Entrust Group

March 2007 Issue

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 nontraditional assets. Entrust does not give investment advice. Nothing in this publication is intended as tax, legal or investment advice. Entrust does not sell securities or other investments products.

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Message From the Editor

Welcome to the March issue of the IRA Insights. In this exciting issue, you'll find out the great advantages of converting your traditional IRA to a Roth IRA and how you can earn more money tax free, the danger of having an Employee Stock Ownership Plan and what you can do to change it, and the importance diversifying your IRA funds into different assets to create more wealth. All of these articles have been written for you by Entrust franchise professionals. Our local offices are made up of experts in the law, financial planning, real estate and accounting fields, providing you with a wealth of information and experience to draw from, for all of your self-directed investments. Please enjoy this issue!

Roxanne DeCarlo
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Option Strategies for Your IRA

By: H. Quincy Long

Many people would like to buy real estate in their IRAs but have a mistaken belief that they do not have enough money to do so. Nothing could be further from the truth! You may invest in real estate with your IRA without a lot of money in several ways, including partnering with other IRAs or non-IRA money, buying property with debt, or by using one of the most powerful and under utilized tools in real estate investing today – the option.

In this article we will focus on some option basics. First, what is an option? Once consideration for the option is paid, it is the owner's irrevocable offer to sell the property to a buyer under the terms of the option for a certain period of time. The buyer has the *right* but not the *obligation* to buy.

You might wonder why an owner would agree to tie up his property with an option. Advantages to a property owner include: 1) the owner may be able to time his income for tax purposes, since option fees are generally taxable when the option is either exercised or expires (always check with your tax advisor); 2) if the owner needs money, an option may be a way to get money that he doesn't have to repay, unlike a loan; 3) options are very flexible, and the owner may be able to negotiate an option which allows him to keep the property until a more opportune time – this is especially true of an owner in a pre-foreclosure situation.

Do the paperwork right! Options are extremely powerful and very easy to mess up. Be very specific, clear and complete about all the details. *Remember, with options, you have to negotiate for both the option and for the purchase of the property.* With a well written option, the following must be, as my old law professor was fond of saying, "patently obvious to the most casual observer":

a) Who is granting the option? Does it include heirs, successors and assigns?

b) Who is receiving the option? Does it include assignees of the buyer, or is it an exclusive option to purchase by the buyer only?

c) What property is being optioned? Property can be anything, including real estate, a beneficial interest in a land trust, a real estate note or nearly anything else.

d) What is the consideration for the option? Remember, there must be some consideration for the option in the form of money, services or other obligations.

e) How is the option exercised by the buyer? This is one of the easiest things to mess up in an option. If the procedure is not clear for exercising the option, it is an *invitation to litigation!*

f) What will be the purchase price of the property if the option is exercised?

g) How will the purchase price be paid when the option is exercised? Will it be for cash? Seller financing? Subject to the owner's existing mortgage?

h) Will the option consideration be credited to the option price or not?

i) When can the option be exercised? For example, does the option holder have the right to exercise the option at any time during the option period, or can the option only be exercised after a specified amount of time?

j) When will the option expire, and under what circumstances? The option should have a definite termination date, but might also include other circumstances under which the option terminates, such as a default under a lease.

k) When it comes time to close, what are each party's obligations? For example, who pays for title insurance, closing costs, etc? Are taxes prorated?

So what forms do you use? The answer is my favorite as a lawyer - *it depends!* There is not and cannot be a "standard" option for all purposes. They are simply too flexible. You must decide on a specific use for the option and then, as Shakespeare said, "Get thee to a lawyer!" (Okay, it was "Get thee to a nunnery" but I like it better as revised!).

When you have negotiated an option agreement for your IRA, you have several choices. First, you can let the option expire on its own terms. Sometimes this is the best course of action if the deal is not what you expected, especially if you only paid a small amount for the option.

