Diversify, Control, and Self-Direct

Taking control of your retirement funds has never been so easy

THE IRA FINANCIAL TRUST COMPANY

WWW.IRAFINANCIALTRUST.COM
800.472.1043
Checklist for Making Self-Directed IRA Investments

An Individual Retirement Account (IRA) is a form of retirement account that provides investors with certain tax benefits for retirement savings. A Self-Directed IRA is an IRA held by a trustee or custodian that permits investment in a broader set of assets than is permitted by most traditional IRA custodians, such as Vanguard, Bank of America, Fidelity, etc. Most IRA custodians are banks and broker-dealers that limit the holdings in IRA accounts to firm-approved stocks, bonds, mutual funds and CDs. Custodians and trustees for Self-Directed IRAs, however, may allow investors to invest retirement funds in other types of assets such as real estate, promissory notes, tax lien certificates, and private placement securities. While Self-Directed IRAs may offer investors access to an array of private investment opportunities that are not available through other IRA providers, investments in these kinds of assets may have unique risks that investors should consider.

Before establishing a Self-Directed IRA, it would benefit an investor to consider the following eight (8) items to provide oneself with the best chance of success.

1. Speak to Your Advisors

Before contemplating using retirement funds to establish a Self-Directed IRA, it is a great idea to speak with your financial advisor, investment advisor, accountant, and attorney, if necessary, to make sure using a Self-Directed IRA makes sense for you. Using retirement funds to make alternative asset investments, such as real estate, is not for everyone. It is important to contemplate the potential risks involved in making any IRA investment, including alternative asset investments. Those risks can include a lack of disclosure and liquidity, as well as the risk of fraud. Your investment and tax advisors would be in a strong position to help you determine whether using a Self-Directed IRA makes good sense for you.

2. Research Investment

Self-Directed IRAs usually allow investors to hold alternative investments such as real estate, mortgages, tax liens, precious metals, and private placement securities. Unlike publicly-traded securities, financial and other information necessary to make a prudent investment decision may not be as readily available for these alternative investments. Even when financial information for these alternative investments is available, it may not be audited. Furthermore, Self-Directed IRA custodians usually do not investigate the accuracy of this financial
information. Therefore, it is vital that one performs a diligent review of the anticipated Self-Directed IRA investment to make sure that it makes financial sense and is something that the investor is comfortable with, while simultaneously understanding any potential pitfalls. For most Americans, retirement funds are generally their most valuable asset, for this purpose it is important to be comfortable with the potential Self-Directed IRA investment and make sure you have carefully researched any potential benefits and negatives. Just because your friend or neighbor bought real estate or precious metals with their IRA should not necessarily be the deciding factor in deciding to make a similar investment. It is important to perform your own research and be sure to understand all the factors involved in making the investment.

3. Understanding the Economics of the Investment

As with every investment, investors should make sure that they understand and have evaluated the economic merits of the investment, as well as the potential financial obligations surrounding the investment. For example, if one is contemplating purchasing real estate with a Self-Directed IRA, it is important to verify that there are sufficient funds in the IRA to cover the purchase price. In addition, it is imperative that the investor consider any potential expenses, such as improvements, taxes, etc., that are likely to arise while owning the investment as only IRA funds can be used to pay for such costs. For example, an investor with $50,000 in retirement funds may have a difficult time coming up with the additional funds to purchase a property for $125,000, in light of the prohibited transaction and unrelated business taxable income rules. Likewise, an investor with $100,000 looking to purchase a property for $100,000 would need to consider additional financing options to cover anticipated expenses, such as improvements, taxes, etc. Performing a comprehensive and realistic evaluation of the potential Self-Directed IRA investment is imperative. Furthermore, it is important to consider the annual costs involved for establishing and maintaining a Self-Directed IRA. The costs involved generally depend on if you will be making the investment via a Checkbook Control LLC or directly through the custodian. A custodian controlled Self-Directed IRA account can cost approximately $360 a year, whereas, a Checkbook Control IRA LLC can cost approximately $1300 in year 1, but only $180 or so each year thereafter.
4. Understanding the IRS Prohibited Transaction Rules

The Internal Revenue Code does not describe what a Self-Directed IRA can invest in, only what it cannot invest in. Internal Revenue Code Sections 408 & 4975 prohibits Disqualified Persons from engaging in certain types of transactions. The purpose of these rules is to encourage the use of IRAs for accumulation of retirement savings and to prohibit those in control of IRAs from taking advantage of the tax benefits for their personal account.

