CHAPTER 4

YES!

YOU CAN INVEST IN REAL ESTATE WITH YOUR IRA!

THE OFFICIAL SELF-DIRECTED IRA INVESTORS GUIDE

IRAR TRUST COMPANY

IRA RESOURCES, INC.

CHAPTER 4

SELF-DIRECTED IRA ACCOUNT TYPES

To start investing in real estate with a self-directed IRA, you need a retirement account. But since there's more than one type of account, which IRA right for your individual situation and strategy? With this chapter, compare options and make the right decision for your financial future.

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Introduction

The first step to investing with a self-directed IRA— deciding what type of account to open.

There are different options for investors and business owners alike, and which account you open impacts what you can and can't do, so it's important to get it right.

If you already have an IRA and need to move it to IRAR, you'll still need to open a new account. Here's how:

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Moving Existing Retirement Funds? Be Sure to Open the Right Account

There are rules about moving retirement funds. You can't just take funds from any retirement account and move them into another— there are restrictions about where and when they can be moved.

Because different retirement accounts have different rules and contribution limits, the IRS restricts the movement of funds between certain accounts. For example, due to the tax differences, a Roth IRA can't be transferred into a Traditional IRA. However, in another example, a Traditional IRA can be moved into a SIMPLE IRA— but only after the plan has existed for two years.

If you plan on moving existing retirement savings from a qualified plan or existing IRA, you should make sure you're opening the right kind of account from the start. Reach out to IRAR if you have any questions.

ROLLOVER CHART

	Roll To							
Roll From	**Roth IRA**	**Traditional IRA**	**SIMPLE IRA**	**SEP-IRA**	**Governmental 457(b)**	**Qualified Plan**[1] (pre-tax)	**403(b)** (pre-tax)	**Designated Roth Account** (401(k), 403(b) or 457(b))
Roth IRA	Yes[2]	No	No	No	No	No	No	No
Traditional IRA	Yes[3]	Yes[2]	Yes[2, 7], after two years	Yes[2]	Yes[4]	Yes	Yes	No
SIMPLE IRA	Yes[3], after two years	Yes[2], after two years	Yes[2]	Yes[2], after two years	Yes[4], after two years	Yes, after two years	Yes, after two years	No
SEP-IRA	Yes[3]	Yes[2]	Yes[2, 7], after two years	Yes[2]	Yes[4]	Yes	Yes	No
Governmental 457(b)	Yes[3]	Yes	Yes[7], after two years	Yes	Yes	Yes	Yes	Yes[3,5]
Qualified Plan[1] (pre-tax)	Yes[3]	Yes	Yes[7], after two years`	Yes	Yes[4]	Yes	Yes	Yes[3,5]
403(b) (pre-tax)	Yes[3]	Yes	Yes[7], after two years	Yes	Yes[4]	Yes	Yes	Yes[3,5]
Designated Roth Account (401(k), 403(b) or 457(b))	Yes	No	No	No	No	No	No	Yes[6]

[1]Qualified plans include, for example, profit-sharing, 401(k), money purchase, and defined benefit plans.
[2] Only one rollover in any 12-month period.
[3]Must include in income.
[4]Must have separate accounts.
[5]Must be an in-plan rollover.
[6]Any nontaxable amounts distributed must be rolled over by direct trustee-to-trustee transfer.
[7]Applies to rollover contributions after December 18, 2015. For more information regarding retirement plans and rollovers, visit Tax Information for Retirement Plans.

Traditional & Roth IRAs

Traditional and Roth IRAs are the most popular retirement accounts overall, but also the most popular held at IRAR Trust. Generally, our clients bring their existing retirement savings (either through a rollover from an old 401(k) plan or transferring existing IRA funds) from a large institution like Fidelity, Schwab, or Wells Fargo, since investing in alternative assets such as real estate is generally not allowed at these establishments. The investments then grow tax-free or tax-deferred (depending on the account in which account they are held), providing a variety of options most investment providers can't meet.