Another choice is that your IRA could exercise the option and buy the property. Since there are ways to finance property being purchased by your IRA, including seller financing, bank financing, private party financing or even taking over property subject to a loan, this may be a good strategy for your IRA, even if the IRA does not have the cash to complete the purchase. Be aware that if your IRA owns debt financed property, either directly or indirectly through an LLC or partnership, its profits from that investment will be subject to Unrelated Business Income Tax (UBIT). This is not necessarily a bad way to build your retirement wealth, but it does require some understanding of the tax implications.

A third choice which is often employed in the context of self directed retirement accounts is to assign your option to a third party for a fee. Your option agreement should specifically allow for an assignment to make sure that there are no problems with the property owner. This is a great technique for building a small IRA into a large IRA quickly. I had one client who put a contract on a burned house for $100 earnest money in his daughter's Coverdell Education Savings Account, then sold his contract to a third party who specialized in repairing burned houses for $8,500. In under 1 month the account made a profit of 8,400%, and all parties were happy with the deal! The account holder then immediately took a TAX FREE distribution to pay for his daughter's private school tuition.

A fourth choice that sometimes is overlooked is the ability to release the option back to the property owner for a cancellation fee. In other words, this is a way for your IRA to *get paid not to buy!* Let me give you an example of how this might work. Suppose you want to offer the seller what he would consider to be a ridiculously low offer. When the seller balks, you say "I'll tell you what. You sign this option agreement for my IRA to purchase this property at my price, and we'll put in the option agreement that I cannot exercise my option for 30 days. If you find a buyer willing to offer you more money within that 30 day period, just reimburse my IRA the option fee plus a cancellation fee of $2,500." Either way, your IRA wins!

The creative use of options can make your IRA grow astronomically if done correctly. In future articles I will be discussing different types of option strategies.

H. Quincy Long is an attorney and is President of Entrust Retirement Services, Inc., with offices in Houston and San Antonio, Texas. He may be reached by email at QLong@TheEntrustGroup.com. Nothing in this article is intended as tax, legal or investment advice.

Coming Soon…A Tax-Free (not deferred) Retirement Account for Anyone

By: Brandon Hall

Many of you are probably aware of the advantages of a ROTH IRA. However, due to income requirements, many of you are not eligible to establish a ROTH IRA. This will change in the near future. In 2006, Congress passed a new law that will make it possible for everyone, regardless of income, to convert their IRAs into a ROTH IRA beginning in 2010.

What is a ROTH IRA?

A Roth IRA differs from a traditional IRA in the sense that your contributions are made with after-tax dollars. This means that eventual distributions from a Roth IRA are tax free. By contrast, with a traditional IRA you pay no taxes up front but pay them when you withdraw the money during your retirement. In other words, with a ROTH IRA, the seed is taxed, not the crop.

Who is currently eligible to establish a ROTH IRA?

In 2007, only individuals filing single with an income of less than $114,000 or couples filing a joint tax return with an income below $166,000 are eligible to establish a ROTH IRA. For those wanting to convert their existing IRA to a ROTH, the income limit is $100,000, regardless of whether you file as single or married.

How the new law affects high-income earners

Come 2010, the conversion limit is removed. Anyone will be able to convert their IRA assets to a ROTH IRA. Many of our clients are opening Traditional IRAs now, with the intention of converting the IRA to a ROTH in 2010. Yes, they will pay taxes on any gains accrued between now and the conversion, but once the conversion happens they will have the potential for a 100% Tax-Free Account.

The new law even makes it easy to handle the conversion tax bill. If you convert in 2010, you can spread your tax bill over two years (2011 and 2012). Another approach to minimizing a single year tax bill would be to convert a portion of your account over time.

Real Life Examples

Lets assume you convert $50,000 to a ROTH IRA in 2010. You pay income taxes on the conversion over a two year period. The investments in the ROTH IRA grow at 8.5% per year for 20 years. The ROTH IRA is now worth more than $255,000, none of which will EVER be taxed.

I have a retired client that has a ROTH IRA that owns a Condominium in SW Florida. The rent from the condo goes back into her ROTH IRA. Each month she takes the rent as a distribution to live off of. She is not taxed on any of the distributed cash and hasn't dipped into the principal (the condo) of the account at all.

