



REAL ESTATE IRA/401(k) INVESTOR'S GUIDE

**A Roadmap for Buying Investment Real Estate
in Your Retirement Plan**



RealTrust
IRA ALTERNATIVES, LLC

Real Control. Real Choice. Real Wealth.



The Guide is designed to equip RealTrust IRA investors with the tools and strategies necessary for navigating a number of specific challenges that arise when acquiring real estate in one’s “Fully” Self-Directed IRA or 401(k). We discuss many of the particular scenarios encountered along the way and set forth proven game plans for success. Our goal is to empower you to anticipate and avoid the pitfalls that may otherwise stand in the way of achieving your investment objectives.



I. Establish Your Self-Directed Retirement Account Early On. We strongly recommend that you establish and fund your RealTrust Self-Directed IRA/401(k) Account well in advance of making an offer to purchase real estate or submitting a bid at a foreclosure auction.

Why? Because, even if you're a veteran real estate investor, there are several key issues unique to acquiring, holding and selling real estate through one's IRA or 401(k).

The RealTrust attorneys and account managers have many years of experience guiding investors through the entire Real Estate IRA/401(k) process. They will share invaluable know-how and insight with you from start to finish so your transactions will have a greater likelihood of success and remain in compliance with the governing rules and regulations. Moreover, by allowing us to help guide the process from the outset, RealTrust IRA/401(k) Investors can avoid many costly missteps and delays.

If you have yet to get started, go to section below titled:

"It's Easy to Establish Your RealTrust IRA Account"

II. Prohibited Transaction Considerations. Keep in mind that a Self-Directed IRA or 401(k) Account is viewed as a trust, separate and distinct from the owner of the Account: the individual IRA Holder or 401(k) Participant. The law requires a Trustee or Custodian to hold the Account assets in trust for the benefit of the IRA Holder or 401(k) Participant. RealTrust serves as a Custodian-Administrator for the IRA Accounts and acts exclusively at the direction of the IRA Holder or 401(k) Participant to buy, hold, improve and sell the asset.



The Prohibited Transaction Rules (IRC §4975) preclude the IRA Account, the IRA Holder and other “Disqualified Persons” from buying, selling, leasing, exchanging, lending to, borrowing from, extending credit, personally using an asset of, or providing goods, services or facilities to, by or between one another.

“Disqualified Persons” are generally defined as: the IRA Holder; the spouse, ascendants and descendants of the IRA Holder; and entities owned 50% or more by the IRA Holder and/or other Disqualified Persons.

It can be argued that the IRA Holder engages in a prohibited transaction when entering into a purchase contract in his or her personal name, then later assigning the contract to the IRA Account. An analogous argument can be made where the IRA Holder personally bids at a foreclosure auction, then later transfers the Trustee’s Deed (or the right to receive the Trustee’s Deed) to the IRA Account. Because the consequences of a prohibited transaction are harsh, we recommend that our clients proceed cautiously and proactively to avoid such a result, as outlined below.



III. Make Offer/Submit Auction Bid in the Name of Your Self-Directed IRA/401(k) Account. One of the first orders of business is knowing how to properly write-up an offer or submit an auction bid to purchase the desired real estate.

A. Purchase Offer. In the negotiated purchase and sale context (e.g.- standard offer/counter-offer scenario), the purchase offer should be written in the name of the Self-Directed IRA Account (e.g. - Purchaser: RealTrust IRA Alternatives, LLC fbo [for benefit of] Robert Jones IRA #22222), not in the personal name of the individual IRA Holder (e.g. - Purchaser: Robert Jones). A RealTrust representative will execute the final Purchase and Sale Agreement on behalf of the IRA Account, with the IRA Holder personally signing and acknowledging the contract as “Accepted and Approved”.

The earnest money deposit should also come from the Self-Directed IRA Account, rather than from the investor’s personal funds for the benefit of the IRA. In other words, be careful not to commingle personal funds with IRA funds in the same account or a “prohibited transaction” may arise (as discussed above).



