

Buy Real Estate With Your IRA

by Michael Bull, CCIM, CRB, ePro

Investors who have experienced disappointment in the performance of their retirement accounts in the past three years are wondering where to place their funds. Bond prices are at 40 year highs, and the price/earnings ratios on the stock market have skyrocketed. Money market rates are now less than 1%. Many people are completely unaware that they can invest in real estate in their retirement accounts. Yes, that's right, you can buy real estate with your IRA and 401K funds.

Thought this couldn't be done? It can. You can use your IRA to purchase most any investment real estate, including land, commercial, and multifamily properties. In general, federal law (Internal Revenue Code section 408) only prohibits an IRA from investing in life insurance policies and collectibles such as art work, gemstones, rugs, and the like. Other investments are, for the most part, are fair game.

It takes a self-directed IRA

The trick is that you can't buy real estate with your basic IRA. You need to open a self-directed IRA - one with an independent IRA custodian that allows real estate investments.

A self-directed IRA is simply an IRA for which the investor calls the shots. Unlike most banks and brokerage firms, an independent IRA custodian doesn't limit your investment options to just bank CDs, stocks, mutual funds, annuities, and other common IRA investments.

And while banks and brokerage firms typically don't allow you to invest your IRA in real estate, a self-directed IRA usually allows you to hold not only real estate but investments such as stocks, mutual funds, and other traditional investments in the same IRA account.

Shopping for an IRA custodian

Though finding an IRA custodian that will hold real estate may seem a little tricky, there are a handful of custodians in the U.S. that specialize in holding real estate. You should thoroughly check out and compare at least several IRA custodians. Compare costs and know the caveats of each custodian.

Fees can vary widely from one custodian to the next; so does the flexibility each custodian provides for account holders. Some custodians may permit debt-financed (leveraged) or foreign real estate properties; others will not. Likewise, some custodians may provide some property services such as filing of the deed or collection of rental income. Other custodians may require you to contract with a third party to provide these types of services. Do your homework and understand what you're getting into.

Determine your IRA needs

If you already have an IRA or SEP-IRA, you're already a step ahead. You simply instruct your IRA custodian that you wish to transfer your IRA funds to the custodian you have chosen to hold your real estate IRA. Your new custodian will typically provide you with a form for you to fill out to handle this. Or, if you have left a previous employer and have 401K funds to rollover, you can instruct the 401K plan administrator to rollover the funds to the custodian of your real estate IRA.

If you don't already have an IRA or retirement funds which are eligible for an IRA rollover, you will have to start by making annual IRA contributions. One thing to consider before setting one up is deciding which type of IRA will work best for you. For an individual, a traditional or Roth IRA may be the answer.

With a traditional IRA, annual contributions may be tax-deductible, but taxes are paid once you

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start withdrawing from it. Better yet, if you qualify for a Roth IRA, even though your annual contributions are not tax deductible, you can withdraw funds later and avoid paying taxes and capital gains altogether. This makes a Roth IRA extremely attractive-especially if you anticipate that your real estate investments will increase in value over time.

Better options for the self-employed

If you are self-employed, a SEP-IRA or individual 401(k) may let you sock away as much as \$40,000 each year! A self-employed business owner with no employees can set up an individual 401(k) - and an IRA custodian that allows real estate in a self-directed IRA may also allow real estate in an individual 401(k). Legislative changes in 2002 enable owner-only sole proprietors, partnerships, and corporations to establish a 401(k) and contribute up to \$40,000 each year! Combine this with the ability to purchase real estate, and a self-employed person can have a powerful resource for directing his or her retirement destiny.

Whether you choose a traditional, Roth or SEP IRA, or an individual 401(k), you can now contribute more money than ever to your retirement account.

You should consult with your tax and financial-planning professional to determine which retirement account best fits your needs. But there is no limit on the number of IRAs a person can have at one time-as long as you meet the given eligibility requirements and don't exceed the annual contribution limit.

Opening your IRA and funding your real estate purchase

Once you choose your custodian and determine the type of retirement account you need, you will need to establish your self-directed IRA. There are several ways to do this. First, you may open your IRA by making your annual IRA contribution as mentioned above. Since it is unlikely that you will

be able to buy real estate with a \$3,000 or \$3,500 initial contribution, another method of funding an IRA will almost certainly serve you better. If you already have an IRA, you may transfer or rollover part or all of your assets from your existing IRA to the new IRA. Lastly, if you have changed jobs or quit working, you may be eligible to rollover money from your former employer's retirement plan.

Purchasing the property

IRA custodians that hold real estate will usually allow most types of real estate: raw land, residential, commercial, or rental property. In addition, some custodians may permit leveraged property and others will not. Restrictions may apply - so make sure you understand them. Another avenue might be to have your IRA purchase an interest in a property in conjunction with other individuals, such as a business associate, friend, a limited partnership or syndication.

Once you locate the property you want to purchase, make an offer, and your offer is accepted, the purchase must be made by your IRA custodian - not you personally. In addition, if you put up earnest money with your personal funds, you'll need to make sure you include that amount in the total due at closing and have the personal earnest money returned to you.

In general, your IRA custodian will require that it hold the original recorded title to the property in safekeeping. The title should reflect the name of your IRA custodian for your benefit (such as Silver Trust Company, Custodian FBO John Doe IRA).

Keep in mind too that your IRA should have some liquid funds available to pay for expenses such as taxes, insurance, and improvement costs, since these must be paid out of your IRA. If your IRA doesn't have sufficient funds for these costs, you will have to make annual contributions within the federal guidelines or else withdraw the property from your IRA and pay taxes and possible penalties.

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A simple choice for some investors using their IRA are real estate syndications. If your net worth is over \$1,000,000 or if you earn over \$200,000 a year you may be able to buy a piece of a larger commercial property and have an experienced general partner acquire and manage the investment.

Don't let it get personal

You may be thinking of the grand possibilities-having your self-directed IRA purchase your residence, maybe even your office building. Not so fast. The IRS will not let you use the real estate owned by your IRA as your residence or vacation home. Nor can your business lease it as office space. The underlying premise for any real estate investment purchased with IRA funds is that you can not have any personal use or benefit of the property. To do so may cost you plenty in taxes and penalties.

There are a few other limitations as well. You cannot place a real estate property that you already own into your IRA. This means that you, your spouse, or your family members (unless it's a sibling) could not have owned the property before it's purchased by your IRA. You also cannot live in or vacation at any property that is owned by your retirement account. And you cannot write off depreciation or other expenses. You cannot manage the property, but you can hire a property manager. The property must remain within the retirement account until distribution at retirement or you will incur penalties.

What makes it attractive

Whether you buy real estate in your IRA for the purpose of flipping for a quick profit or using it as income producing property (and having the rental income flow to your IRA), the most attractive feature is, by and large -- the deferral of taxes and gains.

Even if you plan to hold the investment property for long-term value appreciation, the nontaxable event that occurs when your IRA investment

increases in value - especially if it's a dramatic increase in a short period of time, can enable you to accumulate a nice sum for your future retirement.

To get started using IRA funds for individual or limited partnership real estate investments, call (404) 876-1640.

Michael Bull, CCIM, CRB, ePro is the managing broker of the Atlanta office of Bull Realty, Inc. and its subsidiaries, a full service commercial and investment real estate firm.

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