But there are differences between the types to keep in mind:

Traditional IRA - Tax-Deferred Savings

With no annual income limits, Traditional IRAs make it easier to set aside money for retirement. Your savings are tax-deferred and so are your earnings, and they'll both continue to grow tax-deferred until they are withdrawn. Depending on your income and eligibility, your IRA contributions may also qualify as tax-deductible.

Roth IRAs – Tax-Free Growth

Roth IRAs allow you to make after-tax contributions while still letting your money grow tax-free. Unlike with a Traditional IRA, contributions are not tax-deductible— but they do enable tax-free growth. You contribute to a Roth IRA after already paying taxes on the funds and won't owe any additional taxes on the gains when distributing. This is because you already paid taxes when you contributed, so any money taken out in retirement is tax-free. There are income limitations on who can contribute to a Roth IRA, so make sure you qualify before incorporating a Roth into your strategy.

TAX-DEFERRED:

You don't pay taxes on contributions or owe taxes on income from assets— until distributed.

Traditional and Roth IRA Contributions

The deadline tax year contributions to a Traditional or Roth IRA is on or within a day or two of April 15th, depending how the days fall. You can file a tax extension (making the deadline to file your taxes on or around October 15) if needed but filing an extension does not extend the contribution deadline— this extension applies to the filing of tax paperwork only.

If you are 50 years of age and older by the end of the calendar year, you can make an additional contribution (called a catch-up contribution). Your taxable earned income (or your income combined with your spouse's income) for the tax year can't be less than your contribution limit.

If you are over the age of 70 ½, you can't make contributions to a Traditional IRA. However, you can still contribute to a Roth IRA regardless of age (as long as you have earned income).

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Five Year Rule with Roth IRAs

You may withdraw your original contributions to a Roth IRA penalty-free at any time, for any reason, no matter your age. However, any earnings on those initial contributions will be penalized if the five year rule hasn't been met and they are withdrawn before 59 ½.

The five year rule states that you must hold your Roth IRA for at least five years before withdrawing earnings without penalty. If you don't meet these conditions (say your account was open for three or four years, instead of five), you'll owe taxes and have to pay a 10% penalty on any funds withdrawn. The five years starts from the 1st of January in the year you made your first contribution to any Roth IRA.

Once you meet the conditions five year rule, you still need to be above 59 ½ or other penalties may still apply to any distributions.

For example, say you contributed $10,000 to your IRA and invested those funds well, netting you $5,000 in earnings. If you wanted to, you could distribute the original $10,000 you contributed without paying any taxes or penalties— but if you wanted to distribute the $5,000 in earnings and aren't 59 ½ or if you haven't met the five year rule, you'd have to pay taxes and an early distribution penalty on those earnings.

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SEP IRAs – For Self-Employed or Small Business Owners

If you're self-employed or own a small business, a Simplified Employee Pension (SEP IRA) could be the right option for you and your staff. SEPs offer tax-deferred features (like a Traditional IRA) and extends them to the employer—but instead of the employee making contributions, the employer does.

A SEP IRA does not have the same start-up and operating costs that a conventional employer-sponsored retirement plan does, and you don't have to contribute the same amount each year. The plan lets you make tax-deductible contributions of up to 25% of each employee's compensation each year (up to the maximum)— but note that if you're self-employed then you're considered an employee, so you need to save for yourself at the same time and rate, based on your income.

Who Qualifies for a SEP?

If you're self-employed or if you're a small business owner with one or more employees, a Simplified Employee Pension (SEP) account might be for you. Unlike the Traditional or Roth IRA for individuals (which has a specific contribution deadline, generally April 15), SEPs are different. The deadline for establishing and contributing to a SEP IRA is the filing deadline for the employer's tax return, including extensions for which year the contribution will apply.

