

# IRA & 401(k) Insights

## About: *IRA & 401(k) Insights*

*IRA & 401(k) Insights* is a monthly publication. This publication is for anyone interested in self-directing their retirement funds and investing in non-traditional assets. Entrust does not give investment advice. Entrust purposely does not sell securities or other investment products.

Deadline for article consideration is the 15th of each month. To subscribe to *IRA & 401(k) Insights*, call: 888-340-8977 or email: [editor@EntrustAdmin.com](mailto:editor@EntrustAdmin.com)

## Message From the Editor

Happy New Year!

Welcome to the January 2006 issue of *IRA/401(k) Insights*!

Happy Birthday Baby Boomers! The first Baby Boomer turns 60 this year!

Jack Kiley, CPA, of Entrust MidAtlantic shares two interesting cases where clients converted their traditional IRAs to Roth IRAs to build their retirement portfolio tax-free. Dave Owens and Kathy Moran of 1031 Tax-Free Strategies discuss 1031 exchanges which have become a popular strategy for tax deferral for the real estate investor; Maggie Polisano, Entrust CAMA lets us look at her top two case studies in 2005; Bill Humphrey, CPA, of Entrust New Direction IRA writes a telling article for the sophisticated investor; JP Dahdah of Entrust Arizona looks at your New Year's Resolutions for your retirement plan in 2006; and yours truly takes a look at goal setting for the investor.

I hope you enjoy our January issue!

Lisa Moren, Editor



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## Converting to Roth IRA, Two Interesting Cases

By: Jack Kiley

Recently, we've had two clients convert their traditional IRAs to Roth IRAs for some rather creative reasons. First, both clients anticipate their Adjusted Gross Income this year for conversion purposes to be less than \$100,000. This will allow them to convert to Roth IRAs.

The first client converted \$145,000 from traditional IRA to a Roth IRA. She then bought six lots surrounding a mountain lake. When she retires (more than 20 years from now), she intends sell off some of the lots and to build a house on one of the lots. She will then distribute out the completed home to live in - tax-free.



The other client is an elderly gentleman (age 77). His IRA was worth approximately \$250,000, and he was in the process of taking required minimum distributions. Ordinarily, he would not seem to fit the profile of someone who would want to convert to Roth (and pay the tax at his age!), but he had another reason. One of his grandchildren has special needs and he saw this as a way to provide the grandchild with tax-free income. After he passes, the IRA would go to his beneficiary (the grandchild) and distributions would be made based on the child's life expectancy (she is currently 12). Based on her life expectancy, the Roth IRA would distribute

well over \$1.5 million assuming an 8% average rate of return and still have funds leftover. Not a bad bequest!

Converting from a traditional IRA to a Roth IRA is complex and many issues must be considered. Before completing the conversion process, you should consult your tax advisor.

Jack Kiley, CPA - Partner, Entrust MidAtlantic, LLC [jack.kiley@entrustmidatlantic.com](mailto:jack.kiley@entrustmidatlantic.com)

## Developing Your Investment Strategy Using your Experience as a Real Estate Investor to Build Wealth and a Secure Retirement

By: Lisa Moren

Every one of us has special needs and objectives we want to accomplish. When it comes to building a secure future, we need to look at our investments as a vehicle to get us to our goal. As a successful real estate investor, you have the experience and the capability to take your knowledge and expertise to develop an investment strategy that protects you well into the future.

Our eventual goal should be cash flow, income, appreciation and financial security. Many of us are at different levels in our business. All of us recognize that we must do something now to secure a financial future for ourselves and our families. Isn't that why we got into investing in the first place?

I have listed 7 questions below to help you determine what your investment strategy should be. Take into account your family and your outside interests as you answer these questions.

1. What is your present financial situation? Are you gainfully employed?

An entrepreneur, a retiree? Is your income in today's dollars covering your expenses? Answers these questions with total honesty.