B. Foreclosure Auction. When bidding at a Foreclosure Auction, advance preparation is even more critically important. Not only must the IRA Account be established, funded and the cash available before bidding, but special arrangements should be in place to ensure that the bids are submitted on behalf of the Self-Directed IRA Account (not the individual IRA Holder) at the Trustee’s Sale. The funds must go directly from the RealTrust IRA Account to the Foreclosing Trustee or Foreclosure Auction Facilitator (“Facilitator”). In other words, the IRA Holder should not personally bid at the sale using personal funds or have the Trustee’s Deed made out in his/her individual name (for subsequent transfer to the Self-Directed IRA Account). Such an approach is analogous to the earnest money deposit coming from personal funds, or the assignment of purchase offer from IRA Holder to IRA Account mentioned above, and could also be deemed a prohibited transaction. From a logistical perspective, the funds must go directly from the IRA Account to the Lender’s Trustee calling the sale, not to or from the IRA Holder personally.



1. Pre-Arranged Bidding System. RealTrust has a system in place whereby the funds for bidding at the auction may be wired from the IRA Account to a “non-disqualified” agent selected by the IRA Holder on or before the day of the Trustee’s Sale. A professional Facilitator often serves in this capacity. The IRA Holder first completes and delivers to RealTrust an “Asset Purchase Directive” specifying the targeted foreclosure property and the amount of cash to wire.

In this fashion, the IRA Holder decides how much he/she is willing to bid for a given property and instructs the Facilitator to make the bid and tender the cash on behalf of the IRA

Account. If the bid is successful, title can be vested directly in the name of RealTrust fbo the IRA Account, rather than first vesting in the name of the IRA Holder or Facilitator. How? There is generally a lag time between the auction event and the delivery of the Trustee’s Deed. Moreover, the Foreclosing Trustee will normally follow the parties’ instructions as to vesting of title.



2. Alternative Funding Sources. If the IRA Investor does not have sufficient resources available in the IRA Account to make an all-cash bid at the auction, other funding arrangements may be available.



a. Partnering with Your IRA. IRA Investors are able to partner their “taxable” or “personal” dollars alongside the “tax-advantaged” dollars held in a Self-Directed IRA/401(k) Account. Properly structured, for example, Robert Jones can use personal funds to acquire an undivided 50% interest in a piece of investment real property, to be held by Mr. Jones personally, and concurrently acquire and hold the other undivided 50% interest through his RealTrust Self-Directed IRA, each as tenants in common. In such event, both the income and expenses will be shared on a 50/50 basis between Mr. Jones and the IRA Account. 50% of the net income and profit will be realized by Mr. Jones’ on a taxable basis, but he may be able to deduct the pro rata investment-related expenses on his personal tax return. He can put this after-tax money to use as he sees fit (in other words, he can spend it or save it for his personal account). The IRA Holder may elect to partner with other third parties, as well, provided the assets involved are acquired from non-disqualified sellers.

As concerns the IRA’s interest, 50% of the net income and profit will be realized by the IRA on a tax-deferred basis, but the investment-related expenses are generally not tax-deductible (otherwise, the IRA would receive a double dip tax advantage, heaven forbid). The earnings must return to the IRA Account and remain as retirement savings until a taxable distribution is made after age 59½. IRA funds must be used exclusively for IRA-related matters, of course, not for Mr. Jones’ personal expenditures.

b. Using Non-Recourse Financing to Purchase Real Estate.

Self-Directed IRA and 401(k) Accounts may also use leverage to acquire investment real estate. The debt-financing must be “non-recourse” as to the IRA/401(k) and IRA Holder. In other words, the real estate acquired may be pledged as collateral for a purchase money loan, but the Lender may look only to the real property security for recovery in the event of default. The Lender may not reach other assets of the IRA Account or the IRA Holder in order to recover any portion of the deficiency.



i. No Personal Guarantees.

Because the Prohibited

Transaction rules preclude IRA Holders (and Disqualified Persons) from extending personal credit for the benefit of an IRA/401(k), directly or indirectly, the Lender cannot look to the individual IRA Holder (or a Disqualified Person) for a personal guarantee of the loan, either. As one can well imagine, Non-Recourse Lenders typically require a 40-50% cash down payment in order to justify making a non-recourse loan. The lower loan-to-value ratios normally translate into greater positive cash flows.



ii. Debt-Financed Taxable Income. Another consideration, when it comes to obtaining financing for a portion of the purchase price, is the fact that IRA’s may be subject to “Debt-Financed Taxable Income” (DFTI) on the portion of the acquisition cost that was leveraged. DFTI is a pernicious cousin of the infamous Unrelated Business Taxable Income (UBTI) and must be reported on IRS Form 990T.

