

10 Most Common Mistakes Self-Directed IRA Investors Make



Provident Trust Group is an industry leader in Self-Directed IRA LLCs by keeping our company focused on you – our client. We truly believe that if you are successful, we will be as well. One way we ensure our clients' success is by having an in-depth understanding of how our clients intend to invest their IRA funds. Provident Trust Group's compliance standards are the highest in our industry. Each client transaction goes through four levels of compliance. We spare no expense in ensuring our clients can invest safely, with peace of mind.

Our senior consultants were recently asked to share some of the most common mistakes prospective clients propose to do with their retirement funds on our first consultation. Many of these are simple mistakes or misinterpretations of the law; others are an attempt to get around rules of which the prospective clients are well aware. Attempting to circumvent rules and guidelines of the IRA plan can put your retirement account at serious risk. A \$1 mistake can jeopardize the entire IRA. With so many great ways to make a healthy profit, the risk involved with prohibited transactions is not worth any return.

Regardless of whom you entrust with your self-directed IRA business, please use these guidelines to help you on the road to phenomenal success.



Mistake 1

They inadvertently make personal guarantees.

You, as the individual holding the account are considered a “disqualified person” and cannot provide a personal guarantee of IRA debt. In order to obtain checkbook control of retirement monies, Provident Trust Group (and some other IRA providers) allow the retirement account to invest into a newly formed LLC. Let's say you go into the bank to set up that LLC checking account and, in the process, the teller asks, “Would you like a credit card for this account?” You may think, “Well, I'm surprised they're offering a credit card, since the LLC is an entity that was just formed yesterday, but if they're offering a credit card, sure--why not?” So the teller establishes a card and gets you to sign the application, and the bank authorizes a new card based on your credit history. Bad move: You just stepped into Mistake #1. The problem is that you've just personally guaranteed the LLC's debt and repayment of it. The mere execution of that personal guarantee constitutes an “extension of credit” and, hence, is an automatic prohibited transaction even if the guarantee is never exercised. This document is not intended as investment advice. You should always consult with a qualified attorney when pursuing any type of investments.



Mistake 2

The IRA owner attempts to make a contribution to the IRA by depositing it directly into the IRA/LLC checking account instead of going through the IRA custodian.

In essence, if you make an annual contribution directly rather than through the IRA custodian, you are personally interacting with your IRA/LLC. That is considered a prohibited transaction.



Mistake 3

The IRA owner personally enters into a contract on real property they intend to purchase with their IRA funds.

Many investors wait until they find a property in order to engage the services of an IRA custodian or facilitator. Unfortunately, in doing so, they often suffer from “opportunity loss” because 1) a self-directed IRA typically takes 30 days to establish, and 2) they are not allowed under the prohibited transactions code to use personal assets for the benefit of the IRA. For example, let’s say you find a great piece of rental real estate you’d like to buy as an IRA investment. If you have not already established a self-directed IRA account, you may lose out on the deal because you don’t have immediate access to your IRA funds and you cannot personally deposit your own earnest money or enter into a purchase agreement. Remember, the IRA needs to buy the property, not you.



Mistake 4

They assume no UBTI applies to passive investments into an operating business.

Unrelated Business Taxable Income (UBTI) is generated when an IRA engages in “business activity.” If generated, the IRA has to pay Unrelated Business Income Tax, or UBIT. Oftentimes an IRA owner wishes to passively invest in a business entity, but the business activity itself is not passive. Should that investment be made in a pass-through entity, such as an LLC, the IRA could generate UBTI on any profit derived by the business’ activity.



Mistake 5

Self-directed IRA clients use personally-owned assets for the benefit of the IRA.

For example, the use of a personally-owned bulldozer and construction equipment to develop IRA-owned property would constitute a prohibited transaction. There are multiple layers of problems with this scenario: There’s using the personally-owned assets as well as contributing “sweat equity.” These constitute a de facto contribution that would bust the contribution limits. Another great example of this is a self-directed IRA investor who buys a rental property to use as corporate housing and furnishes it with their own furniture. This is a prohibited transaction. This document is not intended as investment advice. You should always consult with a qualified attorney when pursuing any type of investments.



Mistake 6

They believe that transactions with a non-disqualified party cannot be prohibited transactions.

This is a common belief that simply is not true. You, as the IRA holder, have a fiduciary responsibility to do what is in the exclusive benefit of your IRA. For example, an IRA holder could purchase rental real estate and allow a brother and their family to occupy the property. That would not necessarily be a prohibited transaction, but it does stage the potential to violate the exclusive benefit rule if the rent was not set at fair market value and the terms of the property agreement were not enforced. If the IRA owner has a tenant who is not paying rent, the IRA owner has a fiduciary responsibility to act as a prudent investor would and begin the eviction process. This could be problematic if you have family occupying the property – it creates a conflict of interest for an IRA owner. Not acting in the best interest of the plan could result in a prohibited transaction.



Mistake 7

The attempt by the self-directed IRA holder to take a real estate commission on property purchased/sold by the IRA.

If the IRA owner is a real estate agent, they cannot receive a commission on the buying or selling of their IRA property. You cannot take personal compensation from any self-directed IRA investment.



Mistake 8

The self-directed IRA enters into a de facto partnership in which it loans money to a developer, and instead of making a loan attached with interest and payments, it takes a share of the profits.

Although this is allowed, it's a de facto partnership that will generate Unrelated Business Taxable Income (UBTI). This wouldn't be an issue if the IRA lent the money for an interest rate (what the market bears) and created a monthly payment schedule. But in this profit-sharing scenario, it's simply disguised equity that is dressed up to look like a loan.



Mistake 9

Two self-directed IRA holders engage in a quid pro quo partnership to utilize their own retirement funds.

For example, say each person has \$100,000 in a self-directed IRA. Each then makes a loan to the other for \$100,000 to pursue personal investments. These loans are dependent on the other lending the money and could be viewed as using one's own retirement funds for personal benefit. This document is not intended as investment advice. You should always consult with a qualified attorney when pursuing any type of investments.



Mistake 10

Self-directed IRA holders attempt to “disguise” active investments that can generate UBTI.

Some self-directed account holders will place an ad in the newspaper to supposedly show their intent to rent an IRA investment property, but they “conveniently” can’t find the right tenants, so they use this as an excuse to sell it. They think this will avoid UBTI because the intention was to rent the property as a passive investment. Besides being ethically questionable, this scheme will not change the result at all. Even if it were true that the IRA holder originally intended to rent the property rather than turn around and sell it, the case law says that the most dominant factor is the purpose at the time of the sale, not at the time of the initial purchase. So you can have a perfectly passive non-business purpose going in, but if you change that purpose such that at the time of sale it is a business-type transaction, you will face UBTI.

Self-directed IRA investing can be exciting, secure and profitable. There are a vast number of allowable investments available to self-directed IRA holders that offer both profitability and security.

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Interested in how you can safely invest your retirement funds into potentially more secure and more lucrative investments? Contact an Provident Trust Group representative today to learn how you can leverage your retirement potential.

Call **888.855.9856** to get started today!