Other advantages of a ROTH IRA

In addition to Tax-Free distributions, contributions can be made to a Roth IRA even after you attain age 70 1/2, and unlike a traditional IRA, you are not forced to take distributions when you reach that age. That means that if you don't need the money in retirement, you can just let it sit untouched for your heirs to inherit.

Brandon Hall is the Manager of the Self-Directed Department. He earned his MBA at Florida Gulf Coast University in 2005. He is likely to be your first stop for information in setting up self-directed retirement account. You can contact him at BrandonH@TheEntrustGroup.com

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The Case of the Disappearing ESOP

By: Steve Miszkowicz

The fallout from the Enron and Worldcom scandals has opened the doors for the Department of Treasury to review how really "safe and sound" employee stock ownership plans (ESOP's) are in the hands of corporations.

Well, the jury is back in and it's not good news for corporations who have ESOP's. Those agencies and offices involved in oversight have uncovered distressing findings of speculative investments made by SOME corporate officers in SOME companies. In fact, findings show that the irregularities may be much more prevalent than many originally thought. Preliminary findings indicate that the news is so distressing that many on Capital Hill believe the Presidential Panel may recommend the elimination of ESOP's in favor of a Defined Contribution Plan.

In plain English, there is a building momentum to move corporations away from ESOP'S and toward SEP's, SIMPLE's and especially 401k Plans.

Regardless of when the wheels of government move, the direction is obvious to most retirement plan administrators. Those who are seeking to avoid overt government scrutiny of their corporate ESOP's (and the underlying investment strategy) are on the move. The direction that these decision makers are heading is toward Defined Contribution Plans. In a Defined Contribution Plan the investment risk shifts away from the employer and moves toward the employee. Investment decision making responsibilities are now placed more directly into the hands of the employee.

Once the decision to change from an ESOP to a Defined Contribution Program is made, two issues immediately come into play for the corporation.

- Number One - It may take time for the officers of the company to liquidate some of the ESOP assets into cash equivalents.
- Number Two – The government now requires a review of Plan assets is prior to the distribution of any the ESOP's assets. The actual liquidation process can take up to 2 years! So what are some employers and their plan administrators doing? Interestingly, they are establishing "liquidating trusts" to hold those ESOP assets while they establish new 401k Plans.

How are employees of ESOP's affected? Most employers and employees have a good idea of the value of each employee account, even though the closing value cannot be assigned until the government concludes the audit and gives its final authorization.

So is the employee holding stock certificates, shares or cash? Actually, the answer is - none of the above. Until the final cash figure is assigned or determined the employee only has a "beneficial interest" in the ESOP. Normally this would not be an issue, but traditional broker/dealers cannot hold "beneficial interests" which are deemed non-traditional assets. This is where the role of an independent plan administrator comes into play.

An independent plan administrator (i.e. - a plan administrator with no broker-dealer affiliation) will hold the "beneficial interests". These are held just like all other non-traditional assets. The independent administrator will hold these "beneficial interests" until final government authorization. At that point the original ESOP will be allowed to close and plan distributions will be allowed to begin. Once the new plan, i.e. 401(k) or other designated plan is in place the "beneficial interests" are assigned a value and the assets are transferred to the new 401(k).

I hope this basic information will help you understand the changing role of ESOP's and their relationship to self-directed retirement planning. Do you have questions? Please call us for more information and we'll put our "detectives" to work on your next mystery!

Steven M. Miszkowicz, President, The Premier Companies. Steven brings a unique combination of skills and experience to the client's he serves. Steve can be reached at pfg2000@msn.com

Small Number of Americans Take Advantage of IRA's

By: Jaime Raskulinecz, CPM

According to a recent study by Fidelity Investments and National Financial, only 46% of Americans are using IRA's. The study also found that only 7% of Americans, who don't already have IRA's, plan on opening one before the April 17, 2007 deadline. And, only 16% of current IRA holders said they were extremely or very likely to contribute before the deadline. However, there were 36% of current IRA holders that had contributed for 2006 before the end of last year.

Don't find yourself in this large percentage of individuals who aren't planning ahead for retirement. There are more opportunities than ever to take advantage of tax deferred and tax free accounts. More and more people are becoming aware of self-directed accounts and how they can boost their returns by fully diversifying their retirement portfolios.