The foundation of the prohibited transaction rules are based on the premise that investments involving an IRA and related parties are handled in a way that benefits the retirement account and not the IRA owner. The rules prohibit transactions between the IRA and certain individuals known as “disqualified persons”. The outline for these rules can be found in Internal Revenue Code Section 4975.

Who is a “Disqualified Person”?

The IRS has restricted certain transactions between the IRA and a “disqualified person”. The rationale behind these rules was a congressional assumption that certain transactions between certain parties are inherently suspicious and should be disallowed.

The definition of a “disqualified person” (Internal Revenue Code Section 4975(e)(2)) extends into a variety of related party scenarios, but generally includes the IRA holder, any ancestors or lineal descendants of the IRA holder, and entities in which the IRA holder holds a controlling equity or management interest.

Work with IRA Financial Trust to establish your Self-Directed IRA or Checkbook Control IRA account today!
In essence, under Code Section 4975, a “Disqualified Person” means:

- IRC 4975(e)(2)(A): fiduciary (e.g., the IRA holder, participant, or person having authority over making IRA investments)
- IRC 4975(e)(2)(B): A person providing services to the plan (e.g., the trustee or custodian)
- IRC 4975(e)(2)(C): An employer, any of whose employees are covered by the plan (this generally is not applicable to IRAs)
- IRC 4975(e)(2)(D): An employee organization any of whose members are covered by the Plan (this generally is not applicable to IRAs)
- IRC 4975(e)(2)(E): A 50 percent owner of C or D above
- IRC 4975(e)(2)(F): A family member of A, B, C, or D above (family members include the fiduciary's spouse, parents, grandparents, children, grandchildren, spouses of the fiduciary's children and grandchildren, but not parents-in-law)
- IRC 4975(e)(2)(G): An entity (corporation, partnership, trust or estate) owned or controlled more than 50 percent by A, B, C, D, or E [whether an entity is a disqualified person is determined by considering the indirect stock holdings/interest which would be taken into account under Code Sec. 267(c), except that members of a fiduciary's family are the family members under Code Sec. 4975(e)(6) (lineal descendants) for purposes of determining disqualified persons]
- IRC 4975(e)(2)(H): A 10 percent owner, officer, director, or highly compensated employee of C, D, E, or G
- IRC 4975(e)(2)(I): A 10 percent or more partner or joint venturer of a person described in C, D, E, or G

Note: brothers, sisters, aunts, uncles, cousins, step-brothers, step-sisters, and friends are NOT treated as “Disqualified Persons”.

Open a Self-Directed IRA Account Today!

It's quick and easy and will take only a few minutes.

800.472.1043
www.irafinancialtrust.com
Application of the Prohibited Transaction Rules

In order to determine whether a proposed transaction is a prohibited transaction and violates IRC 4975, it is important to examine all the parties engaged in the proposed transaction rather than on just the IRA owner.

Pursuant to Internal Revenue Code Section 4975, a Self-Directed IRA is prohibited from engaging in certain types of transactions. The types of prohibited transactions can be best understood by dividing them into three categories: Direct Prohibited Transactions, Self-Dealing Prohibited Transactions, and Conflict of Interest Prohibited Transactions.

Direct Prohibited Transactions

Subject to the exemptions under Internal Revenue Code Section 4975(d), a “Direct Prohibited Transaction” generally involves one of the following:

4975(c)(1)(A): The direct or indirect Sale, exchange, or leasing of property between an IRA and a “disqualified person”

Example 1: Jack sells an interest in a piece of property owned by his IRA to his son.

Example 2: Judy leases real estate owned by her IRA to her father.

Example 3: Brian uses his IRA funds to purchase an LLC interest owned by his son.

