

IRA & 401(k) Insights



Message From the Editor

Welcome to another issue of the IRA & 401(k) Insights. We have some really great articles in this issue. You'll learn how Entrust keeps your money safe due to our disaster planning efforts; Glen Mather in Florida provides ideas on how to avoid outliving your retirement income; Catherine Wynne takes a look at the reality of the checkbook IRA; and Jack Kiley provides insight into some new retirement rules for non-spouse beneficiaries. Please email us if there are topics that you'd like covered in upcoming issues by emailing editor@TheEntrustGroup.com. We look forward to hearing from you!

Roxanne DeCarlo
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What Happens To Your IRA in the Event of a Hurricane, Tornado, Power Outage, or Earthquake.

By: Lisa Moren-Bromma

We have had a number of natural disasters over the last few years. The question that we have anticipated is, "What happens to my account in the event that the local office is disrupted or that the management and staff can't be at the office or the office is destroyed?" From the model of branch banking, as well as the advances in data processing and network management, we have a comprehensive plan for any such contingency. Depending on the gravity of the event which may disrupt service, the tested plan calls for an operations team to be sent from our office operations

hub in Reno, or alternatively, from Oakland or Utah, to the office experiencing the disruption. If the problem does not permit the ability to send a team, such as airport or road closure, your account activities can be handled through our backup facilities.

All data for all offices is processed through our central facility in Reno. All data is backed up, as required by our bank regulations. Our backup centers are located in Reno, Oakland and Las Vegas.

(Natural Disaster, Continued on page two)

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.

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

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Any office can be used to access the information in a secure environment from any other office in the event of any disruption in service. Our offices scan the information in your account and all transactions are also backed up through our custodial service center in Cedar City, Utah. The Bank service center in Utah processes all contributions, purchases, sales and income and expenses and has access to all customer data, as it must under our trust agreement with you and our custodial banks.

Our regulators, external and internal auditors, and business sense requires that we physically test this process annually. We test the process by turning off five offices' access to all their data and then making them work from backup. With multiple backup possibilities, your data is not only safe and secure, but up and running from a myriad of locations, such as any of our over 30 offices and four processing centers located in Reno, Oakland, Las Vegas and Utah.

So in the event your office is disrupted or closed for any reason, we will run seamlessly to ensure that your plan, your data, and whatever you need us to do, are protected in safe and secure environments.



Lisa Moren-Bromma has been a real estate investor since 1978, a note investor since 1988, and a marketing consultant since 1984. She is President of The Entrust Group. Recently published "Real Estate Investing for the Utterly Confused" and "Wise Women Invest in Real Estate."

QUESTION OF THE MONTH

Question:

I set up an LLC and the newly issued shares were granted to my solo k. I want to purchase some real estate through the LLC and use financing. I know that if the solo k is invested directly in real estate the financing would have to be non-recourse. However, since the LLC would be seeking the financing, does it still need to be non-recourse financing or does the LLC sidestep this? If the lender required me (as managing member) to be the applicant or guarantee the loan, is this ok?

Answer:

If the LLC is owned by the IRA, which appears to be the situation, the LLC would still be subject to the non-recourse financing issue as well as you as the IRA holder NOT being allowed to guarantee the loan.

This is not a fine line issue/answer, but is a conservative view of the circumstances.

The Blessing of Aging...Perspective

By: Glen Mather

Is now a good time to buy real estate? That seems to be the recurring question that the local marketplace is currently answering with a resounding “no” – at least based on the latest statistics released by the local realtor association.

Regardless of what the general public believes, the professional investor seems to be continuing to find properties with untapped equity, negotiating short sales, buying options, bidding on tax liens, rehabbing, and engaging in other land based investments. In fact, from an investment standpoint, much like the stock market, many believe it is difficult to “time the market” – so just get on with it and invest.

Those of us that have a few wrinkles remember the numbing effect of 15% mortgages in the early 80s, recessions in the 90s, and the recent economic downturn at the beginning of this decade. Both the stock market and the housing market were battered during these cycles, and each came back stronger than before. This speaks to the resilience of our marketplace and the need for patience. Buying when others are selling is a great strategy (as long as you are not buying too early in the decline!)

