

# Use of Retirement Accounts to Finance Investment Real Estate Acquisition

Jeff O'Brien

Mansfield Tanick & Cohen, P.A.

# What is an IRA?

- An individual retirement account (IRA) is the blanket term for a form of retirement plan that provides tax advantages for retirement savings in the United States.

# Types of IRAs

- **Roth IRA** - contributions are made with after-tax assets, all transactions within the IRA have no tax impact, and withdrawals are usually tax-free. Named for Senator William V. Roth, Jr.. The Roth IRA was introduced as part of the Taxpayer Relief Act of 1997.
- **Traditional IRA** - contributions are often tax-deductible (often simplified as "money is deposited before tax" or "contributions are made with pre-tax assets"), all transactions and earnings within the IRA have no tax impact, and withdrawals at retirement are taxed as income (except for those portions of the withdrawal corresponding to contributions that were not deducted). Depending upon the nature of the contribution, a traditional IRA may be referred to as a "deductible IRA" or a "non-deductible IRA."
- **SEP IRA** - a provision that allows an employer (typically a small business or self-employed individual) to make retirement plan contributions into a Traditional IRA established in the employee's name, instead of to a pension fund in the company's name.
- **SIMPLE IRA** - a Savings Incentive Match Plan for Employees (SIMPLE) that requires employer matching contributions to the plan whenever an employee makes a contribution. The plan is similar to a 401(k) plan, but with lower contribution limits and simpler (and thus less costly) administration. Although it is termed an IRA, it is treated separately.
- **Self-Directed IRA** - a self-directed IRA that permits the account holder to make investments on behalf of the retirement plan.

# 401(k) Plans

- A qualified plan established by employers to which eligible employees may make salary deferral (salary reduction) contributions on a post-tax and/or pretax basis.
- Employers offering a 401(k) plan may make matching or non-elective contributions to the plan on behalf of eligible employees and may also add a profit-sharing feature to the plan.
- Earnings accrue on a tax-deferred basis.

# Self-Directed IRA

- A self-directed IRA is a self-directed IRA that permits the account holder to make investments on behalf of the retirement plan.
- A self-directed IRA can be used to facilitate “alternative investments”

# Examples of Alternative Investments

- Real Estate
- Notes
- Private Placements
- Limited Partnerships
- Joint Ventures
- Precious Metals
- Much More...

# What Rules Apply to Self-Directed IRAs?

- The same rules which apply to other types of IRAs
- IRC Section 4975 - Prohibited Transactions for IRAs
- Self-Directed IRA owners must be aware of what they cannot do per Section 4975



# What is a “Prohibited Transaction”?

- For purposes 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 assets 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 interest or for his own account; or
  - (F) receipt of any consideration for his own personal account by any **disqualified person** who is a fiduciary from any party dealing with the plan in connection with a transaction involving the income or assets of the plan.



# What is a “Disqualified Person”?

- (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—
    - (i) 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, (ii) the capital interest or the profits interest of a partnership, or (iii) the beneficial interest of a trust or unincorporated enterprise, which is an employer or an employee organization described in subparagraph (C) or (D)
  - (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—
    - (i) 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, (ii) the capital interest or profits interest of such partnership, or (iii) 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 (or an individual having powers or responsibilities similar to those of officers or directors), 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) ; or
  - (I) a 10 percent or more (in capital or profits) partner or joint venturer of a person described in subparagraph (C) , (D) , (E) , or (G)
- The Secretary, after consultation and coordination with the Secretary of Labor or his delegate, may by regulation prescribe a percentage lower than 50 percent for subparagraphs (E) and (G) and lower than 10 percent for subparagraphs (H) and (I)

# Some Examples of Prohibited Transactions

- Using the property for your vacation
- Letting your child live in the property, paying rent or rent-free
- Hiring your son-in-law to rehab the property
- Selling property that you own to your IRA
- Using your own money for expenses or loan payments

# “Member of the Family”

- The family of any individual shall include his spouse, ancestor, lineal descendant, and any spouse of a lineal descendant

# Penalties for Violations of Section 4975

- If you have a prohibited transaction, you jeopardize the tax free status of the entire IRA.
- The whole IRA might become taxable based on the total account value as of the start of the year in which the transaction occurs.
- The IRS might also apply a 10% early withdrawal penalty.

# “Checkbook Control” Via an LLC

- Self-directed IRA funds can be invested into a newly-created LLC which then acquires real estate
- Owner has “checkbook control” over the funds by virtue of the LLC bank account
- Caution must be exercised to avoid prohibited transactions – *Swanson v. Commissioner*

# Jeff O'Brien

Mansfield Tanick & Cohen, P.A.

1700 U.S. Bank Plaza South

220 S. 6<sup>th</sup> St.

Minneapolis, MN 55402

(612) 341-1263

[jobrien@mansfieldtanick.com](mailto:jobrien@mansfieldtanick.com)

[www.jeffreyobrienesq.com](http://www.jeffreyobrienesq.com)