4975(c)(1)(B): The direct or indirect lending of money or other extension of credit between an IRA and a “disqualified person”

Example 1: Keith lends his wife $10,000 from his IRA.

Example 2: Amy personally guarantees a bank loan to her IRA.

Example 3: Peter uses IRA funds to lend an entity owned and controlled by his mother $60,000.
4975(c)(1)(C): The direct or indirect furnishing of goods, services, or facilities between an IRA and a “disqualified person”

Example 1: Eric buys a piece of property with his IRA funds and hires his father to work on the property.

Example 2: Marilyn buys a home with her IRA funds and personally fixes it up.

Example 3: Sara owns an apartment building with her IRA and hires her father to manage the property.

**Indirect Prohibited Transactions**

4975(c)(1)(D): The direct or indirect transfer to a “disqualified person” of income or assets of an IRA

Example 1: Dan is in a financial jam and takes $12,000 from his IRA to pay his mortgage and credit card bill.

Example 2: Steve uses his IRA to purchase a rental property and hires his friend to manage the property. The friend then enters into a contract with Steve and transfers those funds back to Steve.

Example 3: Victoria invests her IRA funds in a real estate fund and then receives a salary for managing the fund.

**Self-Dealing Prohibited Transactions**

Subject to the exemptions under Internal Revenue Code Section 4975(d), a “Self-Dealing Prohibited Transaction” generally involves one of the following:

4975(c)(1)(E): The direct or indirect act by a “Disqualified Person” who is a fiduciary whereby he/she deals with income or assets of the IRA in his/her own interest or for his/her own account

Example 1: Jessica, who is a real estate agent, uses her IRA funds to buy a home and earns a commission from the sale.

Example 2: James wants to buy a piece of property for $110,000 and would like to own the property personally but does not have sufficient funds. As a result, James uses $90,000 from in his IRA and $20,000 personally to make the investment.

Example 3: Dana uses her IRA to funds to invest in a real estate fund managed by her Son. Dana's son receives a bonus for securing Dana's investment.
**Conflict of Interest Prohibited Transactions**

Subject to the exemptions under Internal Revenue Code Section 4975(d), a “Conflict of Interest Prohibited Transaction” generally involves one of the following:

**4975(c)(i)(F): Receipt of any consideration by a “Disqualified Person” who is a fiduciary for his/her own account from any party dealing with the IRA in connection with a transaction involving income or assets of the IRA**

Example 1: Joe uses his IRA funds to loan money to a company in which he manages and controls but owns a small ownership interest in.

Example 2: Michelle uses her IRA to lend money to a business that she works for in order to secure a promotion.

Example 3: Brandon uses his IRA funds to invest in a hedge fund that he manages and where his management fee is based on the total value of the fund's assets.

**Life Insurance and Certain Collectibles**

In general, pursuant to IRC Section 408(m), a Self-Directed IRA cannot Invest in life insurance contracts or collectibles defined below:

- Any work of art
- Any metal or gem
- Any alcoholic beverage
- Any rug or antique
- Any stamp
- Most coins

Open a Self-Directed IRA Account Today!

It's **quick** and **easy** and will take only a few minutes.
Types of Collectibles That May Be Purchased Using IRA Funds

The IRS has carved out a set of exceptions to the disqualified transaction rules under IRC 408(m) for certain precious metals and coins. In general, the following types of precious metals and coins are allowed to be purchased with a Self-Directed IRA:

- One, one-half, one-quarter or one-tenth ounce U.S. gold coins (American Gold Eagle coins are the only gold coins specifically approved for IRAs; other gold coins, to be eligible as IRA investments, must be at least .995 fine [99.5% pure])
- One ounce silver coins minted by the Treasury Department
- Any coin issued under the laws of any state.
- A platinum coin described in 31 USCS 5112(k)
- Gold, silver, platinum or palladium bullion (other than bullion that is made into a coin) of a certain fineness that is in the physical possession of a trustee that meets the requirements for IRA trustees under Code Sec. 408(a)

In general, all IRS approved precious metals and coins should be held in the physical possession of a United Stated bank or depository. The IRS approved precious metals or coins should never be held personally.

