Entrust Group

August 2007 Issue

# IRA & 401(k) Insights

## Message From the Editor

Welcome to the August issue of IRA & 401(k) Insights.

In this issue, Steve Pauley, Principal of IRA Plus Southwest, LLC, reminds us to review our beneficiaries to ensure your estate will be distributed the way you planned. You may want to take another look at foreign investments after reading the article written by Munzer Ghosheh, Principal of Entrust IRA Services. Quincy Long, Principal of Entrust Retirement Services and Entrust IRA Administration, LLC, takes a look at using other peoples IRAs to grow your financial platform. Hugh Bromma, CEO of The Entrust Group, reviews the history and evolution of self-directed retirement plans. Finally, Maggie Polisano shares how she got started in self-directed investments. All of these articles have been written for you by Entrust 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. We love to hear from our readers. Our goal is to write articles that educate you in all the benefits of self-directed retirement plans. If you have a topic you would like to see in an upcoming issue, please let me know.

Roxanne DeCarlo
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## Who's Your Beneficiary? Are You Sure?

By: Steve Pauley

Benjamin Franklin is purported to have said, "In this world nothing is certain but death and taxes." While death is an all or nothing proposition (I never could understand why the Munchkins insisted that the Wicked Witch was not just dead but completely dead), taxes can be minimized with proper planning. None of us wants to pay any more tax than necessary, so we maximize our IRA and retirement plan contributions and invest the money in these plans to maximize investment return and wealth accumulation.

And of course, we want to pass this retirement plan money on to our heirs in the event of our death. So, we meet with an estate planner and set up wills and trusts and whatever else we need, with each document clear on who is entitled to what we leave behind.

But all too often, the beneficiary designations in our IRAs and company retirement plans are overlooked. Why is this important? Because these beneficiary designations can override what's in a will. This can result in an unintended tax liability for the

### 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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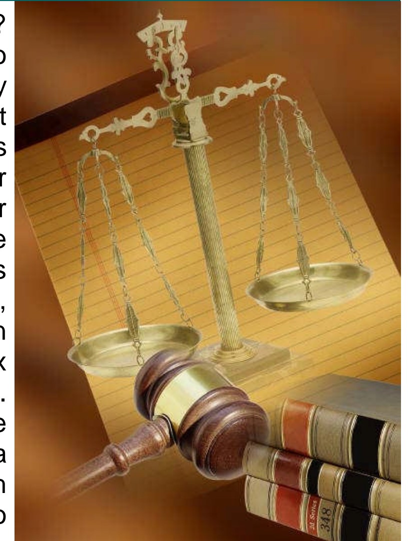
beneficiary of the IRA or retirement plan.

Usually, you can name the beneficiaries of your IRA or company retirement plan, and if you don't name anyone, there is usually language in the plan document which specifies the default beneficiary or beneficiaries. Most company sponsored retirement plans are written so that the spouse is the beneficiary if none is designated. Usually, the plan participant wants his or her spouse to be the beneficiary, so the lack of a beneficiary designation may not cause a problem. However, IRAs are different; in the absence of a beneficiary designation, the estate is the beneficiary. Why is this a bad thing?

Suppose your will names your thirty year old daughter as your heir. So you name your estate as your beneficiary or do not complete the beneficiary designation form. Your intent is probably to leave everything to her, including your $1,000,000 IRA. If she were the named beneficiary of your IRA, upon your death, she would initially have take out, and be taxed on, about $20,000 (based on her life expectancy). She would be able to receive distributions from the IRA for the rest of her life. However, if the estate is the beneficiary of the IRA, the IRA must be completely distributed to the heirs within five years, resulting in a huge tax liability. The heirs of the estate would initially have to take out—and be taxed on—$200,000. And after just five years, the $1,000,000 IRA would be gone. Your nice estate plan was upset by a seemingly insignificant form in the IRA application.



