

Real Estate IRA – Expert Panel Special Report Released

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December 9th, 2011

Real Estate IRA – The Financial Success Institute rushed to release it's Expert Panel Special Report: Real Estate IRAs and Real Estate 401Ks. The report was well received for bringing clarity to the often confusing and misunderstand differences between the Real Estate IRA and Real Estate 401K.

The [Real Estate IRA press release](#) has been widely circulated along with the report. The Real Estate IRA Special report informs investors not only of the advantages associated with the real estate IRA but how much richer they will retire using the real estate 401K.



Among the many findings in the Real Estate IRA study is that although both the real estate IRA and real estate 401K retirement accounts can be used for aggressive and

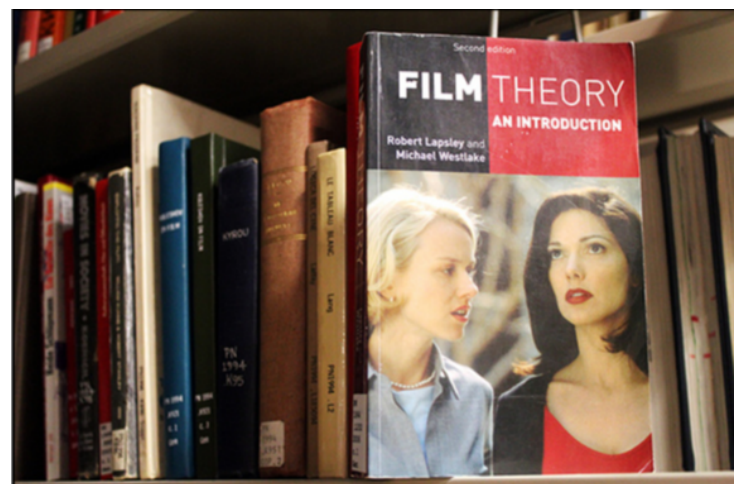
complicated investing it doesn't necessarily have to be that way. The Real Estate IRA and 401K report uses these examples:

"To be sure, the Real Estate IRA and Real Estate 401K are not for everyone. These highly profitable alternatives do require the investor be more active in managing what they own in retirement accounts. However, there are several layers of participation. Some are essentially passive investments.

One of the most passive is when an investor buys a mortgage note and the monthly mortgage payment is deposited into his or her retirement account each month. No work required.

One of the more aggressive is when an investor searches out deeply discounted homes to invest in. They then find a buyer to sell the house to for full market value. They get top dollar by offering owner financing for the home. They can then recover their capital selling the note to a passive investor. Rinsing and repeating the process grows their retirement account at a phenomenal rate."

The Real Estate IRA report points out other similarities with the Real Estate 401K. For instance both the Real Estate IRA and 401K not only invest in residential real estate, they can also invest in highly profitable commercial real estate. Additionally, the real estate IRA and 401K also invest in very diversified properties such as a growth of harvestable Douglas fir trees.



The Real Estate IRA and 401K Report won't be sitting on a dusty bookshelf. Photo courtesy of: <http://www.flickr.com/photos/quinnanya/5813769512/>

Real Estate IRA and 401K Have Important Differences

One of the key differences the real estate IRA study found is the real estate 401K allows nine times more tax-deferred savings each year over the real estate IRA. The real estate IRA maximum is \$6,000 but the 401K allows up to \$54,000 in tax-deferred savings.

Another huge advantage is the real estate 401K allows loans directly to the owner. The real estate IRA strictly prohibits these loans. Instantly, the panel realized this enables real estate 401K owners to be capable of using the loan for a business startup that the real estate IRA is not capable of funding. Another great use of the loan could be to pay off crushing personal debt. Again, the real estate IRA is not allowed to make these loans.

A section of the real estate IRA report titled "Taking It to a New Level" discusses the very real possibility of using a 401K loan and debt settlement to reduce a \$35,000 debt all the way down to \$8,750. This one incredible tip from the real estate IRA report potentially lowers an individual's monthly debt payment from \$1,137.50 to \$163.13.

Be sure to read your copy of the real estate IRA report. It's chalked full of new information never before available to investors. The real estate IRA special report is sure to have a positive impact on the investing world.

Real Estate IRA – Our Panel's Findings Will Shock You

By richard on December 9th, 2011

Real Estate IRA – Today's The Day

Today's the day when we've been studying the real estate IRA with an internal panel that includes a pension consultant with 20 years experience and a well known tax attorney.

Briefly, we're determining if the real estate IRA is the best way for a person to own real estate in their retirement portfolio.



Can a real estate IRA be used to purchase and rehab fixers and apartment buildings. Photo courtesy of http://www.flickr.com/photos/mr_t_in_dc/

Let me add that we at the Financial Success Institute do help people set up both a real estate IRA and a real estate 401K where each fits a particular circumstance better. So we have nothing against the real estate IRA.

So we have no ax to grind here.

There are companies that provide a so-called self directed IRA or self directed real estate IRA, and they will promote an IRA as the cure-all and say that almost everyone should own real estate in an IRA.

We don't have that particular bias here at the Financial Success Institute. We think it is right for some, not right for others, and further, that there may be an alternate solution that is "more right" for most people than a real estate IRA or real estate self directed IRA.

Before we get started let's disclaim our conclusions: You simply MUST consult with a qualified tax advisor who knows the inside outs of both your situation, and local and federal laws including tax laws as they pertain to retirement accounts.