S Corporation Stock

Because of the shareholder restrictions imposed on “S” Corporations, an IRA cannot own stock in an S Corporation. Note: An IRA can own stock in a “C” Corporation.

Overall, when looking at a potential investment with a Self-Directed IRA, it is important to verify that no disqualified person will be involved in the transaction and that no disqualified person will receive any direct or indirect benefit from the Self-Directed IRA investment. In addition, if purchasing precious metals, make sure the metals or coins are IRS approved and satisfy the requirements under IRC 408(m).

Triggering an IRS prohibited transaction can have steep tax consequences as the individual's IRA would lose its tax exempt status and the entire fair market value of the IRA would be treated as taxable distribution, subject to ordinary income tax and penalties which can reach 100%.
5. The Application of the Unrelated Business Taxable Income Rules

Most people believe that when they use their retirement funds to make investments, such as stocks, mutual funds, and real estate, the income and gains generated will be tax-free. In most situations, they are correct. The Internal Revenue Code does not describe what an IRA can invest in, only what it cannot invest in. Internal Revenue Code Sections 408 & 4975 prohibits Disqualified Persons from engaging in certain type of transactions. In general, when it comes to using an IRA to make investments most investments are exempt from federal income tax. This is because an IRA is exempt from tax pursuant to Internal Revenue Code 408 and Section 512 of the Internal Revenue Codes, which exempts most passive forms of investment income generated by an IRA from taxation. Some examples of exempt types of passive income include: interest from loans, dividends, annuities, royalties, most rentals from real estate, and gains/losses from the sale of real estate.

However, in a number of instances a mysterious tax known as UBIT or UBTI, or the Unrelated Business Taxable Income tax, could be triggered when a retirement account invests in certain types of transactions and turn a potential tax-free investment into a very tax-inefficient investment. The terms UBIT and UBTI refer to the Unrelated Business Taxable Income tax rules found in Internal Revenue Code Section 512.

In general, the UBTI tax is triggered in three types of investment categories involving retirement accounts:

1. Using margin to buy stocks or securities
2. Using a Nonrecourse loan to buy real estate (there is an exemption for 401(k) plans under certain conditions)
3. Investing in an active trade or business operated through an LLC or pass-through entity, such as a partnership

Triggering the UBTI tax can turn an investment from being tax efficient to being highly inefficient. The maximum tax rate of 39.6% is triggered at just $12,300. However, the UBTI/UBIT tax rules are not triggered if less than $1,000 of income is generated by the investment at issue. For retirement accounts, the UBTI/UBIT income is reported on IRS Form 990-T and the tax is due by April 15. The tax would be paid by the retirement account.

Work with IRA Financial Trust to establish your Self-Directed IRA or Checkbook Control IRA account today!
6. Beware of Fraud

While Self-Directed IRAs and solo 401(k) Plans can be a safe way to invest retirement funds, investors should be mindful of potential fraudulent schemes when using a self-directed retirement structure. Recently the Securities and Exchange Commission (“SEC”) issued an Investor Alert to warn investors of the potential risks of fraud associated with investing through self-directed Individual Retirement Accounts (Self-Directed IRAs and solo 401(k) Plans). The SEC notes that there has been a recent increase in reports or complaints of fraudulent investment schemes that utilized a Self-Directed IRA or solo 401(k) Plan as a key feature.

The IRA Financial Trust Company or any party cannot guarantee the success of any investment and IRA investors should undertake their own evaluation of the merits of a proposal, and should check with regulators about the background and history of an investment and its promoters before making a decision of potential fraudulent schemes when considering a self-directed retirement structure. Investors should understand that the custodians of self-directed retirement account may have limited duties to investors, and that the custodians and trustees for these accounts will generally not evaluate the quality or legitimacy of an investment and its promoters. As with every investment, investors should undertake their own evaluation of the merits of a proposal, and should check with regulators about the background and history of an investment and its promoters before making a decision. In general, the best prevention technique is to identify and research the persons, products and companies offering their services. The more education and understanding of the product features, especially investment products, the higher the level of scrutiny can be applied.

