-Directed IRA's.

In addition, your LLC asset must be converted to cash and deposited back to your passive IRA custodian. Your passive IRA custodian will then distribute the funds to you and report the distribution to the IRS. You are prohibited from distributing any funds directly to you from the LLC.

To receive funds from your IRA without penalty, you must reach the age of 59 ½ (A Roth IRA also requires that the account has been open for at least five years).

## Required Minimum Distributions

Traditional IRA, SEP, SIMPLE and Solo 401(k) account holders must begin taking required minimum distributions (RMD) from their accounts beginning April 1st of the year following reaching the age 70 ½.

RMD is calculated by a special formula relating to life expectancy; please consult with [IRS Publication 590](#) and/or a tax consultant. RMDs are calculated for each account, which means if you have multiple accounts you are required to take distributions from each account.

## Special Note on Premature Distributions

You can generally withdraw funds from a Traditional or Roth IRA without penalty at any time after you have attained the age of 59 ½. If you decided to withdraw money from your Traditional or Roth IRA account prior to the attainment of age 59 ½ you would be subjected to the imposition of a 10% early distribution penalty tax.

## Are there exceptions to the 10% early distribution penalty tax?

Yes, there are several exceptions to the 10% early distribution penalty tax. Among the exceptions recognized under the Internal Revenue Code are the distributions due to the following events:

- Death
- Disability
- Qualified higher education expenses;
- The distributions are part of a series of substantially equal payments;
- Unreimbursed medical expenses that exceed 7.5% of your adjusted gross income;
- Medical insurance premiums
- Expenses associated with buying or building a first home;
- Payment of any IRS levy; and
- Qualified reservist distribution

For additional information regarding the exceptions to the early distribution rules, please see [IRS Publication 590](#); contact your tax attorney; or accountant.