

THE ARIZONA REPUBLIC

Use a Self-Directed IRA to Invest in Real Estate

June 17, 2009

On 6/3/09, I gave a talk to the Master Investor Subgroup of the AZ Real Estate Investors Association. The topic was "Advanced IRA Strategies" and contained 3 little-known aspects of the tax law: self-directed IRA; Roth IRA; and Multi-generation IRA planning. Here are the major questions that real estate investors and realtors asked:

1. How does one use traditional retirement accounts such as IRA's and 401(k)'s to invest in real estate?

One can only do this if one has a self-directed IRA. Virtually all retirement accounts are tied to Wall Street and you cannot invest in real estate or alternatives to stocks, bonds, mutual funds, and Wall Street securities. The only 2 investments not permitted in a self-directed IRA are life insurance and collectibles.

2. What type of purpose must the real estate investment be inside the IRA?

The real estate cannot be for personal use such as a primary residence, vacation home, or home for your children at college. It must be for investment only such as a rental house.

3. Am I prohibited from dealing with family members with the IRA?

Consider the shape of the sign of a religious cross. "Prohibited family members" include all ancestors (parents, grandparents, great-grandparents) or descendants (children, grandchildren, and great-grandchildren). Oddly enough, the IRS allows you to deal with your siblings such as sisters and brothers.

4. What if I buy an investment property, but there's long vacancy or unexpected repair costs and I run out of money inside the IRA?

This is a very serious situation because one is not allowed to use personal funds to cover any expenses. Legally, the self-directed IRA owns the property for your benefit and you don't own it personally. Annually, one can only contribute \$5,000/year (\$6,000 if age 50 or older) to one's IRA from qualifying earned income (usually wages or net profit from one's business). So, one must be careful to leave a cash reserve to operate the property inside the IRA.

5. How much fix-up work and management can I do on my property inside the self-directed IRA?

You cannot fix it up, receive a management or brokerage fee, or use furniture from your home or other property to furnish it before rental. This aggravates most members of the real estate investment club, as many are "do-it-yourself" folks.

They hate having to pay an outside management firm.

6. What are my major benefits of owning investment real estate inside my IRA?

First, you own a physical property that you can choose, control, and get a deed to. This is a tangible asset that will not disappear overnight when an Enron or Bear Lehman Brothers collapses due to fraud or market reasons. Second, your rental income and future profits are tax-deferred if you have a traditional self-directed IRA. If you choose the



Dr. Harold Wong, Ph.D
DrHaroldWong.com

Roth IRA, then all future gains are tax-free. In other words, if you started with a \$100,000 condo and 30 years later you've turned it into a portfolio with \$2 million of net equity, all that gain is tax free if you use a Roth IRA.

If you use the Multi-generation IRA planning strategies, there is a multiplier effect. In a traditional IRA, all the assets pour out and become taxable when the two parents are killed by a drunk driver. In contrast, the multi-generation IRA often allows your kids to enjoy 3-12 times the income over their lifetime. Your grandkids can get as much as 40 times the income. So, a modest \$25,000 left for a favorite grandchild can become \$1 million of income, which is an awesome legacy. They will absolutely thank you for it.

Author: Dr. Harold Wong earned his Ph.D. in Economics from UC Berkeley and passed the CPA exam in 1979. Through his seminars, publications, and consultations, he helps Seniors and Baby Boomers maximize retirement income and reduce taxes.

Contact him at: (480)706-0177 or Harold@DrHaroldWong.com, or read his previous articles on his AZ Republic blog at: www.DrHaroldWong.com.