What should you do? Pay close attention to your beneficiary designations. It generally makes sense to name your spouse as your beneficiary. He or she can roll those assets over into an IRA, where the money can continue to grow tax deferred for years. The surviving spouse can also name a beneficiary, which could allow the IRA to continue for decades. If naming a spouse isn't an option for your IRA, designating another relative or friend as a beneficiary is better than naming no one at all.

*Steve Pauley is a Principal of IRA Plus Southwest, LLC. Serving North Texas, East Texas and Oklahoma. He can be reached at 800-473-1977 ext. 305 or spauley@TheEntrustGroup.com.*

# QUESTION OF THE MONTH

***Question:***

I have a few questions regarding self-directed IRAs when used to invest in income producing real estate.

Can my wife & I pool our IRAs into the same LLC?

We want to invest in income producing property. Are we allowed to have partners to invest in real estate not in our LLC?

***Answer:***

Income producing real estate has proved very successful for the clients of The Entrust Group. To answer your questions, you can "partner" or "pool" your IRA money with your spouse or any other partner.

A couple of caution flags. If this is done in an LLC, it must be a newly established LLC, not an existing one or one that already has disqualified persons as share holders. This holds true with purchasing real estate not in the LLC. The real estate cannot be purchased from a disqualified person.

# Yes, You Can Use Your Retirement Dollars to Invest in Foreign Real Estate

By: Munzer Ghosheh

The vast majority of IRA holders are unaware that their retirement funds can be used to invest in non-traditional investment vehicles including real estate, both domestic and off-shore. Approximately 3% of the nation's $3 trillion in IRA money is invested in real estate. Most IRA custodians perceive foreign real estate investments as risky, making them hesitant to offer it as an investment option. However, if executed properly, investing in foreign real estate is not any riskier than any other venture.

As with any investment within a self-directed retirement plan, thorough research and due diligence are necessary when looking into international properties. First of all, one would need to gather information on the country's economic and political climate. It is also important to have a clear understanding of its property laws and to know whether or not foreigners can directly own properties or if the title must be held in a trust. Moreover, a potential investor would need to set up a self-directed IRA account with a custodian such as The Entrust Group that would facilitate the purchase of off-shore real estate property in a retirement plan.

Keep in mind that the same IRS restrictions in effect for domestic real estate would also be applicable to foreign real estate when purchased inside your IRA. For instance, you may not use the property owned by your IRA in Mexico as a vacation home. You may, however, at retirement age, elect an in-kind distribution of that property. In other words, assign the title to the property to you and then use it as a vacation or second home.

Incorporating an off-shore real estate investment into a self-directed retirement plan could be a very wise and lucrative investment strategy if approached thoughtfully. It really expands the options available to investors and gives them the flexibility to explore new possibilities. But more importantly, it allows them to take advantage of unique investment opportunities specific to different markets abroad that would not necessarily be tenable domestically.

*Munzer Ghosheh is the manager of Entrust IRA Services, servicing Southern California. The Entrust Group is the largest provider of self-directed retirement plans in the United States. He may be reached by email at mghosheh@TheEntrustGroup.com or by calling 310-899-3811.*

## INTERESTING INSIGHTS

Do you have a retirement plan like a 401(k) or Pension Plan that you would like to invest in real estate or some other self-directed investment that your current provider is not allowing for?

The Entrust Group can provide a recordkeeping outlet for your employer to choose that will allow you to invest in real estate, rental property, notes, or your own side business.

For more information please contact your local Entrust Group office regarding “OUTSOURCING” you retirement assets.

# Using Self-Directed IRAs and 401(k)s to Make More Money Now and to Build Your Retirement Wealth for the Future

By: H. Quincy Long

Self-directed IRAs and 401(k) plans have been around for more than 25 years, but many people are just now becoming aware of how powerful this idea can be. There are currently *trillions* of dollars in retirement plans. Do you know how to unlock your own retirement funds as well as the retirement funds of those within your circle of influence for real estate related and other nontraditional investments? Your knowledge of self-directed retirement plans can help make you money now as well as ensuring that you retire in style.