2. What are the financial goals/obligations you need to meet before you retire? Are you taking care of a parent? Have young children you feel an obligation to get through college? Helping to support a child with a family? These are real situations that just don't go away. Allow for them. After all, this is you spending your money, and you need to plan for the wealth accumulation you need in your retirement.

3. How much investment capital do you have to get started or to keep going?

4. Number of years left until you intend to live off retirement income? There is no such thing as a gold watch anymore, so be realistic.

5. Annual income you will need to retire. A good esti-

mate is to figure 70% of your current income. Of course, if you decide to do extensive travel, make it a higher estimate than if you were gardening around your free and clear home.

6. Number of years you expect this income to last? This is a tough one with people living longer these days. Look at your family history as a guide to this question.

7. How much risk are you willing to take today to accomplish your goals in the future? This is one of the most important questions you need to answer for yourself. A lot of us are not risk takers. Many people leave money sitting in a savings or money market account because they are afraid they will lose it. This answer will address what risk you are willing to take to achieve your goals.

As many of you know, I am an experienced real estate and private mortgage investor. I look at real estate as my ticket to retirement. How about you?

Maybe I can buy a rental property and re-sell it with owner financing, creating paper that I can receive income on well into the future. The possibilities I can utilize within my real estate and paper investments to develop wealth are endless!

Our expertise in any cash flow can be used to grow our investment base which then helps us compound wealth with the same cash flow instruments we know and understand. We can even use our IRA or 401(k) to do these same investments with the money coming back into our retirement plan tax-deferred, or in the case of a Roth IRA, tax-free! Not only are we growing our businesses to earn wealth, we are taking whatever differences in profits that we make and investing in the same type of debt instruments in our retirement plan!! That's a smart strategy!

The type of retirement account you need to have is a self-directed retirement plan where the administrator



or custodian allows you, the IRA owner, to acquire the investment in your own plan. As the marketing director for The Entrust Group, we see investors from all around the country capitalize on their expertise in real estate and other alternative investments to build wealth in their retirement plan. To learn more about this subject, check out [www.iraplus.com](http://www.iraplus.com).

Once you have assessed your situation, you need to develop your own personal investment strategy. No matter how much money you have amassed in your retirement plan, there is a cash flow you can acquire. Think of the income that gets deposited into your retirement account on a tax-deferred or tax-free basis. It is amazing to watch your retirement dollars compound.

With all of the changes in today's economy, it is more important than ever to manage your future. Hopefully, this article will help you start!!

*Lisa Moren has been a real estate investor since 1978, a note buyer since 1988 and is the marketing director for The Entrust Group. Entrust is the nation's largest network of administrators for self-directed retirement plans. For more information, contact The Entrust Group at: 888-340-8977 or visit our web site at [www.iraplus.com](http://www.iraplus.com).*

## The Effortless 1031 Exchange - Facts and Misconceptions

By: Dave Owens and Kathy Moran

1031 Exchanges can be easy if you follow the rules laid out by the IRS. Here are the six basic things everyone needs to know. Knowing these easy rules will guarantee your exchange will qualify.

1. You must use a Qualified Intermediary (QI) as defined by the regulations; typically this is an unrelated third party. Your exchange must be in place prior to the closing of your relinquished property with a QI.

2. Net Selling Price (NSP). This is the amount of money you will need to reinvest in your replacement property to defer all your taxes. This is figured by taking the gross selling price less closing costs.

3. All deeded real estate qualifies for a 1031 Exchange. The relinquished property sold must be held for investment. Typically investment will include rental or properties held for speculative purposes. You can buy multiple replacement properties in an exchange.

4. You cannot touch your equity proceeds at closing. These funds must be held by the QI and applied to your replacement property.

5. 45 day rule - This means you must identify your replacement property(ies) to your QI by midnight on your 45<sup>th</sup> day from the closing of your relinquished property. Your identification must be a specific address(es).

6. 180 day rule - This means you must complete your closing on your identified replacement property(ies) by the 180<sup>th</sup> day from the closing of your relinquished property.