In addition, for counter-cyclical optimists in the real estate market, nothing can compare to the sensation of turning a property for a 100, 200 or 300% return – unless perhaps it is purchased in a Roth IRA, completely free from taxes. For every

real estate investor, the three legged stool for tax savings is 1031 exchanges, IRAs and homeowner exemptions.

1031 Exchanges permit the profits of one real estate transaction to be transferred into an identified like-kind property within 180 days using a qualified intermediary – thus deferring taxable gains into the new property. IRA investing in real estate provides for all gains to be captured within a tax deferred account, only to be taxed upon withdrawal (or not at all for Roth IRAs). The home sale tax exemption, permits the owner-occupied home to be sold after two years, with up to \$250,000 (\$500,000 for married couples) of gains to be captured tax-free!

Resources for exchanges, self-directed IRA administration, CPA and attorney professionals are all part of the important network of providers available through the Internal Revenue Code.

The worst part of aging? Obsessing that you are likely to outlive your investment income. However, with prudent real estate investing and utilizing the legal tax deferral and avoidance tools, you still have time to avoid relying on the kindness of your children during your golden years.

Glen Mather, Director of Entrust Administration Services, Inc. (877) 259-3256. Serving eastern and central Florida.

INTERESTING INSIGHTS

College Education?

I am sure by now you have realized the cost related to college education for your child or grandchildren. It has gotten to a point where every little bit helps.

Your options are:

- Your state’s 529 plan – However these only provide education for post high school only
- Coverdell Education Savings Accounts – Provide for education savings expenses for college, high school or below. However, contributions are limited to \$2,000 per year.

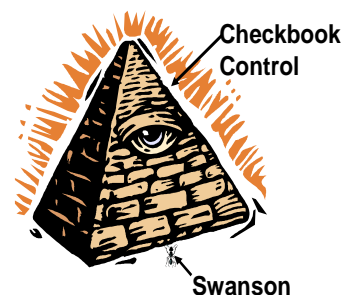
What many individuals choose to do is to fund the \$2,000 into the Coverdell Education Savings Accounts. Then if additional funds are available, fund the state’s 529 plan. For more information please contact an Entrust office near you.

What the Swanson Case Did Not Do For Us

By: Catherine Wynne

BACKGROUND

The Swanson Decision has been lauded as a “landmark decision” for the “checkbook control IRA”. An entire industry has been built around this decision and the internet has become the platform for launching products designed to give “checkbook control” and “reduction of custodial oversight” to the IRA holder based solely on this case. Briefly stated, checkbook control is accomplished by setting up a *single member* LLC which is purchased 100% by the IRA. The IRA holder is subsequently *appointed the LLC manager* after funding the LLC share purchase. The IRA holder has *complete control* over all monies of the LLC and therefore the *IRA’s monies*.



Companies promoting the checkbook control concept have three things in common:

1. They rely entirely on the Swanson Case to justify the legality of the IRA/LLC arrangement
2. They capitalize on the IRA owners’ desire for complete control of IRA funds and disenchantment with the securities industry.
3. They promise “checkbook control” of these funds without the “interference” of an IRA custodian.

WHAT DID SWANSON DO?

Mr. Swanson caused a corporation called “Worldwide” to be created and his IRA purchased 100% of the outstanding shares of that corporation. After funding the IRA share purchase, Mr. Swanson was appointed president of the corporation which, in turn, did business with Swanson’s company, “Swanson Tool”. Swanson Tool paid sales commissions to Worldwide. Note: Worldwide had no employees. The Swanson case attracted attention primarily because a) it was a single member entity where the IRA owned all shares; b) Mr. Swanson was appointed the president with complete control over all monies of the corporation; and c) Worldwide made lots of money in this arrangement.

WHAT WAS THE SWANSON DECISION?

Very few understand what the Swanson Decision addressed. Many think that this was a decisive case that certified the legality of the single member LLC for IRAs. It was not.

TIP OF THE MONTH

If you are looking to buy a house in your IRA that you plan on moving into when you retire.....consider converting to a ROTH.

