



Self-Directed Real Estate IRA 101:

How Does a Real Estate IRA Investment Actually Work?

EQUITY TRUST COMPANY

PART I

“Self-Directed Real Estate IRA 101: How does a real estate IRA actually work?” gets into the nitty-gritty details so that you can take advantage of the wonderful opportunities that a truly self-directed IRA provides—namely tax-free profits on a full range of investments, including tax liens, mortgages, private placements, and real estate, as well as stocks, bonds, and mutual funds. In Part I, you’ll learn the first step in the process, establishing an account with a self-directed IRA custodian.

But before you open an account, **Part I** answers common questions new investors have and provides a checklist you should review before choosing a self-directed IRA custodian.

Part I: Establishing an account with a self-directed IRA custodian.

Establishing an account with a self-directed IRA custodian is easy and usually takes around 10 minutes to complete by filling out a simple application.

But before you begin filling out an application, there are number of things you should review with any potential self-directed IRA custodian. To help you, below is a checklist of questions you should ask any custodian before opening an account.

- How long have you been in business?
- What is your fee schedule? Do you have additional fees for certain transactions? Are there “hidden fees”?
- How are you regulated?
- How are you insured?
- Am I working with a branch office/franchise or the main institution?
- Will there be an account representative to assist me if I have questions?
- What is the minimum initial investment?
- Do you offer brokerage services?
- Can I access my account online?

Answers to these questions will help you determine the best self-directed IRA custodian for you.

Completing Paperwork

Once you’ve completed your research and selected your self-directed IRA custodian, you must fill out an application to open an account. As mentioned before, filling out the application is a quick and painless process, usually only taking around 10 minutes.

Information you will generally be required to provide includes the following: your name, social security number, date of birth, address, contact phone number and very importantly your designated beneficiaries.

Beneficiaries are those who will inherit your account in the event that you pass away.

How long does it take to open an account?

Generally speaking a self-directed IRA can be opened in 1 to 3 business days.

What type of accounts can be self-directed?

The simple answer is that with a truly self-directed IRA custodian any retirement plan can be self-directed.

What types of retirement plans are available for me?

Often people are surprised to learn there are a number of government sponsored retirement plans available to investors. This realization leads to the obvious question, "What type of IRA is right for me?"

Many factors help determine what IRA is best for you including, yearly income, type of employment (self-employed, owner of small business), financial goals, healthcare expenses and future educational expenses.

The two most basic accounts are a **Traditional IRA** and a **Roth IRA**. These accounts were designed for individuals and offer tax-free growth on all profits, but there are differences between them. A Traditional IRA offers a yearly tax-deduction based on how much you contribute in that year, and a Traditional IRA is subject to taxes upon disbursement.

With a Roth IRA you are not eligible for a yearly tax-deduction, but you don't have to pay any taxes upon disbursement. Also, there are income limits to qualify for a Roth IRA and there are no income limits for a Traditional IRA. If your yearly-adjusted gross income is above \$114,000 (or \$166,000 if you are married), you don't qualify for a Roth IRA.

Certain Types of IRAs Allow You to Contribute up to \$50,000!

In addition to individual plans, investors can take advantage of the Simplified Employee Pension Plan (SEP) and the Savings Incentive Match Plan for Employees (SIMPLE). Both plans were designed for small businesses, but also benefit self-employed individuals.

The SEP and SIMPLE IRAs allow you to make larger contributions (up to \$50,000 in 2007) than the Traditional and Roth IRAs (only \$4,000 in 2007, \$5,000 if 50+). Both IRAs offer tax-free growth on all profits and yearly tax deductions, and all disbursements are subject to taxes.

New Health Plans Can be Self-Directed Too...

Government-sponsored retirement plans are also available to help pay for medical expenses and education costs. You can invest in real estate within these plans as well.

A Health Savings Account (HSA) is for individuals with high-deductible health plans, allowing them to set aside funds for medical expenses now and in the future.

Pay for Your Child's Education as Well!

The Coverdell Education Savings Account (CESA) is available to assist in paying for educational expenses.

As you can see there are a number of different types of self-directed IRAs available that allow you to invest in real estate, and depending on your financial goals, you'll want to take advantage of more than one of these plans.

You can also roll over any existing 401(k)/403(b) plan to a self-directed custodian as well. Part II explains this process in more detail.

If you have any questions about this section or self-directed IRA investing in general, please contact an Equity Trust Retirement Specialist at **1-888-ETC-IRAS (1-888-382-4727)**. Equity Trust will help you decide the right plan for your future.

PART II

In Part I you learned how to open an account with a self-directed IRA custodian and the type of accounts available to you.

