Tax Issues Associated with Truly Self-Directed Individual Retirement Accounts

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1. Transactions that will cause problems
   1. Disqualified persons (DP)
      1. IRA owner (and in some cases, family of the owner)
      2. IRA beneficiaries
   2. Prohibited transactions (Code and ERISA restrictions)
      1. Sale/exchange/leasing of property between plan and a DP
      2. Lending of money between plan and a DP
      3. Furnishing of goods/services/facilities between plan and a DP
   3. Practical examples
      1. Purchase of residence to be occupied by IRA owner
      2. Use of residence by IRA owner or child of IRA owner
      3. Sale of assets owned by IRA owner to the plan
      4. Sale of assets owned by the plan to the IRA owner
      5. IRA’s investment in corporation/partnership in with the IRA owner has some affiliation (such as owner, co-investor, employee, director, officer)
         1. IRA owner’s 50% or more of the ownership of entity is a prohibited transaction
      6. Joint investment of IRA and IRA owner in a third-party investment opportunity can cause some issues
2. Unrelated Business Taxable Income (UBTI)
   1. Trade or business activity regularly carried on by an IRA
      1. Partner in a partnership or member of an LLC
   2. Unrelated debt-financed income
      1. Leveraging the purchase of real estate assets owned by an IRA
      2. Ratio of debt value to property value determines taxable percentage
   3. Watch hedge funds and other more exotic investments
   4. Form 990-T required if IRA has more than $1,000 of UBTI
      1. Aggregate all IRA accounts
      2. Tax return is due on April 15, extension is available
      3. Tax is to be paid by IRA, not the beneficiary
3. Planning considerations
   1. Think about practical issues “up front”
      1. What is the exit strategy for the investment? Who will buy it?
   2. Understand disqualified person rules “up front”
   3. Consider implications of potential tax on UBTI