

## How to Setup a Self-Directed IRA

You may have an IRA, or may have heard a lot about IRA's. They are pretty common nowadays, where you can walk into just about any bank or credit union and open one.

But when you hear about a fully Self Directed IRA, what is it that they are talking about?

Wikipedia defines the Self Directed IRA as such:

An IRA that requires the account owner to make investment decisions and investments on behalf of the retirement plan. IRS regulations require that either a qualified trustee, or custodian hold the IRA assets on behalf of the IRA owner. Self-directed IRA accounts are typically not limited to a select group of asset types (e.g., stocks, bonds, and mutual funds), and most truly self-directed IRA custodians will permit their clients to engage in investments in most, if not all, of the IRS permitted investment types (an almost unlimited array of possibilities including foreign real estate). Some of the additional investment options permitted under the regulations include, but are not limited to, real estate, stocks, mortgages, franchises, partnerships, private equity and tax liens.

The difference between the IRA that you may already be contributing to, and a fully self directed IRA is in those two lines that I underlined.

As the account owner YOU decide where to invest your retirement money, and the possibilities of where to invest it are almost unlimited.

I have seen some companies bill their IRA's as Self Directed, meaning that as the account owner you get to choose from a handful of different stocks, bonds, mutual funds, etc. Or they even allow you to invest in ANY stocks, bonds, mutual funds, etc.

The bottom line is that you will be spending your money on Wall Street.

In a fully self directed IRA you are not limited to only investing on Wall Street. The opportunities are unlimited as well as your choices for investment and can include investing in real estate, businesses, franchises, tax liens, etc.

Don't misunderstand me; I have no problem with investing in the stock market. With a fully self directed IRA, you can and may still invest some of the money into a few mutual funds, stocks, etc. The nice thing about the self directed IRA is that you have that choice of doing so, or using the funds for different types of investments.

Imagine you gave me some money in the morning and I told you that I would buy you anything you wanted for dinner at any restaurant this evening.

Now imagine you gave me some money in the morning and I told you that I would buy you anything you wanted for dinner this evening...at Red Lobster.

That's the difference between the two. With one option you have unlimited possibilities. With the other, you still have choices, but are limited to the venue.

### **Choosing a Custodian**

The second line in Wikipedia's definition mentions the fact that the IRS requires that a self directed IRA must be held by a qualified trustee or custodian, on behalf of the account owner.

This simply means that when you open a Self Directed IRA, it must be through a bank, credit union, trust company, or savings and loan; or an entity that is licensed and regulated by the IRS as a "non-bank custodian."

The custodian acts on your behalf in the handling of the assets within the IRA, and makes sure you follow all of the rules.

There are a few custodians out there to choose from. Simply Google "Self Directed IRA Custodian" and you'll get a whole list of them. I highly recommend that you do your homework before choosing one.

Here is some selection criteria:

1. **Make sure the organization is regulated as either a bank or a non-bank custodian.**
  - a. Ask for evidence, such as a bank charter document
  - b. Ask for regulatory contact information

- c. Ask both the company and the regulators for the value of customer assets under administration.
- d. Ask both the company and the regulator how long the company has been regulated.
- e. Ask about insurance.
- f. Check the Better Business Bureau in their area.

## **2. Knowledge**

- a. Read the company's marketing and web site material to see if you can understand it.
- b. Decide if you think the material is professional, detailed, and look for corroborating evidence (e.g., references to actual IRS regulations, etc.)
- c. Check to see if the company provides ongoing education at no or nominal charge.
- d. See if the company offers free educational information

## **3. Service**

- a. Check to see what their standard operating procedures and delivery goals are.
- b. See how they inform you about activity in your account (by mail, e-mail, internet look up, written statement, etc.)
- c. Ask if they have a dedicated customer service department.
- d. Ask about their forms and accessibility of their forms.

## **4. Cost**

- a. Ask for an explanation of their fees and to provide you access to their fee schedule.
- b. Explain your plans for investing and ask them to explain what their charges will be.

Many people will skip all of these and just choose based on cost. Remember, this is your money that you are saving and growing for your retirement. Choose the custodian of your retirement assets carefully. Your decision should be based on comparing the relative safety, integrity, knowledge, service and costs of several alternatives.

## **"What kind of IRA do I need?"**

There are many different types of IRA's that you could use and they all depend on what it is that you are specifically looking for, and the

requirements for each type of IRA. Here are the two most common types of self directed IRA's that you can choose from.

- **Traditional Self Directed IRA** – Anyone who is under the age of 70 ½ and has earned income is eligible for a Traditional Self Directed IRA. This can be established even if an individual already participates in any type of government plan, a 403(b), a tax sheltered annuity, simplified employee pension plan (SEP), savings incentive match plan for small employers (SIMPLE), Individual (k) plan or a qualified pension or profit sharing plan established by an employer. All earnings on your Traditional Self Directed IRA contributions (deductible and/or non deductible), as well as profits made on investments within the account, remain tax-deferred until you make withdrawals from the account.
- **Roth Self Directed IRA** – Anyone who has earned income and falls within the MAGI (Modified Adjusted Gross Income) limits can establish a Roth IRA. Unlike the Traditional IRA, the Roth IRA has no age limit for contributions, so individuals can continue to contribute as long as they like. You may contribute to a Roth IRA if you have taxable compensation and your Modified Adjusted Gross Income (MAGI) is less than \$114,000.00 (166,000.00 if you are married and file a joint return.) All earnings in a Roth IRA are TAX- FREE, because contributions are made with after-tax dollars. The only requirements necessary to receive these benefits are that the IRA owner must have reached the age 59 ½ and had his or her account established for at least 5 years.