Part II explores the many ways to fund an account (i.e. put money in your IRA!) after it is opened. This might be the most important part of the series because without money in your self-directed IRA, you can't take advantage of the tax-free profits.

You'll learn the differences between an out-of-pocket contribution and a transfer/rollover. Part II also explains whether you need to liquidate assets from your previous account and how long it takes to get an account funded.

Part II: Funding a new self-directed IRA

There are two basic ways to put money into your newly established self-directed IRA: an out-of-pocket contribution, or a transfer/rollover.

These funding processes are simple, but you should be aware that each process has its own unique requirements. Below you'll learn what process you'll need to fund your account, what materials you'll need and how long it will take to get your account funded.

Funding Your IRA Through Contributions

To make an out-of-pocket contribution to your self-directed IRA, you must meet two basic requirements. You must be alive (if you are reading this, you qualify!) and have earned income in the year you plan to contribute.

Eligible Income:

Earned income includes: wages, tips, bonuses, and other compensation reported in Box 1 on your IRS Form W-2. If you are self-employed, earned income is your share of net income reported on your IRS Form 1040.

Passive Income Not Eligible:

Many Americans receive multiple sources of income, such as rental income. But some income isn't considered earned income, including: passive income like earnings and profits from property, interest or dividend income, foreign income, annuity income and deferred compensation.

What can I contribute annually:

What you can contribute annually depends on which type of IRA you have established. Below is quick list of the contribution limits for 2006. As mentioned early ANY IRA can be self-directed including the plans listed below.

IRA Plan	Contribution Limit (Employer)	Contribution Limit (Individual)	Catch Up (over 50)
Roth/Traditional IRA	N/A	\$4,000	\$5,000
SEP IRA	up to \$45,000	up to \$45,000	N/A
SIMPLE IRA	1-3% of compensation	\$10,500	\$13,000
401(k)/403(b)	0-25% up to \$45,000	\$15,500	\$20,500
Roth 401(k)/403(b)	0-25% up to \$45,000	\$15,500	\$20,500

How do I actually get the money in the IRA? Do I need any paperwork?

This is the easy part. In order to make a contribution, send funds to your self-directed custodian in the form of a check, money order, cashier's check, wire or by credit card. You will need to attach a form to your funds designating the correct tax-year for your contribution.

I know there is a maximum contribution, but is there a minimum amount I need to contribute now?

It varies among custodians, but generally most self-directed IRA custodians have a \$500 minimum contribution.

How to Transfer/Rollover an Existing IRA to a Self-Directed IRA

Another way to fund a new self-directed IRA account is through the “transfer-in” or rollover process—taking an existing IRA and transferring it to a self-directed IRA. While there are some slight differences between a “transfer-in” and a rollover, both IRA funding methods are essentially the same.

IRA funds must be transferred between like accounts:

When transferring IRA funds between custodians, the IRAs must be similar accounts. For example, transferring an existing Traditional IRA to a new self-directed Traditional IRA, or a Roth IRA to Roth IRA.

What type of paperwork do I need to fill out during the transfer process?

After completing your new self-directed IRA application, you'll fill-out a account transfer form. The transfer form must be signed by you and by your new custodian. The form will be sent to your current custodian to initiate the transfer. You'll also need to include a copy of your most recent statement when submitting the transfer form.

Do I have to transfer all of my money from my current IRA to my new self-directed IRA?

Absolutely not. You can transfer as much as or as little as you want.

Do I pay taxes when I transfer from my current custodian to a self-directed IRA custodian?

No. A transfer from an existing IRA to a self-directed IRA is not a taxable event. The exception is when converting an existing Traditional IRA to a self-directed Roth IRA. (See below.)

I already have a Traditional, but I really like the idea of having a Roth IRA. Can I transfer from a Traditional IRA to a Roth IRA?

If you wish to convert funds from a Traditional to a Roth during the transfer process, you can. You can transfer a Traditional to a Traditional and simultaneously covert it to a Roth, but this is a taxable event and you will pay taxes on the amount transferred.

Do I have to liquidate all of my assets before I transfer my funds?

Absolutely not. You can liquidate some of your assets or none at all, and may choose to rollover your assets in kind.

If you have any questions about this section or self-directed IRA investing in general, please contact an Equity Trust Retirement Specialist at **1-888-ETC-IRAS (1-888-382-4727)**. Equity Trust will help you decide the right plan for your future

PART III

In **Parts I and II** of “**Self-Directed Real Estate IRA 101: How does a real estate IRA investment actually work?**” you learned how to open a self-directed IRA account and how to fund it. In **Part III**, you learn how to make an actual real estate IRA investment.

We'll describe a of self-directed IRA investment example, using a typical real estate purchase. It is similar to purchasing real estate outside of an IRA, with only a few differences that are explained in the following paragraphs.