There are many reasons our clients open SEP IRAs for their business. Aside from how easy these accounts are to manage, you can change the contribution amount from year-to-year. So, say you have a construction company and you open a SEP plan for your employees. You chose this plan due to the cyclical nature of the industry, so in good years you can contribute more, but in off years you can reduce contributions. With a self-directed SEP, employee John Doe can decide where and what to invest in— though he can't make any additional contributions. The account is solely owned by him and is under his control.

Not all employees need to be included in the plan, but they **must** be included if they have:

- Attained age 21;
- Worked for your business in at least 3 of the last 5 years;
- Received at least $600 in compensation from your business for the year over the last three years.

You can decide to have requirements that are less restrictive (i.e. attained age 18), but not more restrictive than what is listed above.

Contribution Limits for SEP IRAs

A SEP IRA is tax deferred, like a Traditional IRA. That means up-front tax deductions and tax-deferred savings, so you aren't paying taxes until you withdraw the money from the account during retirement. But with a SEP IRA, you get a much higher contribution limit (up to 25% of your total income).

You can contribute a significant portion of your income compared to a much lower maximum in a Traditional or Roth IRA, though the SEP IRA doesn't allow for catch-up contributions like other IRAs.

Since the employer is making the contributions, the amounts are related to the employees' salary or wages. This means that everyone's contribution is the same percentage of salary. If you make a 25% SEP IRA contribution on behalf of yourself as the owner, you also must make a 25% contribution for your employees who qualify to participate in the plan.

One neat thing about a self-directed SEP IRAs with IRAR is that the participants can invest in a wide variety of investment types. The self-directed SEP IRA has all the same limits and rules as a regular SEP, but allows investments in alternative assets. The higher contribution limits allow you to invest in alternative assets (like real estate) faster.

Things to Remember

- The IRS has a handy checklist for business owners to use to determine their eligibility for a SEP IRA. You can use this to help you make sure your plan is compliant with IRS regulations.
- You must contribute the same percentage for all employees, including yourself. If the business contributes 20% of your income to your SEP account, it must also contribute 20% of each individual employee's income to their personal SEP accounts.
- The SEP IRA cannot issue a loan to the account-holders, and the assets cannot be used as collateral.
- SEP IRAs do not allow catch-up contributions, unlike some other accounts—the maximum contribution is capped at 25% of an individual's compensation per the tax year. See page 13.
- Employees cannot contribute any additional funds to their SEP accounts—the contribution is limited to the percentage set by the employer.
- If an employee leaves before the end of the plan year and was eligible for contributions, you must still contribute to their SEP account, even if they have already left your company. They must receive the same percentage contribution as the rest of your employees.
- Your business can deduct your contributions to employee SEP accounts. The IRS has more detailed information on limits and allowances here.

SIMPLE IRAs – Retirement Plans for Small Businesses

Another option some small business owners consider is a Savings Incentive Match Plan for Employees IRA. Also known as a SIMPLE IRA, self-employed or small business owners sometimes choose these plans for the lower costs, the easy set-up process, and the additional employee control— with this plan, employees can also make contributions (unlike a SEP IRA).

A SIMPLE IRA is designed for small businesses with 100 or fewer employees, and for self-employed individuals (if you're self-employed, you're considered both 'employer' and 'employee'). These accounts provide a "simplified" method for small business owners and employees to save for retirement.

Is a SIMPLE IRA Right for Your Business?

An employer must meet three conditions to be eligible to establish a SIMPLE IRA (along with opening an account.)

These are:

- Currently have 100 or fewer employers
- Complete Form 5305-SIMPLE outlining the terms of the plan
- Can't offer any other retirement plans

The administrative costs of establishing and maintaining a SIMPLE IRA are very low compared to other plans. For example, at IRAR Trust we charge only our $100 account opening fee to establish the plan. They're easy to setup— aside from our new account paperwork, you only need to complete a 5305-SIMPLE to get started.

You must establish your SIMPLE IRA plan by October 1 for the tax year in which your qualifying contributions will apply, unless your business is newly created after 10/1. Contributions are tax-deferred, meaning you can deduct them and don't pay taxes on your savings until you withdraw it from your account. Unlike a SEP IRA (which only allows the employer to make the contributions), a SIMPLE IRA allows the employee to make salary reduction contributions.