Many clients are planning ahead for one of the most exciting provisions of the new tax laws. This provision states that in 2010 you will be able to convert funds from a Traditional IRA to a Roth IRA, regardless of earned income. Presently, if you earn more than $100,000 a year you may not convert to a Roth.

Clients are contributing as much as they can to IRA products (Traditional, SEP and SIMPLE) in order to take advantage of this one-time provision to convert in 2010. Another advantage to this provision is that you will have two years to pay the tax bill from the conversion. Any amount converted would be added to your earned income and taxed at your income tax rates.

Some benefits of a Roth IRA are that all gains are tax free as long as you are at least 59 ½ and you have held the account for at least 5 years before taking distributions. There are also no mandatory distributions at age 70 ½. Is there any better phrase than "tax free"?

Contact your local Entrust office to learn more about these plans and how they can benefit you. Don't be unprepared for retirement, start planning today.

Jaime Raskulinecz, CPM is the CEO of Entrust Northeast, LLC, and a NJ licensed Real Estate Broker. Entrust Northeast, LLC is a locally owned and operated office that is part of The Entrust Group. Ms. Raskulinecz has been a successful real estate investor herself for more than 20 years. For more information or to schedule a workshop or presentation contact Jaime at 973-857-8058.

Mixed Portfolio Theory Revisited

By: Jon A. Galane

In the June 2006 Insights I established the basis for a theory I called at the time "Independent Portfolio Theory." I have since honed this idea more and developed it into "Mixed Portfolio Theory." The basis is this; use a mix of real estate, first trust deeds and stocks to increase returns and have investments producing income, capital appreciation and speculative growth. This, instead of Modern Portfolio Theory that states you can lower your risk and increase your returns by having a mix of stocks, bonds and cash. This concept just hasn't held water in the long term. It is mathematically impossible to have, let's say, 10% of your portfolio in cash that has historically earned 3.7%, 30% bonds that have historically earned 5.5% and 60% stocks which have historically earned 10.4%. Adding these returns together equals a total return of 8.26%. After an average inflation rate of 3% that is a net return of 5.26%. So let's recap, for a net-of-inflation pre- tax return of 5.26% you need to have 60% of your portfolio in the stock market, and 30% in bonds that fluctuate with interest rates while the income remains static and then 10% in cash for emergencies.

Let's go back to "Mixed Portfolio Theory." If you take the cash and bond investments of 50% and put those into income producing real estate investments such as first trust deeds that many hard money lenders are currently charging between 10-14% let's split it at 12% return for 20% of your portfolio and also take a portion, let's say, 30% and put it into a rental property earning income and growth due to that fact that you are using a non-recourse loan. This now leverages your retirement investment portfolio, an option that is not available to traditional investments in the market. Let's say the rental property value goes up in value 12% annual average return. That means at 70% loan-to-value your actual rate of return is 40% on that portion of your portfolio. Let's look at this with actual numbers to get a feel for it. If you buy a bread and butter rental in our area an investor will pay around $180,000. 30% down is $54,000. 12% return on this property would be $21,600. So a $54,000 investment divided by $21,600 return equals an actual return of 40%.

Now you also have the opportunity to find raw land and add it to your portfolio vs. a high risk stock portfolio. In our area we were undervalued the last three years so land increased in value 40-100%. Does this mean the next three years will be that good? Probably not, but land is speculative so who knows what it will do. Let's be conservative and say it goes up 20% annually. Now let's take a look at your portfolio:

20% @ 12% return, 30% @ 40% return and 50% @ 20%. This gives us a combined rate of return of 24.4%, after inflation a return of 21.4%. So let's say you have a $250,000 portfolio, let's compare how your actual returns will end up between Modern Portfolio Theory and Mixed Portfolio Theory:

Modern Portfolio Theory - Based on an initial investment of $250,000:

Beginning of year value: $250,000

10% Cash @ 3.7%	30% Bonds @5.5%	60% Stocks @10.4%
$25,000.00	$75,000	$150,000
+ $925.00	+ $4,125	+$15,600
$25,925	**$79,125**	**$165,600**