The biggest difference is the tax-free profits you receive when doing a real estate deal inside a self-directed IRA!

Part III: Example of a Self-Directed Real Estate Investment

I've Found An Investment Property, What's Next?

After you've found a property to purchase, you need to fill out a Direction of Investment (DOI) form. This form tells your self-directed IRA custodian the specifics on the property you'd like to buy, how much money you need, and where to send the funds.

Investment Must be “Arms Length”

Remember when searching for investment property that your IRA cannot purchase from a “disqualified person.” A disqualified person includes you and your family members of lineal descent. Investments using your IRA should be “arms length.”

Also, you cannot receive an indirect benefit from the property purchase. You aren't allowed to use a vacation property that your IRA owns or rent personal office space from your real estate IRA investment.

Additional Documents You'll Need to Complete the Investment

In order for a self-directed IRA custodian to process your DOI they need additional documentation verifying the property sale. Examples of proper documentation include purchasing agreement, HUD statement, a sales contract, etc.

In addition, documents should include your self-directed IRA custodian's tax ID number instead of your personal social security number. If you are unsure of your custodian's tax ID, please contact them before sending in the documentation.

Ensuring Proper Titling: You and Your IRA are Not the Same

One of the most common mistakes (and cause of delays) in real estate IRA investing is when the property is titled incorrectly. Before a title company draws up documents, make sure you notify them of the proper titling. Frequently the IRA owner's personal name is incorrectly put on the title of the property.

Remember you and your IRA are two separate entities, and as such, the property needs to be titled in the name of your IRA and not you personally.

The correct title for most real estate IRA investments is:

Equity Trust Company custodian FBO (for benefit of) YOUR NAME IRA

Preparing for Closing

You've filled out the DOI's and titled the documents properly, now you are ready to close. Closing documents, which are prepared by a title company, are forwarded to your self-directed IRA custodian to be signed on behalf of your IRA.

Funds Remitted From Your IRA

With everything in place, funds will be remitted (via your self-directed IRA custodian) to the title company for your investment. Funds can be remitted by check, money order or, the most popular option, bank wire.

How Long Will This Take?

Processing times can vary with self-directed IRA custodians. At Equity Trust, it takes 3 business days for regular processing. If you need to close a deal fast, Equity Trust offers expedited service and can process your documents the same day.

After the closing and the sale is final, the last step is to send original documents to your self-directed IRA custodian for safekeeping.

Your IRA Owns the Property!

You now own a property with your self-directed IRA! After following the simple steps above you are ready to enjoy tax-free profits!

After the Purchase: Expenses and Cash Flow

Now that you've purchased your investment, you are ready to reap the rewards.

If you have any questions about this section or self-directed IRA investing in general, please contact an Equity Trust Retirement Specialist at **1-888-ETC-IRAS (1-888-382-4727)**. Equity Trust will help you decide the right plan for your future

PART IV

Part III of “Self-Directed Real Estate IRA 101: How does a real estate IRA investment actually work?” described how to make a self-directed IRA investment, using real estate as an example. In **Part IV** you’ll learn what happens to after you’ve made your investment, continuing with the real estate example.

In **Part IV** you’ll really begin to see the real power of a self-directed IRA when you realize the cashflow coming into your account is tax-free!

Part IV: What Happens After You Purchase A Property With Your IRA?

Once you’ve purchased a property you need to decide if you will manage it or if you will hire a professional management firm. If you choose a professional management firm, they will handle all of your property’s income and expenses for you.

But, if you plan to manage the property on your own this report will detail the two main parts to managing your investment--how to deal with expenses like property taxes, maintenance, and utilities, and how rental income actually gets back into your account.

Paying Property Expenses Out of Your IRA

IRA Responsible For Expenses

A self-directed IRA investment property is just like a property outside of an IRA. From time to time you’ll need to pay for things, like property taxes, maintenance, or upgrades to the property.

The IRA is responsible for paying expenses related to the asset it owns. You cannot make these payments personally.

Paying For Expenses Simple Process

For expenses, you will need to complete a Bill Pay Direction of Investment (DOI) form and submit supporting documentation such as a bill, receipt, or invoice. This form tells your self-directed IRA custodian how much money is needed and where they are to be sent.

At Equity Trust you can actually make expense payments under \$1,000 completely online!

Re-Occurring Expenses Can Be Paid Automatically

If your property has re-occurring bills (such as an association fee), they can automatically be paid on a schedule.

Rental/Mortgage Income in Your IRA

Getting Income From Your IRA Investment Property Back to Your IRA?

Once your real estate investment starts to generate cash flow you will need to ensure that it gets back to your IRA in proper form. To properly deposit those funds into your self-directed IRA, you’ll need to first make sure the payment is titled correctly.