As an example, if the IRA borrows 50% of the purchase price from a Non-Recourse Lender (including seller-financing), then 50% of the ongoing income (in excess of \$1,000.00 per year) and realized capital gain may be subject to DFTI. So, if Mr. Jones’ IRA buys real estate for \$100,000.00, using \$50,000.00 cash and \$50,000.00 debt- financing, then flips the property in

six (6) months and makes a \$50,000.00 profit, 50% of the profit (or \$25,000.00) will be subject to DFTI. Assuming an effective tax rate of 30% (or \$7,500.00), the resulting \$17,500.00 would return to the IRA alongside the untaxed 50% profit of \$25,000.00, leaving a \$42,500.00 net profit, after tax. That still amounts to an 85% cash-on-cash return.

Using a Qualified Plan vehicle (e.g.- EZ 401(k)), rather than an IRA per se, may exempt the income/gain from DFTI, so this option is well worth exploring. Further specifics of the DFTI and UBTI issues are beyond the scope of this writing, but feel free to contact RealTrust for additional resources.

Real Estate IRA Purchase w/Debt	
50% Cash:	\$50,000.00
50% Debt:	+\$50,000.00
Total Purchase Price:	= \$100,000.00
Re-Sale Price:	\$150,000.00
Total Profit:	\$50,000.00
50% of Profit Subject to Tax:	\$25,000.00
Effective Tax Rate (est.):	x 30%
DFTI Tax Bill:	= \$7,500.00
Total Profit:	50,000.00
DFTI Tax Bill:	- 7,500.00
Profit After Tax:	\$42,500.00
Cash on Cash Return: (\$42,500 / \$50,000 = .85)	85%

iii. IRA's Bidding with Leverage at the Foreclosure Auction.

Foreclosing Lenders/Trustees require bids to be made “all cash” at the foreclosure auctions. Certain Foreclosure Facilitators offer their investor clients up to 75% of the necessary cash bid amount through bridge financing. The Investor only has to come up with cash for the remaining 25% of the successful bid amount. However, the financing terms typically require the Investor to provide a personal guarantee of the bridge loan. When the Investor is a Self-Directed IRA or 401(k), even as a partner, neither the IRA Holder nor a Disqualified Person can personally guarantee the obligation without triggering a Prohibited Transaction. So, careful, proactive structuring is essential.



In order to obtain bridge financing without making a personal guarantee, the Real Estate IRA should approach the Lender well in advance of the Trustee's Sale and arrange a non-recourse loan. This, of course, will require a greater cash contribution by the IRA at the foreclosure auction (e. g. 40% - 50% of the successful bid amount). Significantly, not only will this technique avoid the prohibited transaction of extending one's personal credit for the benefit of the IRA, but with a loan-to-value ratio of 40%-50% against the property acquired at the foreclosure auction, the IRA Holder will be well-positioned to turn around and obtain more economical permanent financing from a non-recourse lender specializing in IRA Lending (e.g.-5% interest vs. 12% interest).



IV. Specific Concerns when Buying Short Sales and REO's.

Several obstacles may present themselves when one attempts to buy other categories of distressed property with their Self-Directed IRA or 401(k). Some common scenarios are addressed below.



A. Distressed Property Context: Bank-Owned. When processing an agreement to purchase one of its REO's, many Lenders will not allow the Buyer to be substituted or the Buyer's name to be changed during the course of the transaction. So, if the Buyer under the Purchase and Sale Agreement reflects "Bob Jones", but Mr. Jones intends to assign the Agreement to his Self-Directed IRA Account prior to closing, the REO Lender may nix the deal when the "new" Buyer materializes. There have been a number of cases like this where the IRA Investor has lost the deal and the Lender sold the property to someone else. Hence, the importance of being prepared to write the deal up in the name of RealTrust IRA Alternatives, LLC fbo Bob Jones IRA #22222 at the outset.



Of course, some REO Lenders choose not to sell to entities at all, so writing up the deal in the name of an entity as Buyer may prevent the deal from ever getting off the ground. One way to overcome this challenge is to have a trusted third party serve as "nominee" for the IRA Account. In this manner, the deal is written up in the name of the individual Nominee as Buyer (e.g. - Mary Benjamin, as her separate estate) and title is transferred to Mary Benjamin at closing. Because Ms. Benjamin was serving in the capacity of Nominee for the IRA Account, title can be subsequently transferred to the IRA Custodian (RealTrust) fbo the IRA Account without incurring an additional excise tax. How?