The facts are:

- The Swansons sought to recover legal fees from the IRS after a settlement with the IRS on a number of tax issues. The question put forth in this case was whether or not the IRS was overzealous in pursuing the Swansons during the negotiation and settlement process in resolution of these tax issues.
- The entity purchased by the IRA was not an LLC at all but a foreign sales corporation.
- The case was decided at the administrative or lowest tax court level and was not appealed by the IRS.
- The IRS behaved badly in this case by misapplying the prohibited transaction rules and choosing to pursue the Swansons in spite of (The IRS admitted) hazy understanding of the facts of the case and application of the rules.
- The IRS confined the defense of their actions to only three potential prohibited transaction areas. They chose wrong.

WHAT WAS DECIDED?

Only one issue was decided: the Swansons were entitled to monetary relief for excessive legal fees resulting from the long, entrenched battle with the IRS. The issues viewed as “key” to the advocates of “checkbook control” rest on the three arguments the IRS chose to pursue in defense of their actions during the settlement process.

The IRS believed that these three actions by Swanson constituted prohibited transactions under IRC 4975. These issues were:

- Was the purchase of shares in the corporation by the IRA a prohibited transaction?
- Was the appointment of Mr. Swanson as president/director of the entity a prohibited transaction?
- Was the payment of dividends by Worldwide back to the IRA account a prohibited transaction?

The court decided that none of these three areas constituted a prohibited transaction.

WHAT WAS NOT REVEALED BY SWANSON



The following issues, which directly impact the operation of the IRA-owned entity, did not come up in the Swanson Case but are of importance to anyone attempting to operate an IRA-owned LLC:

Subsequent funding of entity following initial funding:

There appears to be no question that funding the LLC after the IRA's initial purchase of shares constitutes a prohibited transaction because the LLC becomes a disqualified entity after funding.

IRA holder as manager: What can an IRA holder do as the manager of the LLC? This was not addressed in Swanson and still is not defined. The extent to which an IRA holder can work on behalf of the entity is still in question.

Arrangements: The IRS more recently has looked at entities set up specifically to avoid application of certain tests, such as *fiduciary responsibility*, and *setting up entities as part of a pre-arrangement to avoid a prohibited transaction*, as being invalid (C.F.R. § 2509.75-2(c)). What does the IRS view as an “arrangement”? What about circumvention of the custodian requirement set forth in IRC 408?

Custodial requirement: The code requires that all IRAs have a custodian. A custodian is defined as “... any bank, insured credit union, a corporation subject to supervision and examination by the Commissioner of Banking (paraphrased)”. Setting up an entity for the purpose of giving the IRA holder direct access to the funds appears to clearly be an arrangement for avoiding custodial oversight.

The IRA holder as manager and signer on the entity account can take money out of and put money into the entity and thus take distributions and make contributions to the IRA without the custodian reporting either of these activities to the IRS. The prohibited transaction rules, such as no personal use, no guaranteeing of credit, and no use of the IRA's asset for the IRA holders benefit: all of these can happen without custodial involvement because they happen within the created entity.

WHAT CAN BE TAKEN FROM SWANSON

One thing we can rely on with regards to the Swanson Case is that the IRS is not going to make the same mistake twice. IRA investment in closely held or “checkbook control” LLCs, because of their high profile, will loom large as an IRS target. When (not if) the IRS decides to challenge “checkbook control” IRAs, they will be ready. The questions not answered by the Swanson Case will most likely be the focus of any future IRS court case.

Lastly, there is a limited understanding of prohibited transaction rules across the spectrum of IRA owners in self-directed investments. There is much inexperience with regards to the use and operation of business entities such as LLCs which may, in turn, result in inadvertent prohibited transactions because of confusion in the relationship between the individual, the LLC and the IRA member as three distinct entities.

In summary, the Swanson Case may only be the start of IRS scrutiny of self-directed IRA investments and single member LLCs in particular. Anyone entering into this type of IRA investment must understand the basis in law on which this type of investment structure is built, what the rules are with regards to both prohibited transactions and how to operate a registered business entity.

Lastly, everyone needs to know what the Swanson Case did not do for us!

Catherine Wynne is a principal in Entrust New Direction IRA, Inc., a licensee of The Entrust Group (TEG). TEG has been, since 1981, the leader in self-directed IRA, Roth, SEP and 401(k) administration. New Direction, in Lafayette, Colorado, provides administration services as well as continuing education for tax and investment professionals and the general public. Website: NewDirectionIRA.com.