**Self-directed plans available.** A lot of retirement wealth is in traditional IRAs and employer sponsored plans. If you leave an employer, the funds in the employer plan can be moved into a self-directed traditional IRA. This includes money rolled over from 401(k) plans, 403(b) plans, 457 deferred compensation plans, and the federal thrift savings plan. Self-employed people may have their own individual 401(k) plan, which may even include the new Roth 401(k), no matter what their income level. Other employer sponsored plans which can be self-directed are SEP IRAs and SIMPLE IRAs.

The king of all IRAs when it comes to building tax free wealth is the Roth IRA. Even if you do not qualify for a Roth IRA due to current income limitations, in 2010, the income limitation for conversions from a traditional IRA to a Roth IRA will be eliminated. At that point even the very wealthy will be entitled to have a Roth IRA. This is a great planning opportunity!

How does paying for your child's education or your health care expenses with tax free money sound? You can even self-direct a Coverdell Education Savings Account (ESA) or a Health Savings Account (HSA), and as long as distributions are for qualified education or health care expenses they are TAX FREE FOREVER. With an HSA you even get a tax deduction for putting the money in!

Perhaps the best news of all is that you may combine your IRAs and other self-directed plans to make nontraditional investments. Even better, you can invest your IRAs with other people's IRAs or even non-IRA money of people you know. The key element is that you must have your plans administered at a self-directed IRA company like Entrust Retirement Services, Inc.

**Make money now.** We have all heard that knowledge is power. Your knowledge of self-directed retirement plans can translate into money in your pocket today. How? It's easy! While it is true that you may not derive a current benefit from your own IRA's investments, this does not mean that you cannot benefit right now from Other People's IRAs (OPI). Simply become knowl-

## TIP OF THE MONTH

Whenever 30 year fixed interest rates are over 8% you are guaranteed to save a lot of money in the first few years with a good ARM product. To know whether an ARM is the best choice for you, ask yourself the following questions:

1. Is it likely that I will sell or refinance within five to seven years? Currently, most home loans are paid off within five to seven years. Largely, this is due to people selling for a profit and moving up. The shorter the time that you will be in a particular house, the less risk that rates will work against you.

2. Is it likely that the Fed will have slowed the economy down (causes rates to drop again) within 3 years? ARMs have a "teaser rate" - a very low starting rate. The rate will rise until it reaches its "fully indexed rate" - index + margin = fully indexed rate. If it is likely that the economy will slow down in a couple of years, then your rate may also decrease after the first few years depending on the fully indexed rate at that time.

3. If I can save several thousand dollars in the next three years, am I willing to take the risk that my payment may increase significantly after that time? Look at the history of our economy and the subsequent fluctuations in rates. You'll find that rates normally run through a rise-fall cycle in a 3 to 5 year period. If you're buying a home with an ARM product two years after rates started rising, the odds are in your favor that you will be able to take advantage of the low start rate and also the lower future rates brought on by recession.

edgeable about self-directed plans by reading books and attending seminars or workshops, then spread the good news!

Entrust has many seminars and workshops to help you and those whose IRAs you want to use to make money for yourself. There are also numerous books on the market explaining the power of self-directed retirement plans, such as Hubert Bromma's "Investing in Real Estate With Your IRA and 401(k)" which are selling quickly. For more information on seminars and workshops in your area, visit the Entrust website at www.TheEntrustGroup.com. Even if you don't have a dime of retirement funds yourself, you can use your knowledge to:

- Borrow other people's IRA money to do your deals today
- Sell real estate, notes or other non-traditional assets to people's IRAs
- Make others aware of an opportunity to invest in your business (always be aware of securities laws when raising money)

Anytime you go to a gathering of people, there are most likely millions of dollars available for nontraditional investments in their retirement plans. It is up to you to let people know about this powerful tool and how they can take some or all of that anemic money and put it to work in a way that benefits both you and them. You will look highly intelligent and will inspire confidence with your advanced knowledge. You owe it to yourself to learn more today. Entrust can help.