Below I have included a chart comparing the Traditional IRA to a Roth IRA.

Compare At A Glance Description	Traditional IRA	Roth IRA
Tax Advantages	Government savings plan that offers tax advantages for individuals to set aside money for retirement. Contributions are made with pre-tax dollars.	Government savings plan that offers tax advantages for individuals to set aside money for retirement. Contributions are made with after-tax dollars..
Maximum Contributions	Account balances compound tax-deferred until funds are withdrawn.	Account balances compound tax-deferred. BUT funds that are withdrawn are tax-free if account is five years old and account owner is over 59½.
Eligibility	100% of earned income, up to \$5,000 in 2008 and 2009. Plus an additional \$1,000, if age 50+. Total of \$10,000 for married couples in 2008 and 2009. (Contribution limits are reduced by any contributions made to a Roth IRA.)	100% of earned income, up to \$5,000 in 2008 and 2009. Plus an additional \$1,000, if age 50+. Total of \$10,000 for married couples in 2008 and 2009. (Contribution limits are reduced by any contributions to a Traditional IRA.)
	Individuals must be under 70½ and have earned income.	Individuals must have earned income and adjusted gross income less than \$116,000 for singles and \$169,000 for married couples in 2008. In 2009, individuals must have earned income and adjusted gross income less than \$120,000 for singles and \$176,000 for married couples.
Tax Deductions on Contributions	Yes	No
Penalties for Early Withdrawal	10% penalty for withdrawals before age 59½.	10% penalty for withdrawals before 59½. (Note: Roth contributions can be taken out at any time without penalty.)
Exceptions for 10% Penalty	Yes	Yes
Maximum Age to Begin Contributions	70½	No Limit
Required Distributions	Yes. Minimum withdrawals	No

begin after the age of 70½.  
**Special Note:** RMDs have  
been suspended for 2009.

- **Other types of Self Directed IRA's –**
  - The SEP IRA – Simplified Employee Plan
  - The SIMPLE IRA – Savings Incentive Match Plan for Employees
  - Individual (k)'s
  - Coverdell Education plans
  - HSA – Health Savings Accounts

Below you'll find a few Self-Directed IRA Companies and their contact information. Please note that we have no relationship with these companies and do not receive any financial compensation for recommending them. We suggest calling each one and asking your questions to see which company might be best for you. Here they are:

Equity Trust Company  
Phone: 1-888-ETC-IRAS (382-4727)  
EMAIL: [help@trustetc.com](mailto:help@trustetc.com)  
FAX: (440) 366-3750  
<http://www.trustetc.com>  
Pensco Trust  
PENSCO Trust's Business Development Center  
(866) 818-4472  
[takecontrol@pensco.com](mailto:takecontrol@pensco.com)  
<http://www.penscotrust.com>

Guidant Financial Group  
**Phone:** 888.472.4455 (Customer Service/Sales)  
**Fax:** 888.418.0374  
**Email:** [info@guidantfinancial.com](mailto:info@guidantfinancial.com)  
<http://www.guidantfinancial.com>

Entrust Group  
Phone: (888) 340-8977  
Fax: (925) 472-0350  
<http://www.theentrustgroup.com>

## **How does this all work?**

Well, it's actually pretty simple. Once you have your self directed account setup, you simply complete a "Direction of Investment Form" with you IRA company telling the custodian what investments you'd like to make.

As an example, let's assume you want to start a Part-Time Retirement Side Business with a partner. Fill out the appropriate form and your IRA custodian will fund this new business based upon the applicable partnership percentage, dictated by the partnership agreement.

Your self directed IRA will now be a shareholder in this new business. As such, your self directed IRA is entitled to dividends from the business on profits earned. You're self directed IRA may have to pay taxes on income earned, but the money is still being funnelled into your Retirement Savings Account and can grow tax-free.

Here's an example we found of how someone is using their self directed IRA in a creatively from Equity Trust's website:

Brian Harris, a private music teacher from Tuscon, Arizona, has had a lot of success with his musical career. Now as a business owner, Brian is taking his success to the next level. Brian noticed that many of his students needed musical instruments to rent.

Brian thought to himself, "Why not invest in my future with something I have a passion for" by purchasing the instruments with his self-directed Roth IRA, and leasing them to students? The money he receives from renting instruments automatically goes to his Roth IRA to grow tax-free!

Brian believes his Roth IRA will profit because of the steady flow of income. "I have recouped money in over a year [from his initial investment] and the rest is just gravy. This is an easy source of income."

To help generate interest in the musical instruments, Brian displays them at demos and also works with other private teachers. Currently Brian has around 20 instruments in his self-directed Roth IRA.

Brian says that Equity Trust is easy to work with because of the great client service and ability to be on top of

things. "For the low amount of money you [Equity Trust] charge to process forms, I think it is a steal."

Once Brian setup his self directed IRA account, he simply filled out a form to have his IRA purchase the musical instrument. A check was processed from his self directed IRA to pay for the instrument. Next, he simply drafted a simple lease to rent the instrument to one of his students. The lease is between his IRA and the student. Each month, the student's family writes a check for the rental, but the check is payable to Brian's IRA and his IRA grows month-after-month without Brian contributing a penny.

As his account continues to grow, he can buy additional instruments and rent these out to other students creating a retirement savings snowball.