Learning Objectives

- Discuss the types of assets that are considered alternative investments
- Identify potential prohibited transactions that may arise when investing in certain alternative assets
- Consider additional custodial requirements necessary for holding alternative assets
- Explore guidance on how to value and report alternative investments
What Is a Self-Directed IRA?

A self-directed IRA allows individuals to invest in traditional and non-traditional assets.

No tax law differential exists between a standard IRA and a self-directed IRA.

Investment identified by IRA owner or advisor

Why Would Someone Want a Self-Directed IRA?

- Availability of alternative investments
- Familiarity with certain types of investments
- Portfolio diversification and potential for significant investment returns
Most Common Alternative Investments

- Private Debt
- Private Equity
- Precious Metals
- Real Estate

Other Possible Alternative Investments

- Crypto-Currency
- Hedge Funds
- Intellectual Property
- Mineral Rights
- Structured Settlements
- Stock Options
Certain Investments Not Allowed in IRA

- Collectibles
- Life Insurance
- S-Corp Stock

Alternative Investment Prohibited Transaction Concerns

- Transacting with Disqualified Persons
- Extensions of Credit
- Self Dealing
Disqualified Persons

- IRA Owner
- IRA owner’s spouse
- IRA fiduciaries
- IRA beneficiaries
- IRA owner’s ancestors and lineal descendants
- Companies where ≥ 50% ownership is attributable to IRA owner/disqualified persons
- Certain persons in companies that are owned ≥ 50% by IRA owner/disqualified persons

Ancestors/Lineal Descendants

- IRA owner’s grandparent
- IRA owner’s parent
- IRA owner (and IRA owner’s spouse)
- IRA owner’s child (and child’s spouse)
- IRA owner’s grandchild (and grandchild’s spouse)
Transacting With Disqualified Persons

- Investments cannot be purchased from disqualified persons
- Investments cannot be sold to disqualified persons

Extension of Credit

- Disqualified person may not extend credit to the IRA
- Disqualified person may not take a loan from the IRA
- Disqualified person may not personally guarantee loans made to the IRA
- Nonrecourse loans are permitted
Self Dealing

- Occurs when a disqualified person uses IRA assets for their own benefit
- Disqualified person may not provide or receive goods or services from IRA
- IRA assets may not be used by disqualified persons
- Often difficult to determine if self dealing has occurred; based on facts and circumstances

Consequences of Engaging in a Prohibited Transaction

- IRA loses its tax-exempt status
- Assets are deemed distributed as of the first day of the tax year that the prohibited transaction occurred
- If an IRA is pledged as security for a loan, only the pledged portion is deemed distributed
Common Alternative Investments

Private Debt

**Promissory notes**
- Written promise to repay a debt
- Generally used for lending for a short term or small amount
- Parties involved usually have a degree of proximity
- Legally enforceable
- Generally unsecured

**Loans**
- Comprehensive document setting out lending agreement
- Substantial debt involved
- Parties are unknown to each other
- Legally enforceable
- Generally secured by real property
- Typically handled through a 3rd party loan servicing provider or escrow service
Private Debt – Custody of Assets

Documents
Titling of documents should identify the IRA as the lender (Custodian Name, FBO Account Owner, Type of IRA)
Obtain completed lending application from borrower and information to evaluate creditworthiness

Secured Loans
For real estate, completed and executed mortgage/deed (with documentation confirming filing/recording)
Personal property will require Uniform Commercial Code (UCC-1) filing
For motor vehicle, the IRA is added to the title as lien holder

Terms
Agreements should reflect commercially reasonable terms
Interest income will not generally generate UBTI

Private Debt – Prohibited Transaction Issues

Borrower (or guarantor) cannot be IRA owner or disqualified person

IRA owner or other disqualified person should not receive loan payments and pass them to IRA custodian

Loans cannot provide a personal benefit to IRA owner or disqualified person
**Private Debt**

Craig has a $150,000 cash balance in his IRA. He wants to lend $75,000 to Jones Landscaping, LLC. Jones Landscaping will purchase new lawnmowers with the funds. Jones Landscaping is owned by Craig’s brother, father, and neighbor.

Is this transaction permissible?

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**Common Alternative Investments**

- Private Debt
- Private Equity
- Real Estate
- Precious Metals
Private Equity

- Limited Liability Companies
- Limited Partnerships
- Non-Publicly Traded Corporations

Private Equity – Custody of Assets

**Documentation**
- Articles of Organization
- Copy of Tax ID (EIN)
- Operating Agreement/Limited Partnership Agreement
- Purchase Agreement

**Other Considerations**
- Documents signed by partner or manager that accept the IRA as investor
- Determine if IRA is subject to UBTI; determine how to file and pay
- Agreement to provide annual valuations to support Form 5498 reporting
- Provide specific titling on all documentation, identifying IRA as investor in entity
Jack has a $300,000 cash balance in his IRA. He wants to lend that money to his best friend's start-up company.