There are a few common misconceptions when it comes

to doing 1031 Tax Deferred Exchanges. These misconceptions can be avoided by discussing the exchange with your accountant and Qualified Intermediary in advance of closing.

- Does the replacement property have to be of equal or greater value? No, you can buy down. If you purchase a replacement property of lesser value, you would defer partial taxes and be subject to tax on the amount not reinvested. Your tax consultant should review the partial exchange to make sure you will still have a tax savings if you are buying down.

- Can I take cash out of the exchange? Yes, you can take cash out of your exchange at the time of the closing on the relinquished property; these funds will be subject to capital gains tax.

- Can I take out a larger mortgage on my replacement property and get cash back? No. If you do this, the funds going back to you will be looked at as boot and they will be subject to taxes.

- Can I sell in mine and my wife's name and buy in a LLC or Corporation? No, you need to buy title the same way you sold title. There are a few exceptions to this rule; LLCs or Grantor Trust can be considered the same as the taxpayer.

A little planning can go a long way in a 1031 exchange. If a transaction is reviewed with a QI and your tax advisor, the exchange can be a seamless process.

*Dave Owens and Kathy Moran are 1031 Specialists with 1031 Tax Free Strategies in Fort Myers, Florida.*

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

## My Two Favorite Deals of 2005

By: Maggie Polisano

My two favorite deals of 2005:

1. \$3,000 turned into \$53,000 -selling a real estate contract for \$50K
2. \$80,000 turned into \$135,000-sheriff purchase and subsequent sale

Reviewing the different client investments at the conclusion of 2005, I was able to identify 2 excellent uses of "truly" self-directed IRAs.

### Deal #1

Kate, a mother of five and a real estate agent in New Jersey, was able to grow her Roth IRA from \$3000 to \$53,000 in three months. The following table summarizes the investment.

Date	Activity	Account Value	Asset
15-Aug	Kate opens self-directed Roth IRA with \$3K cash contribution	\$3,000	\$3K Cash
9-Sep	Kate Finds a property to buy for \$200,000	\$3,000	\$3K Cash
10-Sep	Kate fills out Buy Direction Letter; Entrustcama FBO Kate's IRA signs contract with 180 days to close and sends \$3000 to the Escrow agent	\$3,000	\$0 Cash \$3K RE contract
15-Nov	Kate finds a Buyer for the property for \$250,000	\$3,000	\$0 Cash \$3K RE contract
16-Nov	Kate fills out Sell Direction Letter; Buyer sends a check to Entrustcama FBO Kate's IRA for \$53,000; Contract is assigned to the new buyer	\$53,000	Cash \$53,000 Contribution \$3K Earnings \$50K

*Cash Invested: \$3,000.00      Profit: \$50,000*

*Return on Investment: 1667% (\$3K/\$50K) in 3 months time*

*Annualized Return: 4 X 1667 = 6667%*

*Taxes Paid: \$0*

Kate had only these two comments:

"I didn't have to pay any taxes, a savings of \$15,000, but I wish I used my Coverdell IRA because my daughter is going to college next year. Oh well. I will do my next investment with my Coverdell"

"I like the Roth and Coverdell because I am optimistic, and I believe I will have more wealth when I am in retirement than I do now. I prefer to pay the taxes on the seeds and not the crop. All the money in my Roth is mine and all the money it makes for me is mine. None of it goes back to the government."

### Deal #2

Greg, a realtor in Pennsylvania, was able to put his IRA funds to great use, taking advantage of the power of compounding and tax-deferred savings. He essentially is earning on his taxes—not paying taxes on his earnings.