**Invest your own IRA in what you know best**. With all your knowledge of self-directed IRAs, you will most likely want to invest your own retirement funds in non-traditional investments as well. What investments do you know the most about? Almost without exception, you can invest in what you know best with your own IRA. The law contains very few investment restrictions for retirement plans, but most custodians refuse to allow IRAs to invest in nontraditional investments such as real estate simply because they are not set up to handle them. Not true with Entrust!

Entrust self-directed retirement plans are under the same laws as plans at any other custodian or administrator. We are simply more flexible when it comes to administering nontraditional investments in your IRA or other self-directed plan. Entrust clients have used their retirement plans to purchase all of the following and much more: real estate, both foreign and domestic, including debt leveraged real estate; real estate options; loans secured by real estate; unsecured loans; limited partnership interests; limited liability company shares; stock in non-publicly traded corporations; land trusts; factored invoices (including factored real estate commissions); tax lien certificates; foreclosure property; joint ventures; oil and gas interests; and even race horse colts! You are limited only by your imagination.

**Ignorance may be bliss to some people, but it will not make you wealthy.** Use your knowledge of self-directed IRAs and other plans to make money now, to help others build their retirement wealth as well as your own, and to retire in the style and comfort in which you would like to become accustomed. Contact Entrust today!

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

# Truly Self-Directed Retirement Plans

By: Hubert Bromma

Over the history of tax advantaged programs, qualified plans and individual retirement accounts have consistently been at the forefront of opportunities to defer tax. Within this context, self-directed investment opportunities have not received the attention that standard IRA and Qualified Plan investments, such as stock, bonds, mutual funds and certificates of deposit, have had. Although non-standard investments in tax deferred accounts are relatively small as a proportion of overall US investments, such investments may be a significant part of anyone's diversified portfolio. Self-direction of plans and IRAs are straightforward as long as the IRS disqualification rules, unrelated business income tax, and other related tax sections are followed. This article provides a brief history of tax deferral in Qualified Plans and IRAs, and investing in non-standard opportunities, using real estate as an example.

In 1974, Congress passed the Employee Retirement Income Security Act or ERISA to clarify and provide non-abusive circumstances under which pensions could be created. Tax advantages to the employer and employee would become available and regulated with the intent of being fair handed.

Variously known as Keogh and HR-10 plans, these eventually became known as Qualified Plans, which are employer originated tax deferral retirement programs. (These include Defined Benefit, and Defined Contribution Plan. Defined Contribution Plans generally consist of Profit Sharing, with or without a 401(k) deferral option and Money Purchase Pension Plan).

In addition, Individual Retirement Arrangements, or IRAs, which are generally individually originated programs, were also included in this legislation. Employer contributions to IRAs could also be made following specific rules. Contributions to Qualified Plans could be made by employers to employee participants, and employees could, under specific adoption of tax code provisions, (401(k)), defer funds from their pay to their plan account. Individuals could also always make contributions to their Individual Retirement Accounts provided they had earned income.

From the day the ERISA became effective, January 1, 1975, all Qualified Plans and IRA contributions and deferrals could be invested in anything permitted by law. This included any asset anyone could sell or buy in the market place. The limits were and are covered by IRC Sections regarding Prohibited Transactions, and Unrelated Business Income Tax and Unrelated Debt Financed Income Tax.

Because of the abuse by the sellers of certain investments, Congress passed legislation effective on January 1, 1981 prohibiting such investments, specifically gems, stamps, coin collections, works of art, and antiques. In addition, that legislation also permitted the deductibility of IRA contributions. Significantly, all other investment opportunities were not excluded.

The other investment opportunities which became increasingly interesting to qualified Plan and IRAs included Real Estate, Notes, Options on Real Estate, Private Placements, Investment Partnerships, and Operating Businesses, just to mention a few.