Is this transaction permissible?
Common Alternative Investments

Real Estate
- Farmland
- Residential Property
- Commercial Property
- Raw Land
- Renovations/Flips
- Development Properties
Real Estate – Custody of Assets

Costs
- All costs must be paid from IRA
- In real estate purchase, IRA must also provide earnest money, closing costs, taxes, insurance, maintenance, repairs, rental income, UDFI tax, renovations, etc.
- Income from real estate cannot be handled by IRA owner

Property
- Property managers should be used for income producing properties
- IRA must have sufficient cash to pay taxes, insurance, utilities, maintenance, repairs
- Traditional IRAs must be able to pay RMDs (or be able to take RMDs from other IRAs)

Real Estate – Prohibited Transaction Issues

- Selling a piece of real estate to an IRA that an individual owns outside of the IRA
- Buying real estate for personal use (e.g., hunting land, farmland, vacation home)
- Providing sweat equity to help asset appreciate or to reduce expenses
- Letting a disqualified person use or live in a piece of property
Real Estate

Ellen’s IRA purchases a piece of rental property. She personally owns a construction company. Ellen uses her construction company to do work for her IRA’s rental property. Is this permissible?
Precious Metals

Coins
- **Gold** – American Eagle, American Buffalo, Australian Kangaroo, Canadian Maple Leaf
- **Silver** – American Eagle, America the Beautify, Australian Kookaburra, Canadian Maple Leaf, Mexican Libertad
- **Platinum** – American Eagle, Australian Koala, Canadian Maple Leaf, Isle of Man Noble
- **Palladium** – Canadian Maple Leaf

Bars and rounds
- Produced by a refiner/manufacturer certified NYMEX/COMEX, FYSE, or a national government mint

Handling and Funding
- Purchase invoice
- IRA owners may not handle or hold precious metals
- Precious metals cannot be used to make an IRA contribution, cash from IRA can purchase a precious metal

Movement and Storage
- Transferring precious metals between depositories should be done by a 3rd party, not IRA owner
- Must be stored at an authorized financial organization (federal or state-regulated bank or trust company); IRA owner cannot handle the metals
Precious Metals – Prohibited Transaction Issues

- Cannot be considered collectible
- IRA selling precious metal to the IRA owner
- IRA owner personally storing

Precious Metals

Eve has a $100,000 balance in her self-directed IRA. She wants to use that money to buy some American Eagle coins. Is this transaction permissible?
Valuing and Reporting Alternative Investments

Who Is Responsible for Valuation?

- Trustees/Custodians
- Limited Guidance
- Establish Own Procedures
Valuing Self-Directed IRA Assets

- How to determine the FMV of an alternative investment
- All plan assets need to be valued
  - Annually, for Form 5498 FMV reporting
  - For RMD purposes
  - When a distribution occurs

Asset Valuation Guidance – U.S. v. Cartwright

Price at which property would change hands between a hypothetical willing buyer and a hypothetical willing seller, neither being under any compulsion to buy or to sell, and both having reasonable knowledge of the relevant facts
Asset Valuation Guidance

- IRC Sec. 408(i)
- Treas. Reg. §1.408-5
- Interpretive Letter EP:R:9 ("Riddle Letter")
- OCC Handbook

Determining Common Alternative Investment FMV Examples

**Private Debt**
- Outstanding principal balance of the loan, plus any accrued interest
- Notes not in good standing may require other supporting evidence to support reduced valuation

**Private Equity**
- Cumulative value of all LLC assets plus cash balances held in an account under the LLC's name
- 3rd-party LLC valuator also can provide an analysis of the overall value

**Real Estate**
- Appraisal
- Comparative market analysis or broker price opinion

**Precious Metals**
- Bar values based on 'spot value'
- Coin values based on daily market pricing summaries 'the Grey Sheets'
How Are IRA Alternative Investments Reported?

Alternative Investments Reporting Form 5498 Codes

A – Stock or other ownership interest in a corporation that is not readily tradable on an established securities market
B – Short- or long-term debt obligation that is not traded on an established securities market
C – Ownership interest in a limited liability company or similar entity (unless interest is traded on established securities market)
D – Real estate
E – Ownership interest in a partnership, trust, or a similar entity (unless interest is traded on an established securities market)
F – Option contract or similar product that is not offered for trade on an established option exchange
G – Other asset that does not have a readily available FMV
H – More than two types of assets (listed in A through G) are held in this IRA
How Are IRA Alternative Investments Reported?

Enter distribution codes to indicate type of distribution and that it does not have a readily available FMV

Alternative Investments Reporting Form 1099-R Codes

K – Use code K to report distributions of IRA assets not having a readily available FMV, including

- Stock or other ownership interest in a corporation
- Short- or long-term debt obligation that is not traded on an established securities market
- Ownership interest in a limited liability company or similar entity (unless interest is traded on established securities market)
- Real estate
- Option contract or similar product that is not offered for trade on an established option exchange
- Other asset that does not have a readily available FMV
Questions?

Thank you for attending

IRA Investments – Beyond CDs

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