Date	Activity	Account Value	Asset
15-Feb	Greg opens self-directed IRA with \$100K Rollover	\$100,000	\$100K Cash
9-Mar	Greg Finds Property for \$76,000 at Chester County Sheriff sale	\$100,000	\$100K Cash
9-Mar	Greg fills out Buy Direction Letter; Entrustcama FBO Greg's IRA sends \$76,000 to Sheriff	\$100,000	\$24K Cash \$76K Real Estate
24-Mar	EntrustCama receives deed; Greg's IRA hires a property manager and sends \$4k for maintenance and rehab purposes per Greg's instruction	\$100,000	\$20K Cash \$80K Real Estate
16-May	Greg finds a Buyer for the property for \$135K	\$100,000	\$20K Cash \$80K Real Estate
17-May	Greg fills out a Sell Direction Letter; Entrustcama FBO Greg's IRA signs the contract and returns it to title company	\$155,000	\$20K Cash \$135K Real Estate & contract
12-Jun	EntrustCama signs the deed and other papers per Greg's direction; Title company closes and sends a check to EntrustCama FBO Greg's IRA	\$155,000	Cash \$155,000 Rollover \$100K Earnings \$55K

*Cash Invested: \$80,000.00      Profit: \$55,000*

*Return on Investment: 69% (\$55K/\$80K) in 3 months time*

*Annualized Return: 4 X 69 = 275%*

*Taxes Paid: \$0*

*Tax deferred savings in 30% bracket= \$16,500.00*

Greg only had one thought: "This is a great tool, almost too good to be true. I have to do more, and I better get my wife and her IRA involved."

Although these two investments are great examples of how individuals can use their knowledge and expertise to build their wealth, I look forward to following the multitude of investments such as timber rights, condos in the Caribbean, tax liens in Florida, etc. It will be interesting to see the favorites 2006 brings with new clients signing up everyday.

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**A**ttention CPA's: stop by our booth at the AICPA show on January 8-11 in San Diego. Register to win one of Hugh Bromma's best selling book "How to Invest in Real Estate and Pay Little or No Tax."

## For Sophisticated Investors Only - Self-Directed IRAs

By: Bill Humphrey

The power and flexibility of a self-directed IRA is not for everyone. With flexibility comes choices, and choices require more detailed investment knowledge. Less active investors find that the time required to find and make investment choices is not worth the trouble. Creative and knowledgeable retirement investors are more likely to benefit from the flexibility of self-direction.

We often hear comments or concerns from securities-based firms and companies who caution retirement investors about the myriad of rules related to non-traditional IRA investing. It is true that the rules relating to self-directed IRA investing are new to many investors, but the basics are not complex. Sophisticated retirement investors are discovering that the investment options open to self-directed plans are well worth the additional education and effort.

The additional knowledge and skill required to best grow a self-directed IRA presents an opportunity for financial professionals such as CPAs and independent investment advisors. Creative and motivated retirement investors need a support team to help them analyze and select investments. The world of non-traditional investments presents opportunities that have previously been out of reach for most retirement plans. With a self-directed IRA, those investments are suddenly viable options. Since many investors are not familiar with the rules, we offer educational programs to help both the investors and their advisors learn the details for a wide variety of self-directed plans.

Who should consider a self-directed IRA? Self-directed IRA benefits are often best realized by retirement investors who fit into one or more specific categories. If you are considering a self-directed IRA for yourself or for a client, consider the following questions:

1. Are you or your client a creative investor willing to find investment opportunities in areas other than just securities?
2. Does your personal investing experience include non-traditional assets and have you been successful in those investments?
3. Do you occasionally discover an investment opportunity that leaves you thinking, "If I only had the money, I could have taken advantage of that?"
4. Are you comfortable using leverage and interested in taking advantage of the potential of using leverage in your retirement plan?

If you answered yes to one or more of these questions, then a self-directed IRA may be a perfect fit for you or your client. However, affirmative answers to both of the next two questions are critical before you go forward:

1. Are you and/or your advisor(s) willing to help you analyze investments and make informed investment decisions on non-traditional investments? **AND,**
2. Are you and/or your advisor(s) willing to learn about the power and advantages of self-directed IRAs and the rules that go along with them?

