

# INDIVIDUAL RETIREMENT ACCOUNTS

## "HOW REAL ESTATE CAN BE PURCHASED WITHIN AN IRA"



### Compliments of



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### RETIREMENT ACCOUNTS

There are a number of retirement plans such as 401(k), 403(b), SEP and other plans where people can accumulate assets for retirement in a tax advantaged way. One of these is an individual retirement account which is more commonly referred to as an IRA. Depending on the type of IRA, the income and capital gain taxes can be deferred or tax-free. It is possible to use an IRA to invest in real estate, and potentially, in the case of a Roth IRA, the capital gains are also tax-free.

### TRADITIONAL IRA vs. ROTH IRA

What is the difference between a traditional IRA and a Roth IRA? With a traditional IRA, subject to certain income and contribution restrictions which are beyond the scope of this article, an investor can make contributions to a tax deferred account with pre-tax funds (i.e. the investor's income for income tax purposes is reduced by the amount of the contribution). With a Roth IRA, which is also subject to certain income and contribution restrictions, the contribution is made with after-tax dollars. However, the advantage of a Roth IRA is that it allows for the tax-free growth of the investment account and tax-free distributions during retirement.

The first step in using an IRA for real estate investing is to create or rollover the IRA to a company that provides the option for a self-directed account and where there is an option to invest in real estate. Generally, the investor will want to make sure the self-directed IRA is set up where the company holding the funds functions more as an administrator (as opposed to a custodian) and where they have the accounting systems set up to handle real estate investments.

### FINANCING ISSUES AND "UBI"

IRS Publication 598 states the income from debt financed property within an IRA is considered unrelated business income ("UBI"). UBI is defined as *"the income from a trade or business that is regularly carried on by an exempt organization and that is not substantially related to the performance by the organization of its exempt purpose or function, except that the organization used the profits derived from this activity."*

If the IRA receives more than \$1,000 of UBI during a tax year, it is subject to taxation and an additional tax form must be filed (if there is less than \$1,000 of UBI, no filing is required). **Tax Planning Tip:** Some advisors recommend using the excess UBI to make principal reductions on the mortgage each year since once the debt is paid off, the income is no longer considered UBI.

A way to locate a company that specializes in real estate purchases within a self-directed IRA is to perform an internet search looking for "self-directed IRA". One well known company in this niche is Sterling Trust Company (SterlingTrustCompany.com; 800-955-3434) This is only a brief overview of the opportunities available with an IRA purchase of real estate. Always consult with your tax and legal advisors to more fully explore all issues.