In Washington State, WAC 458-61A-214 exempts the second transfer from excise tax liability when title transfers from nominee to principal, provided the following conditions are met:

1. Excise tax was paid on the first leg of the transaction (REO Lender to Mary Benjamin);
2. The funds used by the Nominee (Ms. Benjamin) to purchase the property from the REO Lender came from the Principal (IRA Account);
3. The Principal legally existed at the time of the initial transaction (another reason to have the IRA Account already established); and
4. The subsequent transfer from Nominee to Principal is not for greater consideration than that of the initial transaction.

It is important that the Nominee not be a “Disqualified Person” vis a vis the IRA Account (as previously discussed). Otherwise, the parties may fall into the “Prohibited Transaction” trap. Be sure to check local rules pertaining to nominees if the desired real estate is located in a jurisdiction other than Washington State.



B. Distressed Property Context: Short Sale. As in the REO situation, many Short Sale Lenders may not approve a short sale where the Buyer is an entity. Moreover, if the Buyer’s name is changed during the approval/closing process, quite often the Short Sale Lender will require the package to be re-submitted and the entire process started over. Utilizing the nominee approach outlined above may overcome this challenge. On occasion we have achieved success by having the Buyer reflected as “Bob Jones IRA”, rather than RealTrust fbo Bob Jones IRA Account # 22222. The main point is to make sure that the Self-Directed IRA Account is set-up before the offer is made, if at all possible. That way, we can provide specific guidance to the parties as to how best to structure the transaction for the greatest chance of success.

V. Using an IRA-Compliant LLC to

Purchase Real Estate. Some IRA/401(k)

Self-Directors prefer to establish an IRA-Compliant LLC when bidding for properties at foreclosure sales or engaging in “fix and flip” transactions. In this context, the IRA Holder directs RealTrust to fund the newly-formed LLC with IRA monies and to serve as custodian/administrator of the LLC member units, rather than holding the real estate directly. The IRA Holder becomes the Manager of the LLC and sets up a bank account for the LLC, giving him or her “Check Book Control” over the funds. The LLC vehicle is often used when “partnering” one’s IRA with co-investors.



With ready access to the LLC’s cash, the IRA Holder/Manager, either in person or through an agent, can easily obtain a cashier’s check from the LLC bank account and bid at a foreclosure sale up to the maximum he/she is willing to offer for a given property. Similarly, the IRA Holder/Manager can easily initiate a wire transfer of the purchase money when closing a negotiated deal.

Title to the property acquired will be vested in the name of the LLC (rather than RealTrust). Expenses associated with holding, improving and selling the property acquired will be paid from the LLC checking account. Revenues, such as rent and sales proceeds, including capital gains, will return to the LLC on a pass-through basis. IRA Account members of the LLC will enjoy tax-advantaged treatment on a pro-rata basis, but may still be subject to DFTI (discussed above) if the LLC’s acquisition of the real property was leveraged.

The Charter Documents for the LLC must be drafted to ensure compliance with the rules pertaining to self-directed IRA investing.

In other words, the on-line LLC “specials” generally won’t do the trick. The LLC Members and Managers remain subject to the

pertinent IRA/401(k)-related rules, and may commit prohibited transactions unwittingly, or otherwise. Our affiliate “Real Estate Law Firm” is available to provide the LLC formation and document preparation services for substantially less than many competing organizations.



VII. It's Easy to Establish Your RealTrust Account.

A. Account Set-up. To set up your new Self-Directed IRA or 401(k) Account, contact us for a Self-Directed IRA/401(k) Application Kit at: (425) 556-4100 or (877) 536-4100 or info@realtrustgroup.com

Feel free to go to the “Open an Account” section of our website [www.realtrustgroup.com] and download the pertinent IRA Application Kit.

B. Fund Your Account. To fund your Self-Directed IRA Account, simply complete the Transfer or Rollover Form contained in the Application Kit and return the Form, with completed Application, to your Account Manager. Generally, the Transfer Form will instruct your existing custodian to liquidate existing Wall Street products so you have the cash necessary to buy real estate (or other Alternative Assets) in your Self-Directed IRA/401(k) Account. You can also fund your account with annual contributions up to the applicable limits.



C. Locate Prime Real Estate Opportunities. You're now ready to seize real estate opportunities that present themselves in today's swift-moving market.

Many promising real estate opportunities exist for Self-Directed IRA/401(k) Investors. By working with the experts at RealTrust from the outset, you will be best-equipped to take advantage of those opportunities and avoid the pitfalls that may otherwise cause the deals to slip through your fingers.

"Taking Wall Street Back to My Street[®]"



RealTrust[®]
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Call or email us today!

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