3 Common Mistakes Real Estate IRA Investors Make (and How to Avoid Them)

By Kent Kinzer

Investing in real estate in a self-directed IRA is a different process than if you were investing outside of an IRA. Some investors, not realizing the differences until it's too late, have made mistakes that have caused them to lose the tax-advantaged status of the account, miss out on potentially lucrative investments, or other avoidable consequences.

It doesn't have to be that way: you have the benefit of learning from these past mistakes to successfully complete your investment the first time. Here's what you need to know.

3 Common Self-Directed IRA Mistakes and How to Avoid Them

1. Not having the right documents/titling for a self-directed retirement plan

The first mistake we often see is clients not having the right documents in order, or not having those documents titled in the name of the Equity Trust self-directed retirement plan.

For example, when you enter into a purchase contract to buy a property with your IRA, it's important that the purchase contract lists the buyer as your IRA – not you personally or your LLC.

We've seen clients in the past try to put a property under contract personally and then assign the contract to their IRA; that can be considered a prohibited transaction. Your IRA would essentially be distributed January 1 in the year in which that transaction occurred.

Make sure that from the very beginning, the contract is titled properly. Even if you could amend the contract, or draft a new contract, that amounts to extra work, time, energy, effort, and, of course, money to prepare the documentation. So make sure you get this right from the very beginning.

What does this look like? When you title a property contract or any other investment documentation for your self-directed IRA, it would include your IRA custodian. For example:

Equity Trust Company Custodian, FBO (for benefit of) [your name] IRA

If you're using a Roth IRA, you would swap "IRA" for "Roth IRA." If it's a health savings account or Coverdell Education Savings Account, you would plug and play the applicable account. If you're using a solo 401(k), there's a little bit different naming convention; your IRA custodian can walk you through the specific titling.

Another example: If you're buying notes, originating loans, or being a private or hard money lender using a self-directed IRA, the lender on the promissory note and mortgage must be in the name of the IRA.

Sometimes, at the 11th hour, investors need to fund their transaction and they send their documentation to the custodian without proper titling. That's not acceptable and can put you at an extraordinary amount of financial risk of not being able to process a transaction, as well as the risks associated with the tax efficiency of the IRA.

Also, if you're investing in a private entity like an LLC or corporation that's privately held, usually you need to fill out what's called a subscription agreement. Under that subscription agreement, the subscriber is your IRA. You would use that same titling. There again, all too often we see investors make the mistake of not properly titling that investment documentation.

2. Trying to obtain standard bank financing for a real estate property purchase in an IRA

Some self-directed investors who want to buy a property think, "I'll just go down to my local bank, and my banker or mortgage broker whom I typically work with will give me a loan to buy this property with my IRA."

Other investors may think: "Well, I'm just going to use my IRA as a down payment and then get a bank loan." You may be able to do that. But you have to borrow the money on what's called a non-recourse basis.

Your IRA cannot take on conventional financing because your bank or mortgage broker is going to require what's called a personal guarantee that you personally sign. Under the provisions of Internal Revenue Code 4975, you personally cannot guarantee that debt. So you have to make sure that if you're going to borrow money to buy real estate, you obtain a non-recourse loan.

3. Waiting too long to fund your self-directed IRA or 401(k)

All too often, investors fail to establish and fund their account well in advance of making an investment. They call us two to four days before they need to close on a deal to open and fund their self-directed IRA with an existing retirement account.

Why is this a problem? First, if they are in a stock market position – that could be individual stocks, ETFs, or mutual funds – it’s going to take one to three days to settle those assets and liquidate those positions in order to transfer the funds over to your self-directed IRA.

Additionally, it is not an overnight process to move your funds from one financial institution to another. You are at the mercy of that other financial institution.

And all too often, folks wait until the 11th hour. This leaves them to worry about not meeting their closing deadlines, having to negotiate with the seller to extend the closing date, or – even worse – missing out on the opportunity altogether. We see this happen time and time again.

It's not always easy to hear that mistakes can be made, but it's important to learn so they’re not repeated.

Special self-directed IRA offer for National REIA members only

Equity Trust Company, a leading self-directed account custodian, is a national sponsor for the National Real Estate Investor Association (NREIA) and is offering NREIA members and its affiliated chapter members a special introductory self-directed account offer.

NREIA members can open an Equity Trust account for a discounted rate of $99 and receive bonuses worth $720 or more:

- National REIA GOLD Level membership (includes priority processing and an experienced client service team dedicated to members) for one year
- Digital download of #1 ranked book on Amazon - *Self-Directed IRAs: Building Retirement Wealth Through Alternative Investing*
- More wealth-building education

Visit www.trustetc.com/nationalreia or call 844-732-9404 to learn more.

Kent Kinzer, Sr. Manager of Business Development at Equity Trust Company.

Case studies provided are for illustrative and educational purposes only. Past performance is not indicative of future results. Investing involves risk, including the possible loss of principal. Quotes and information included in the case studies and testimonials were provided by the investors and included with permission. Equity Trust Company does not independently verify all information provided by third parties.

Equity Trust Company is a directed custodian and does not provide tax, legal or investment advice. Any information communicated by Equity Trust Company is for educational purposes only, and should not be construed as tax, legal or investment advice. Whenever making an investment decision, please consult with your tax attorney or financial professional.