The employer also generally has no filing requirements with the IRS, since IRAR Trust Company handles the reporting requirements for the plan, leaving less for you to worry over when planning for retirement.

SIMPLE IRA Requirements for Employers

Once the employer has established the SIMPLE IRA plan, they are responsible for distributing an annual notice to eligible employees. Before the employees' 60-day election period (which generally begins on November 2nd prior to each calendar year), the employer must provide to each eligible employee:

- Details about the employee's opportunity to make or change a salary reduction
- The employer's decision to make either a matching or non-elective contribution
- A summary description (the firm that established the SIMPLE IRA usually provides this)

For an employee to be eligible to participate in the SIMPLE plan, they need to have received at least $5,000 in compensation during any two years preceding the current calendar year and be reasonably expected to receive at least $5,000 for the current calendar year. The two-year requirement doesn't need to be the immediate two years before the current calendar year in order for the employee to qualify. Example:

Jill has been working for company A for the last 7 years and has earned annual compensation of:

Jill's Compensation

2013	2014	2015	2016
$2,700	$21,200	$4,350	$18,500

Since Jill earned more than $5,000 in 2014 and 2016, she would be eligible to participate in the SIMPLE IRA plan. You can decide to have requirements for eligibility that are less restrictive, but not more restrictive, than what is listed above. The IRS has some resources if you'd like more information on the rules and regulations surrounding SIMPLE IRA plans.

Contribution Limits for a SIMPLE IRA

With a SIMPLE IRA, the contributions are tax-deferred. That means up-front tax breaks and tax-deferred savings, so you don't pay taxes until you withdraw the money from the account during your retirement. Like all IRAs, SIMPLE IRAs have contribution limits. Like Traditional and Roth IRAs, if the employee is age 50 or above they are eligible for a catch up contribution. The employer is also responsible for contributing to the SIMPLE account for the employee. The employer must make either a matching contribution or a non-elective contribution to the employee IRAs.

This means that the employer is required to either:

- Match each employee's salary reduction contribution on a dollar-for-dollar basis up to 3% of the employee's compensation, without any limit,

  OR

- Make non-elective contributions of 2% of the employee's compensation, whether the employee makes contributions or not, up to the maximum.

If the employer decides to make the non-elective contributions, they must be made even if the employee decides not to make salary reduction contributions.

Things to Remember with Your Self-Directed SIMPLE IRA:

- You must establish the plan by October 1 of the tax year in which your qualifying contributions will apply.
- Employees can contribute to their SIMPLE IRA through regular payroll deductions. The contributions are tax-deferred and the investments in the account can grow tax-deferred until withdrawn at retirement.
- If the employer decides to make the non-elective contributions, you must make them even if the employee decides not to make salary reduction contributions.
- With an IRAR Trust Company SIMPLE IRA, you get all the benefits of saving for retirement combined with the freedom to invest in a wide variety of different investment types. Being able to invest in alternative assets may help you reach your retirement goals sooner than you thought. With this ability to truly self-direct your retirement, you can finally start making strides for your financial future.

IRA COMPARISON

SEP

ELIGIBILITY	CONTRIBUTION LIMITS	HIGHLIGHTS	DEADLINE TO ESTABLISH
Self-employed individuals or small business owners, including those with employees: Sole proprietors, Partnerships, C corporations, S corporations	25% of compensation or maximum cap for the year (the lesser amount) 2019 max: $56,000 2020 max: $57,000 Each eligible employee must receive the same percentage Contributions are not mandatory	Tax-deferred— so you don't pay taxes until withdrawn at retirement Tax-deductible contributions Easy to set up and maintain Funded by employer contributions only	April 15 or your tax-filing deadline