Land, single family, multi-family and commercial properties found their way into many portfolios, and the values of Plans and IRAs rose in direct proportion to property values. In some states, investments of $10,000 have returned routinely $100,000 in two years. Properties being rehabilitated offer 30% returns to the savvy investor. On some occasions, options on real estate can turn a tidy profit with a very small investment. Cash flow provides many retirees tax free income in Roth IRAs.

Plan participants and IRA owners discovered that leverage was a way to increase the income potential of the land or other property. Leveraged, or debt financed property, was subject to Unrelated Business Income Tax (UBIT) rules, as was operating income generated by assets. Significantly, acquisition debt for real estate in qualified plans is not subject to unrelated business or debt financed income tax. IRA acquisition debt for real estate was not given such generous treatment. In addition, tax payments for the debt financed income needs to be paid by the plan or IRA.

Depreciation expense, interest expense and certain maintenance expenses are allowed as deductions on the Form 990-T, Exempt Organization Business Income Tax Return for the affected debt financed asset or operating income asset. The implications of UBIT are consideration in making the investment decisions. Often the results are positive.

Debt financing requires the services of lenders willing to lend to an IRA or plan. Non-recourse loans are the only loans permitted for plan or IRA assets. This also precludes the beneficial owner to use their credit or sign on the loan. Any extension by an IRA owner or participant of a plan to their IRA or plan is specifically prohibited. There are a number of non-recourse lenders but some diligence is necessary to find such lenders.

Many individuals elect to partner with their plans and/or IRAs and others, as undivided interests in real or other

property. A growing number have established Limited Partnerships, C Corporations and Limited Liability Corporations. Each method has its advantages depending on the situation.

**Steps to self-direction are straightforward:**

1. Locate a plan sponsor or IRA provider which offers completely flexible investment options in their plan and trust document.
2. Adopt that plan.
3. Rollover from any existing IRAs or past qualified plans to the new self-directed plan.
4. Determine the appropriate diversification you desire and direct the trustee or custodian to make the asset purchases on behalf of the plan or IRA.
5. Income and expense are treated on a prorated basis of ownership of the assets and recorded accordingly.
6. Distributions must be made beginning age 70 ½ for all plans other than Roth IRAs. Distributions may also be made in kind.

True self-direction of IRAs and plan assets is a method to increase diversification and grow retirement income. Following the rules is straightforward and with proper assistance from tax professionals, sponsors, and Plan/IRA providers, the benefits can be enormous.

*Hubert Bromma, CEO of The Entrust Group, the oldest administrator of truly self-directed retirement arrangements catered to individuals who wish to acquire real estate and other non-traditional investments in their IRA/401(k). For more information, or to find an office near you, visit www.TheEntrustGroup.com or contact Entrust at 888-340-8977.*

# Getting Started

## How I Got Started……It's Not What You Make, but What You Keep

By: Maggie Polisano

Life was good. I was an IT consultant in the late 90's, my husband in sales. We had two small children and our income and finances were in great shape. We contributed the maximum to our retirement plans and had additional income from investment properties.

I quickly realized that the more we made, the more we were taxed. In some cases, almost 50% was taxed. I now had a lot of questions. Do I invest in Real Estate at all? Do I sell after a year? Can I structure my pay at work differently? Can I defer income?

My brother mentioned the use of IRAs to purchase real estate and defer taxes or, in the case of Roth IRAs, have tax free income for life. Knowing that I did not need that income to live off of, this idea seemed brilliant. The stock market was booming at this time and my 401(k) was heavily invested so I decided to open the self-directed IRA and diversify my assets by investing in real estate. I decreased my taxes; I was in control and would not have to depend on the market to build my retirement. My first investment was in Florida where real estate prices were ridiculously low and with a steady rental income. Our net worth was increasing due to the tax savings. I was diversified and when the stock market crashed, all my friends thought I was smart. Cha Ching!

It's not just what you make, but what you get to keep. I was never taught tax tools or income structuring in college. It was after this experience that my friends and family suggested I teach people how to do this. It is a great job with great rewards such as seeing people securing their future and minimizing taxes using knowledge and expertise they already possess.

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