The core of a self-directed IRA is "self." That "self" is you, the investor. With a self-directed IRA, the account owner or their advisor makes all decisions. Without a knowledgeable investor and/or advisory support system, the tremendous power of a self-directed IRA cannot be harvested. We occasionally have clients that like the idea of self-direction and enthusiastically open an account but quickly get frustrated because they don't know what to do with the account. For those individuals without the time or interest in finding investment opportunities on their own, the key is to have an advisor to help with the investment selection and planning. As the IRA administrator, we are not able to provide any investment advice or products. All truly self-directed accounts are directed by the account owner or the advisors they select. Through that control, they are able to make their own choices and grow their plan assets to provide themselves a comfortable and prosperous retirement.

The most important service that Entrust Group offices provide is education. Through teaching, we help investors and their advisors understand the power of a self-directed IRA and how tax-deferred plans work. When an investor is considering a real estate IRA, they often have many questions because they have no experience with using an IRA for anything other than securities. To help investors and their advisors open the door to non-traditional investment opportunities, we created specific classes covering a wide variety of topics. These classes introduce such topics as what investments are available for self-directed IRAs and how to open what is often called a "Real Estate IRA." For investors with more specific questions and investment types, we can customize classes to meet their individual needs. Visit our website for a list of class offerings or contact us to schedule a class for your group.

*Bill Humphrey, a Colorado CPA, is President of Entrust New Direction IRA, Inc. Serving the states of Colorado and Wyoming [www.NewDirectionIRA.com](http://www.NewDirectionIRA.com)*

# New Year Retirement Resolutions

By: JP Dahdah

With 2005 behind us, we can begin to focus our attention on the new list of goals for the upcoming year. For some of you, the tradition of writing down your New Year resolutions has become a dreaded routine. Why? Because your list always seems to look the same every year, and you never seem to be able to stick to your grand plan.

In order to get better results, you have to change the unsuccessful pattern you are currently in. In an effort to add a little pizzazz to your list this year, I ask that you add the following resolution for 2006: "Learn More about Self-Directed Retirement Plans"

Why is this so important? Well, whether you are concerned about your retirement planning right now or not, believe me, you should be. The majority of people I talk to have very ambitious retirement goals, but they are not taking the necessary steps to accomplish them. If you are reading this article, you are most likely an active real estate investor or have the hopes to become one. The sole purpose of investing is to build wealth

over time so you can become financially independent, right? Well, retirement plans offer tremendous tax advantages that can help you accelerate that process due to their tax-free status. Once you have acknowledged that the smartest investment vehicle to use to build wealth and save taxes is a retirement plan, the next step is to select the asset class you feel comfortable

with and enjoy investing in. Again, if you are reading this newsletter, I would have to guess that you prefer real estate. Self-directed retirement plans allow you to purchase real estate in a tax-free environment! No more stressing over the impact of capital gain taxes on

your real estate investment return or hustling to identify a property for a 1031 exchange. All that goes away when you use a Self-directed retirement plan.

The most common answer when I ask an investor how they feel about their retirement plan is "it hasn't done anything in years." 2006 is the year to change all that!

*JP Dahdah is the President of Entrust Arizona.*

*[www.entrustarizona.com](http://www.entrustarizona.com)*

## Add a little pizzazz to your list this year

### QUESTION OF THE MONTH

"Realtor Fix and Flips"

#### Question:

If we have not made any contributions for the 2005 tax year - can we somehow put a price on 'sweat' equity and use that as a non-cash contribution up to the max allowable amount? I know we are not allowed to physically rehab a property. Please advise.

#### Answer:

All contributions to an IRA must be in the form of cash. Sweat equity contributions are not allowed. Sorry.

### TIP OF THE MONTH

Not sure how long to keep your tax records, bank statements and rental receipts? Email us to receive our "what to keep, what to toss" checklist for the IRS!

### INTERESTING INSIGHTS

Last year, developers sold \$1.1 billion in time-shares, fractionals, and destination club memberships worldwide. Source: Conde Nast Traveler 12/05

Half of all self-employed and small-business owners do not have a retirement account. Source: Charles Schwab 12/05

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