Getting Started

I was employed at Lockheed Martin at the Kennedy Space Center and Cape Canaveral Air Force Station when my brother called and told me my father was ill and was admitted to Princeton Hospital. He died one day later at the age of 59 in 1993. My father was “land rich and cash poor” when he died. I was the oldest son of twelve and was helping my mother organize her finances. I needed to borrow some money but my mother had no credit. I used the newspaper and found a lender who would lend money on property at 12% with a 50% loan to value. It was an IRA that made the loan.

A year later, I tried to open my own self-directed account at the bank where I had borrowed the IRA money. I was told to leave and “only the bank’s best customers could talk about it!” I then went to the IRS and asked the answer/help line about using IRAs to lend money and was told it was illegal. I then asked to speak to a supervisor and he said the supervisor would tell me the same thing. I hung up the phone and called back getting another person who informed me *she* had never heard of this before but she would have her supervisor call me back. The supervisor never called.

I told my sister about it and, thanks to the internet, she was able to find information on how to lend money through your IRA. I compiled all the information, brought it to my accountant, my broker, my personal banker with a consensus of “It sounds too good to be true...but if you find it *is legal*, please let me know as I would like to do it myself!”

My first deal was to have my IRA lend \$10K to a friend who owned an electrical shop in town at 18% return to upgrade his busy repair shop. He upgraded the shop and returned my money with a 20% return. My accountant received the statement and agreed it was legal and a great investment. After further research, it was obvious that this was the greatest wealth building tool I knew about. I told my family and friends how it worked and the benefits of self direction with the tax-deferred and tax-free compounding of funds and advised them not to procrastinate because of the time value of money. I purchased all information on the subject I could find, attended seminars, and have invested in real estate, tax liens, notes, mortgages, flips, etc.

New Retirement Plan Rules Will Help Non-Spouse Beneficiaries

By: Jack Kiley

During 2006, many significant changes were made to existing IRA and Retirement Plan (401(k)) rules. One interesting item deals with non-spouse beneficiaries receiving distributions from retirement plans.

All retirement plan participants have the opportunity to name a beneficiary of retirement plan assets in the event of their demise. Under old rules, if this beneficiary was not the spouse, the beneficiary would face a significant tax bill. Generally speaking, the non-spouse beneficiary would have up to five years to distribute the funds from the account. This in turn, would trigger tax at the ordinary income tax rate of the beneficiary. Many times, this additional income would not only move the beneficiary into a higher tax bracket but quite possibly, because of this added income, begin to limit deductions that the beneficiary would otherwise have been entitled to. The other downside to this (adding insult to injury) was that these funds also lost their tax-deferred status. For many plan participants—especially those without spouses, this posed a difficult estate planning issue and many were forced to accept the notion that upwards of 35% of their hard earned retirement funds would go to the government and not to their intended beneficiary.

The 2006 Pension Protection Act changed this. New rules allow non-spouse beneficiaries to avoid significant tax issues by directly rolling these inherited plan assets over to a 'Beneficiary IRA' and take distributions over their life expectancy.



As is usually the case, the rules are somewhat complex.

First, the Retirement Plan must allow for direct roll-overs to Beneficiary IRAs and any other required distribution rules will also apply. For instance, any required distributions from the Plan must be taken (and are taxable) before rolling funds over to a Beneficiary IRA.

Non-spouses can only use the direct rollover method to transfer funds from the retirement plan to the Beneficiary IRA. This means that these funds must be transferred from the plan directly to the Beneficiary IRA custodian. The beneficiary cannot touch the funds. If he does, they will not be available for Beneficiary IRA treatment.

Lastly, the IRA must be properly titled (i.e., John Doe, beneficiary of Jane Jones, IRA).

This new IRA designation essentially places beneficiaries of IRAs and Qualified Plans on an equal footing. These new rules provide tremendous planning opportunities for plan participants and gives beneficiaries the ability to grow these inherited retirement plans tax-deferred. If completed properly, the tax savings can be significant. As always, any tax implications should be discussed with competent advisers.

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