SIMPLE

ELIGIBILITY	CONTRIBUTION LIMITS	HIGHLIGHTS	DEADLINE TO ESTABLISH
Businesses with 100 or fewer employees: Sole proprietors, Partnerships, C corporations, S corporations Participating employees must have earned at least $5,000 in compensation during any 2 years preceding	Employer: mandatory 3% matching contribution or 2% non-elective contribution Participants contributions 2019: Up to $13,000 in salary deferrals ($16,000 if age 50 or older) 2020: Up to $13,500 in salary deferrals ($16,500 if age 50 or older)	Tax deferred— so you don't pay taxes until withdrawln at retirement Employer contributions are deductible as business expenses Funded by employee deferrals and employer contributions	October 1

ROTH

ELIGIBILITY	CONTRIBUTION LIMITS	HIGHLIGHTS	DEADLINE TO ESTABLISH
No age limit Must have earned income	2019: $6,000 ($7,000 if age 50 or older) 2020: $6,000 ($7,000 if age 50 or older) Contributions are not tax-deductable	Earnings grow tax-free Taxes are paid up front, so you're able to withdraw your contributions tax-free and penalty-free at any time	April 15

TRADITIONAL

ELIGIBILITY	CONTRIBUTION LIMITS	HIGHLIGHTS	DEADLINE TO ESTABLISH
Individuals less than 70½ years of age Must have earned income	2019: $6,000 ($7,000 if age 50 or older) 2020: $6,000 ($7,000 if age 50 or older)	Tax-deductible contributions based on Modified Adjusted Gross Income (MAGI)	April 15

Beneficiary (Inherited) IRAs

If your retirement account has been inherited after the death of the original account holder (like a parent or spouse), your IRA is now an inherited IRA. Also, known as a beneficiary IRA, these accounts have special rules regarding handling and processing.

Your inherited IRA could be either a Traditional or Roth account as well as a beneficiary IRA (depending on the original account), so be sure to keep those tax implications in mind for future planning. If you're unsure what type of account you hold, check with your IRA Custodian.

If you've inherited an IRA, you can use it to invest in real estate while still in the IRA— you don't have to distribute it. You just must follow some specific rules for beneficiary IRAs.

Opening a Beneficiary IRA

The process for opening a Beneficiary IRA is the same as any IRA, but in addition to the new account application and other paperwork we need a certified copy of the death certificate for the IRA account holder. We'll return the death certificate once we have verified its legitimacy. The Beneficiary IRA is also titled differently than a typical IRA, with the deceased account holder's name also listed on the Beneficiary IRA.

> **For example:**
> IRAR Trust Co. FBO Jane Does as beneficiary of John Doe

Even though the account titling is different and a death certificate is required, we don't charge extra for a Beneficiary IRA— all fees are the same. Find more information on our fees here.

Note

If you're attempting to move the funds to another retirement account, no account application is needed.

The Differences Between Spouse and Non-Spouse Beneficiary IRAs

The options a beneficiary has changes depending on who is inheriting the IRA. The biggest difference is if the beneficiary is a spouse— the spouse can treat the inherited accounts as if they were his or her own. This means the spouse can transfer the assets into their own existing or new IRA. The money is available to them at any time, to be treated as if it were the spouses' own. This includes if the money is taken out (distributed) before the spouse is 59 ½ for an inherited Traditional IRA— though this is still considered an early withdrawal and the penalty will apply.

Both spouse and non-spouse beneficiaries inheriting an IRA (where the account holder was under 70 ½ and not yet taking Required Minimum Distributions) have the following options:

Open a Beneficiary IRA (Life Expectancy Method)

Distributions must begin no later than December 31st of the year the account holder would have reached 70 ½, with the annual distributions spread over the beneficiary's life expectancy.

If there are multiple beneficiaries, separate accounts for each beneficiary must be established by December 31st of the year following the year of death.

Open a Beneficiary IRA (5-Year Method)

With this method, all funds need to leave the account within 5 years from the death of the account holder. The money is available at any time, up until December 31st of the fifth year after the year in which the account holder died.

You will be taxed on each distribution, but you will not have to pay the 10% early withdrawal penalty.