Payees Must Make Payments to Your IRA: Proper Title A Must

Similar to correctly titling for your property, you need ensure payments are made out to your IRA, NOT to you.

Remember you and your IRA are two separate entities, and as such, payment checks need to be written to the name of your IRA and not you personally.

The correct title for most real estate IRA investments is:

Equity Trust Company custodian FBO (for benefit of) YOUR NAME IRA

Variation For Privacy Purposes

Some IRA owners do not want tenants/payees to know who owns the account. If this is a concern for you the solution is quit simple. The payee is instructed to title checks the same way as above with one exception, the IRA owners name is replaced with the IRA owners account number.

For example: *Equity Trust Company custodian FBO (for benefit of) IRA #12345678*

Documentation Needed For Income

In addition to correct title on checks, a deposit coupon is required for all funds deposited to your self-directed IRA. The coupon is created by your custodian and given to you to submit back to the custodian with payment.

The deposit coupon must accompany the submitted checks by either you or the sender of the check. Similarly, a deposit coupon must be faxed or emailed to your custodian if funds will be wired.

Making Sure Rental/Mortgage Payments Are Made

Rental/Mortgage payments received by your custodian are deposited immediately into an interest bearing account. Most self-directed IRA custodians have online account logins, which allow you to monitor payments deposited into your account 24 hours a day, seven days a week without having to pick up the phone.

Good Funds Available to You Faster

Now that you have funds coming into your account, a question you might ask is when are those funds available for reinvestment?

Personal checks have a holding period to ensure they are good funds, i.e. the checks do not bounce. Funds are available to you the same day if submitted by cashier's check, money order or wire.

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PART V

Throughout the “Self-Directed Real Estate IRA 101: How does a real estate IRA investment actually work?” series you’ve learned how to open a self-directed IRA account, fund the account, make an investment deal, and how to handle expenses and income within your account.

In the last installment of this series, **Part V**, you will learn how to sell an investment in your self-directed IRA and collect the tax-free profits!

Part V: How To Sell An Investment In Your IRA

Starting The Sales Process: A Simple Example

At some point after purchasing real estate with your self-directed IRA, you may want to sell the property.

Let’s assume you’ve purchased a home 10 years ago with your self-directed IRA for \$100,000 and now you’ve found a buyer* willing to purchase the house for \$200,000.

*Remember, as when purchasing real estate in your self-directed IRA, you should only sell the real estate in an “arms length” fashion. You may not sell property in your IRA to yourself, family members or any other “disqualified person.”

Working With A Title Company: What You Need From Them

Before funds can be remitted to your IRA from the sale, you must complete the sale process through a title company. The following are examples of documents the title company may require to complete the sale:

- A settlement statement, HUD 1, closing statement, purchase agreement (which ever is applicable)
- Correct titling on all documents showing your IRA as current owner
- A Warranty Deed that releases your IRA as owner and gives ownership to the buyer

Proper Title Is A Must...

After the \$200,000 contract price has been accepted, ensure the sales agreement/contract is titled properly and any earnest money is submitted to your self-directed IRA, not you.

You and your IRA are two separate entities, and as such, any check given to you as earnest money must be made out to your IRA. The contract also has to be titled in the name of your IRA.

The correct titling for most real estate IRA investments is:

Equity Trust Company custodian FBO (for benefit of) YOUR NAME IRA

Work With Your Self-Directed IRA Custodian: What You Need To Give Them

Notify Custodian With Sale Direction Of Investment

Before the closing you need to fill out a Sale Direction of Investment (DOI) form. This form tells your self-directed IRA custodian the specifics on the property you’d like to sell, how much money you’ll receive and what supporting documents you will need them to sign on your behalf.

It is important that all information is complete on the Sale DOI and that you indicate what documents will need to be signed by your IRA custodian for the closing.

Submit Documents From Title Company For Signature With DOI

Once you have the Sale DOI completed you will need to submit all documents from the title company that requires a signature. Your self-directed IRA custodian will sign all closing documents on your behalf.

Custodian Submits Final Documents to Title Company

After receiving a sale DOI with necessary documents the custodian will then remit all the paperwork to the title company/escrow agent. Once the title company/escrow agent processes the paper work, funds will be ready to be remitted back to your account.

Funds Back Into Your Account...Tax-FREE!

The title company/escrow agent will remit payment to your account via physical check or a wire transfer. After your custodian receives these proceeds your account will be credited and then...you are ready for your next investment!

If you have any questions about this section or self-directed IRA investing in general, please contact an Equity Trust Retirement Specialist at **1-888-ETC-IRAS (1-888-382-4727)**. Equity Trust will help you decide the right plan for your future

