

A Reprint from *Tierra Grande*

buildings for your golden years

by Jerrold J. Stern



Tax law allows real estate investments to be included in traditional and Roth Individual Retirement Accounts (IRAs). However, various criteria must be satisfied for real estate investments to be valid IRA investments. Costly penalties apply if these criteria are not met.

IRA investor interest in real estate has increased recently as dramatic stock market declines have prompted investors to look for ways to diversify IRA investment risk. Any type of investment real estate can qualify for IRA investment including apartment buildings, office buildings and motels.

Establishing a Self-Directed IRA

IRA real estate investments must be acquired by establishing a self-directed traditional or Roth IRA through one of three types of IRA trustees — an IRA custodian, an independent IRA administrator or an IRA advisor. According to *The Wall Street Journal*, initial account setup fees can range from \$50 to more than \$1,500. Annual fees range from \$200 to more than \$500 depending on the type of IRA trustee. The more “hand-holding” (advice, management, help with paperwork) offered by the IRA trustee, the higher the fees.

IRA custodians offer no hand-holding and charge the smallest fees. IRA advisors provide a full range of services and charge the highest fees. To find IRA trustees, *BusinessWeek Online* advises investors to search the Internet using “self-directed IRA” as the search term.

Only cash can be placed into an IRA. IRA cash can then be used to purchase real estate, stocks, bonds, mutual funds or other investment assets. IRA cash can be rolled into a self-directed IRA from the taxpayer’s existing IRAs or from certain corporate pension funds on retirement.

When IRA real estate is sold, the proceeds can be reinvested in real estate or invested in other assets. Taxes are avoided

as long as funds are kept in the IRA. If the IRA is a traditional deductible IRA, taxes are postponed but eventually paid. Taxes are permanently avoided for Roth IRAs as long as withdrawals comply with IRS rules. Typically, only taxpayers older than 59½ can make qualified IRA withdrawals.

Because ordinary (not capital gains) tax rates apply to qualified withdrawals from traditional deductible IRAs, Roth IRAs are the best type of IRA for real estate investment. However, rollovers from traditional deductible IRAs into Roth IRAs are precluded if taxpayers have more than \$100,000 of adjusted gross income.

Potential Pitfalls

Interested investors should do their homework before setting up a self-directed IRA to invest in real estate. If IRS criteria for self-directed IRAs and qualified withdrawals are not followed, combined penalties and income taxes can range from 15 percent to more than 100 percent of the real estate’s value.

Properties included in IRAs cannot be the investor’s personal residence or purchased from immediate family. There must be enough cash in the IRA to pay annual property expenses (mortgage, repairs, maintenance) if the property does not generate sufficient cash flow. Additional funds can be rolled into the self-directed real estate IRA from other IRAs or certain corporate pension funds if necessary and tax criteria are met. However, only \$3,000 of new IRA funds (\$3,500 for taxpayers age 50 or older) can be added annually.

Mandatory minimum IRA withdrawals begin at age 70½, so investors must plan IRA cash balances carefully to avoid being forced to choose between selling the real estate or paying a penalty. Minimum IRA distributions are based on the taxpayer’s age and the total value of all the taxpayer’s IRAs.

for more information

- “Hatching Property from Your Nest Egg,” Ellen Hoffman, *BusinessWeek Online*, 9/19/02
- “IRA Holders Add Real Estate To Their Mix,” Brian J. O’Connor, *The Wall Street Journal*, 8/14/02, page D-2
- “Retirement Plan Strategies — Using IRAs for Private Investments,” Bruce D. Steiner, *Journal of Retirement Planning*, October 2000

Real estate IRAs have numerous potential benefits and drawbacks. Because of the complexities of the rules governing these transactions, consultation with an experienced real estate professional is recommended. ♣

Dr. Stern (stern@indiana.edu) is a research fellow with the Real Estate Center at Texas A&M University and a professor of accounting in the Kelley School of Business at Indiana University.



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Texas A&M University
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