Lump Sum Distribution (Beneficiary Doesn't Open an Inherited IRA)

All the assets the IRA owned are taken out immediately.

You will be taxed on the distribution, but you will not have to pay the 10% early withdrawal penalty.

If the account holder was older than 70 ½ at their time of death, the 5-year method is not an option for the spouse or non-spouse beneficiary. The remaining options would still apply.

The spouse and non-spouse beneficiary have different options when it comes to moving the inherited IRA funds. Non-spouse beneficiaries need to transfer directly from one account to another, or from one IRA custodian to another. Unlike the spouse beneficiary, the non-spouse beneficiary doesn't have the option for a distribution or a 60-day rollover when inheriting IRA assets. If a non-spouse beneficiary takes a distribution (assets or a check), not only is the distribution taxed as ordinary income, it is ineligible to be rolled into the Beneficiary IRA it was originally taken from or one at another firm. A non-spouse beneficiary can NEVER do a 60-day rollover of Beneficiary IRA funds.

If you inherit IRAs from different owners, you cannot combine them into a single inherited IRA because of the titling requirements mentioned above. If you have inherited multiple IRAs (of the same account type) from the same original owner, you can combine them.

For example:

If a beneficiary inherited two IRAs from their Mom (a non-spouse beneficiary), they can be combined into one beneficiary IRA. If at some later point, the same beneficiary inherits an IRA from their Dad (who had also inherited an IRA from Mom), this IRA comes from Dad, not Mom. It cannot be combined with those previous two IRAs inherited, even though they were all Mom's IRAs at one point.

The main reason for this is that the Required Minimum Distributions (RMDs) on the inherited accounts will be calculated differently. RMDs on accounts that are inherited directly are generally based on the beneficiary's age in the year after the account owner's death.

Taxes Due When Distributing Inherited IRAs

Whether or not you'll owe taxes on an inherited IRA depends on the type of account you have inherited. With an Inherited Traditional IRA, you will pay taxes on any distributions they take. With an Inherited Roth IRA, you won't owe taxes on distributions if the account had been open for five years before the original account owner's death, just like a regular Roth IRA. A Beneficiary IRA maintains the tax advantages (traditional or Roth) of the original account.

IRA Tax Deductions

For Traditional IRAs, depending on your income and eligibility, your contributions may qualify as a deduction on your federal income tax return. If you or your spouse are covered by a retirement plan at work and your income exceeds certain levels, your deduction may be limited. But if you are not covered by a plan at work, your deduction may be fully allowed. See IRS IRA Deduction Limits for more information.

Unfortunately, you cannot get a tax deduction for contributions to a Roth IRA, but remember that earnings and withdrawals are generally tax free. This is one of the tradeoffs with opening a Roth IRA.

Both SEP and SIMPLE IRAs are also tax-deferred. That means up-front tax breaks and tax-deferred savings, so you (and your employees) don't pay taxes until the money is withdrawn during retirement.

Excess IRA Contributions & Penalties

If you contribute more than the limit or are over 70 ½ years of age and contribute to a Traditional IRA, you're subject to tax penalties. To avoid excess contribution penalties, withdraw the excess contribution from your IRA before the tax deadline (along with any income earned on the excess contribution). You must complete Form 5329, which you'll use to calculate a 6% penalty tax on the excess contribution. This penalty tax will continue to be assessed every year on ALL excess contributions until you withdraw the excess contributions and all income earned based on those excess contributions. But first, talk to a tax professional about your situation— they may be able to help.

TAX-DEFERRED SAVINGS:

That means up-front tax breaks (with no taxes on contributions or income from assets until they're distributed)

In a Nutshell

As you can see, the type of IRA you open does make a difference. There are tax implications and different contribution limits for you and your employees, depending on the account.

Have any questions? IRAR is ready to assist.

For any tax or legal concerns, please consult an outside advisor.

READY FOR THE NEXT CHAPTER?

CHAPTER 5:

How to Open Your Real Estate IRA