This may mean you have to educate your CPA who probably doesn't know a lot of this stuff. We find that most accountants are very competent with preparing routine tax returns but they are not knowledgeable about the complexities of IRAs, 401Ks and the tax code. So you will probably have to find someone else to do this stuff for you.

That said, let's look at the advantages of owning real estate in an IRA over owning real estate outside of a qualified retirement account.

Advantages of the real estate IRA over owning real estate outside of a qualified retirement account

Real estate owned outside of a qualified retirement account is subject to taxation of course. Now, real estate in an IRA is not subject to any form of taxation if you follow certain rules, so that can be an advantage of owning real estate in your IRA.

However, real estate has some tax shelters built into it. If you purchase improved properties, as opposed to land, you can depreciate the improvements and this depreciation helps offset, or shelter, your rental income.

If you pay \$500,000 for a property, say a small apartment building, then assume that \$400,000 is for the building. The shorter time you are allowed to depreciate the property the greater the immediate write-off.

Your accountant will have to tell you how long to depreciate the property but a common number is 27.5 years. So \$400,000 over 27.5 years would yield \$14,545 in yearly depreciation. If your rental income, after expenses, is less than \$14,545 you will have effectively no taxable income. Yet, you may still have take-home income!

So this is the magic of real estate owned outside an IRA. It is one strike against owning real estate in an IRA.

Another strike against owning real estate in an IRA is the 1031 exchange that is allowed.

Why the real estate IRA may not be the best way to own real estate considering the 1031 tax free exchange

Remember you get to “trade up” properties for other properties, and roll your profits from one property to the other, with real estate. As long as you exchange real estate for more real estate, you have the 1031 tax code that makes the profits non-taxable under certain conditions.

This is the second strike against owning real estate in an IRA. The 1031 exchange is for real estate owned by taxable entities so it is an advantage that does no good for real estate in an IRA.

Now let’s look at the case for owning real estate in an IRA.

The real estate IRA: The case for owning real estate in an IRA

If you own property outside a qualified retirement account, such as real estate owned by you or by a living trust, you will pay taxes when you sell the real estate if you make a profit.

Much of that profit may be inflationary gains. If inflation is 5% per year (which is probably on the low side) then a \$500,000 property will be worth \$525,000 in one year. Yet you will pay taxes on that \$25,000 gain as if it was a real capital gain.

If you own the real estate IRA and the real estate is sold out of your IRA, then the IRA is a tax deferred vehicle and you won’t pay taxes on the gains at all.

So there is zero inflation tax on real estate in your IRA that is sold at a profit.

And if you have rental income over and above operating expenses and depreciation, there will be no tax paid on that either.

This is a huge advantage to owning real estate in your IRA, the real estate IRA as some call it.

But watch out because a huge hidden pitfall makes the real estate IRA less than desirable for many and that is UBIT, Unrelated Business Income Tax. I will simplify it here and remember to consult your tax advisor because we are over simplifying and will be committing errors when we come down to specific cases, so please make SURE you don’t take this as gospel but use it to check out your own situation.

The debt profit trap in a real estate IRA

The beauty of real estate is often that you can extend your profits by leverage, using debt to increase your cash on cash returns.

If you purchased the above example apartment building for \$500,000, what if you only put \$200,000 down? If the building is worth \$750,000 when you sell it, you have put in \$200,000 and got back \$250,000 (ignoring closing costs and other complexities) and your cash-on-cash return was 125%!

But watch out! If you borrow money for real estate inside your IRA, the profits arising from that borrowed money may and probably will be taxable!

This is a terrible tax trap with the real estate IRA and it is not necessarily a problem if you consider a better vehicle for owning real estate in your 401K which we’ll get to.

But remember that you must be very wary of owning real estate in your IRA if you borrow money on that real estate. This makes seller financing and bank financing problematic for a real estate IRA. Which defeats one of the major advantages of real estate investment which is leverage.

Let’s look at two more disadvantages of owning real estate in your IRA.

IRAs are often too small to make significant and substantial real estate investments

You and your spouse may have several IRAs, maybe a SEP or two. And each may only have \$20,000 or \$50,000 in it. Together you may own \$300,000 in qualified retirement money, but the funds are separated into small accounts.

There are rules about investing with related parties so it is very hard to invest several IRAs such as your IRA and your spouse’s IRA into a single rental property. The law prohibits this in many cases.

So this “size” problem is a huge obstacle with investing in real estate through an IRA.

Third disadvantage of a real estate IRA: the custodian or trustee needs to grant permission

Now, we have studied these issues and we do offer IRAs that can hold real estate. The IRA is set up with a limited liability company and a complexity is that IRAs have a custodian, or trustee, that cannot easily be you. So you have to get permission from a custodian to form an LLC that is owned by your IRA and the whole thing becomes even more complicated.

We hear stories all the time amongst our clients who had a real estate IRA with a company that acted as the custodian. “We need to get permission to write a check,” they tell me. “We needed permission from the trustee to do x, y or z.”

This can be problematic because real estate decisions especially buying a really good distressed property have to be rapid decisions. And sometimes a flurry of deals and checks are required in a short time to get the cheap and great deal that is out there. How practical is this with a real estate IRA, considering the rules of requiring a trustee that is some other company or firm?



A real estate IRA promises freedom, whether at work or hopefully at play! Photo courtesy of flickr.com/photos/worldizen/

So given these disadvantages, the Financial Success Institute recommends you consult with your tax advisor about a different option than a real estate IRA, which is a real estate 401K. We'll have more about this option very soon.