Total after one year investment: $270,650 or 8.26% after inflation = 5.26%

Mixed Portfolio Theory – Based on initial Investment of $250,000:

Beginning of year value: $250,000

20% 1st Trust Deed@12%	30% rental@40%	50% Land@20%
$50,000	$75,000	$125,000
+$6,000	+$30,000	+$25,000
$56,000	**$105,000**	**$150,000**

Total after one year investment: $311,000 or 24.4% after inflation = 21.4%

One more interesting statistic, and hopefully this will help you to see the advantage of self-direction of your retirement portfolio in a mixed portfolio model is as follows:

This rule we are going to use is a model that establishes how quickly your investments will double. It is called the Rule of 72 and it works like this,

72 / % return = years to double.

So let's look at our above Modern Portfolio that earns 8.26% before inflation:

72/8.26 = 8.7 years or

$250,000 is worth $500,000 in 8.7 years and ($1,000,000 in 17.4 years).

Now look at our mixed portfolio theory example that earns 21.4% before inflation:

72/24.4 = 2.9 years or

$250,000 is worth $500,000 in 2.9 years and ($1,000,000 in 5.9 years).

Further let's take this out to about 17 years.

8.8 years = $2,000,000

11.7 years = $4,000,000

14.7 years = $8,000,000

17.6 years = $16,000,000

Choose wisely your investments and how they work best for your retirement plan.

Entrust Group and Entrust of Idaho does not give tax, legal or investment advice and does not purport that any investor can duplicate these returns.

Jon A. Galane, GRI is Principal of Entrust of Idaho. Jon holds non placed licenses as a Broker/Dealer, supervisor/ manager investment advisor and REALTOR®. He has 24 years experience in the financial services industry and is a retired Vice President of the number 30 firm in the fortune 100 firms.

QUESTION OF THE MONTH

Question:

I am currently in a 401(k) plan. 46 years old. I am not happy with my investment choices. Can I take the money out and rollover to an Entrust Self Directed IRA?

Answer:

You are only capable of taking money out of the 401(k) and rolling it over to an self directed IRA if you are age 59 1/2, separated from service or some other life changing events. For the most part you are limited on your investments based upon what your employer has chosen.

Talk with your employer or plan administrator, it may be possible for the plan to be amended to allow for self direction in real estate type investments. A local Entrust office would be more than willing to discuss options available to your plan and employer.

INTERESTING INSIGHTS

What is a Self-Directed IRA?

One question I am consistently asked is "*What is a self-directed IRA?*" Or, I'll receive a comment such as *" I have a self-directed IRA with a major financial institution. Can I buy real estate?"* To clarify, a self-directed IRA is legally no different from any other IRA, although not all firms can offer you a 'self-directed IRA'.

The term "self-directed" means that you, the investor, can select ***alternative** investments* that are permitted by the IRS. There are over 40 different types of assets (or asset classifications) that you can 'self-direct' your IRA funds into, including real estate, mortgages, notes, and private placements such as investing in a business, to name a few. Depending on your investment strategy, and how much diversification you need, these alternative investments within your IRA can make sense.

Traditional investment plans allow you to invest your retirement funds into stocks, bonds or mutual funds. Through a self-directed IRA administrator, such as The Entrust Group, you can invest your IRA funds into real estate, notes, limited partnerships, commercial paper, and many other types of assets.

I like to think of my self-directed IRA as a second identity. I consider all of the same things that I would with my traditional retirement investments, such as appreciation, income, cash flow, tax benefits and value.

It's a fact that the future of Social Security and other programs designed to assist us during our retirement are in question. By utilizing a self-directed IRA and selecting alternative investments, you have the ability to potentially compound your retirement savings into a much larger nest egg.

And, best of all, the returns on these investments are tax-deferred or tax-free!

TIP OF THE MONTH

Know investment basics before you invest. What do you invest in with your IRA or 401(k)? Real Estate, Loans, Equities, CDs, Private Placements? Most investors go into an investment blind. Learn the facts about the type of investment and the risks to it, before you invest.

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