Open a Self-Directed IRA Account Today!

It's quick and easy and will take only a few minutes.
7. Timing of the Investment

When making a Self-Directed IRA investment it is essential to consider the timing involved in making the investment as well as the anticipated timeline for exiting the investment. Depending on whether you elect to establish a full-service Self-Directed IRA account or a Checkbook Control Self-Directed IRA LLC account, the timing involved for establishing and funding the account can take anywhere between 3-14 days. Hence, it is important to understand the necessary timing when electing to make an IRA investment so that funding is available at the time of closing. Furthermore, having a realistic idea of the potential life of the investment, including the timeline for a potential sale, is helpful when deciding whether the particular Self-Directed IRA investment makes sense.

8. Your Age & Exit Strategy

Like any investment, the age of the investor is a factor that should be considered when contemplating making a Self-Directed IRA investment. In general, the younger the investor is the more risk the investor would be inclined to take versus an investor nearing retirement who would likely need the funds for living purposes. In addition, as one nears the age of 70 and 1/2 and has a pre-tax IRA, the IRS requires that the individual take into income a minimum amount of retirement funds, known as a required minimum distribution (“RMD”). Therefore, it is important that investor nearing the age of 70 and 1/2 understands the RMD rules and would want to have a high level of confidence that the Self-Directed IRA investment would not hinder his or her ability to come up with the necessary funds to cover the RMD. In the case where the investor does not have sufficient funds in his or her IRA to cover the RMD because all the funds have been allocated to liquid investments, the investor would be required to take a distribution of an IRA asset in-kind in order to satisfy the RMD, which could cause a higher tax bill depending on the value of the asset. Accordingly, understanding the timing and potential exit strategy of a particular Self-Directed IRA investment is crucial. Paying special attention to the probable liquidity of a potential Self-Directed IRA investment is important, especially for investors nearing the RMD age requirement.

Our Self-Directed IRA account specialists will help you understand the rules involved for establishing a Self-Directed IRA. Our specially trained Self-Directed IRA account specialists are committed to helping you make investments quickly and easily, while minimizing annual fees.
Why IRA Financial Trust

With IRA Financial Trust as your Self-Directed IRA Custodian, your IRA funds will be held with Capital One Bank, one of the most respected private banks in the world, which offers our Self-Directed IRA clients a safe and secure way to make Self-Directed IRA investments.

The IRS has always allowed retirement investors to use their retirement funds to make a wide range of investments, such as real estate, precious metals, tax liens, private business investments, private equity, hedge funds, hard money lending, and much more. The reason this is not more widely known is that most traditional financial institutions that hold retirement accounts only make money when you buy financial products they sell, such as stocks or mutual funds. Hence, it does not make much financial sense to allow a client to take their retirement funds and make investments in which they do not sell and do not make any money off, such as real estate. As a result, almost all the traditional financial institutions holding retirement accounts will not allow you to make non-traditional or alternative types of investments with your retirement funds. This is where the IRA Financial Trust Company comes in. By establishing a Self-Directed IRA or Solo 401(k) plan account with the IRA Financial Trust Company, you will gain the ability to make traditional as well as non-traditional investments with your retirement funds providing your retirement account with diversification as well as allowing you to invest in what you know and understand.

Whether you want to make the investment directly from your custodian account or would like a bit more control through a Checkbook Control IRA, the retirement specialists at IRA Financial Trust Company will help you make your investment timely and cost effectively.

IRA Financial Trust Company is a regulated non-banking financial institution that is made up of retirement tax specialists committed to helping you make Self-Directed retirement investments quickly, while minimizing annual fees.

IRA Financial Trust offers one low flat IRA Custodian fee without any transaction fees and annual account valuation fees. We believe that Self-Directed IRA investing should be affordable and simple and IRA Financial Trust is committed to helping all our clients build their retirement wealth through Self-Directed IRA investments without the high costs and complexities.

Work with IRA Financial Trust to establish your Self-Directed IRA or Checkbook Control IRA account today!

800.472.1043
www.irafinancialtrust.com