



**WHAT CPAs DON'T KNOW THAT THEY NEED
TO KNOW ABOUT SELF-DIRECTED IRA INVESTING.
MOVE YOUR BUSINESS BEYOND TAX RETURNS.**

WEDNESDAY, FEBRUARY 8th, 2006

HOSTED BY TOM ANDERSON, PRESIDENT & CEO, PENSCO TRUST COMPANY

SPECIAL GUESTS:

Barry C. Picker, CPA/PFS, CFP, Picker & Weinberg, CPAs, P.C.

Franklin H. Federmann, MS (Taxation), CFE, CPA / PFS President of Federmann Financial Advisors, Inc.

PENSCO Trust does not give legal or tax advice. We do our best to understand and educate about building wealth through self-directed IRAs. However, you are advised to consult your own legal and tax advisors for specific guidance regarding your investments. This document is for educational purposes only.

What CPAs don't know that they need to know about self-directed IRA investing

BASIC CONCEPTS

- An IRA **CAN** invest directly into domestic and foreign property or any private placement (e.g., British company of any type)
- An investment in real estate helps to protect IRA portfolios from downturns in traditional markets
- An IRA can use leverage to accelerate earnings just like taxable investments
- Income on leveraged investments is subject to UBIT

Possible IRA Investments

- ANYTHING, *but* the following:
 - Collectibles;
 - Life Insurance Contracts;
 - Stock in a Sub-Chapter "S" Corp.
- EVERYTHING else, including real estate

Wealth in U.S.

- 44% of per capita net worth in U.S. is in real estate (per 2001 DOL statistics)
- Yet, it is estimated that less than 2% of total IRAs' asset value is invested in real estate.
- But now, the genie is out of the bottle!

Not all Portfolios are the Fungible*

- Taxable
- Tax deferred (IRAs)
- Tax deferred qualified funds (401-ks)
- Tax-free Roth IRAs

* But each should be optimized

IRA Asset Allocation approaches vary

- Family of mutual funds MF firm
- Certificates of Deposit/MFs Banks
- Stocks/Bonds/MFs/annuities Brokers

IRA asset allocation possibilities at a truly self-directed custodian like PENSCO Trust

All of the above- PLUS:

- Direct Real Estate (foreign and domestic)
- Private Equity
- Private Loans (e.g., trust deeds)
- Land Trusts
- Myriad of other choices

What some CPAs say

- *Don't use an IRA to invest in real estate*
 - Lose tax benefits (e.g. depreciation) (not quite)
 - “destroys” tax deferred compound growth in an IRA (wrong)
 - Have to pay ordinary income tax versus capital gains tax at the end of the line (true, just like any other IRA investment)
 - I don't much about it, but it sounds illegal

What Tom Anderson says:

- CPA view:
 - Does not recognize that after-tax yield is the primary goal of the investor
 - Does *NOT* address need for diversification in the retirement portfolio to hedge against other assets (e.g. MPT)
 - Broadly implies that even if you know that you can get better results through IRA real estate investing you shouldn't do it (discourages people without reason)
 - Is *IRRELEVANT* if real estate out performs other IRA investments
 - *IGNORES* the facts (44% of net worth in this country is in real estate)

Let's compare

Real estate investing

IRAs

- tax deferred growth on income and cap gains
- no 1031 requirement
- no annual tax reporting

Taxable investments

- tax deferred cap gains (if 1031)
- tax on net earnings
- annual reporting required

Examples

An all cash IRA purchase of a rental property

- How is any income treated from a tax perspective?
- Where does the income go?
- When, if ever, is tax paid?
- How are capital gains treated at time of sale?

Examples (cont.)

An IRA land purchase with 25% down

- How is any income taxed?
- How is the tax handled?
- Where does the after-tax (net) income go?
- How is the after-tax income handled in the IRA?
- How does the tax treatment differ from the treatment for taxable investments?
- Does a 1031 exchange come into play?

Examples (cont.)

An IRA investment in a pizza parlor as an LLC member

- Are there any taxes paid on income?
- What about capital gains if membership is sold?
- What if debt is used by the LLC to generate income?
- What if the company was a “C” corporation?

An example of a leveraged real estate IRA purchase and the tax effects

Purchase of a rental property that does not generate income in excess of \$1,000 after deducting expenses

- All cash purchase of \$400K
- Sells after being held one year for a 10% profit

Same example, but with four rentals with 25% down

- Four houses purchased for \$400k each with 25% down and bank financing (income covers mortgage)
- Houses all sold after one year
- What is the tax at time of sale?
- What is the net income to the IRA?

Conclusion

- Leveraged transactions generate \$160K gross income, less \$18K capital gains tax*, for a profit of \$142K and a return of 36%
- Cash purchase generates \$40K gross and tax-deferred return (10% yield)
- Which would you prefer?:
 - 36% after-tax return growing tax-deferred
 - Or a 10% return growing tax-deferred

*could be deferred through 1031 exchange

Conclusion II

- If your clients' IRA real estate investments could generate, on average, a 10% + tax deferred annual return and the Dow Jones generated a cumulative -5% return over five years (1999-2005), would you still recommend that they avoid real estate investments with their IRA?
- No. Yield (after-tax) is the key
- In this real estate case, the difference is \$643K vs \$380K
- With leverage of 75%, 10% annual appreciation, the difference would be \$1,158K vs \$380K

What IRA Owners Can Do...

- Combine:
 - multiple IRAs, SEP IRAs, Roths, 401-K rollovers
 - personal funds,
 - relatives' IRAs,to buy property as co-tenants or LLC members.

Note: income and capital gains on sales have to be prorated based on legal ownership.

Certain Prohibited Transactions

- Can **NOT** buy from or for a direct relative.
- Can **NOT** make personal use of property.
- Can **NOT** use IRAs as collateral for loans.

Personal Use Examples (prohibited)

- Buying a vacation home for your family
- Putting a new roof on yourself
- Hunting on your IRA land
- Lot on Private lake co-owned by an IRA

Have a client that wants to start or run a business?

- You can buy the corner store or own a dry cleaner on your block with your IRA
- There are an estimated 25 million small businesses in the U.S.
- PENSCO has enabled thousands of new startups over the past 16 years.

What's the role of a CPA?

- If your client is using leverage to buy real estate or if the IRA is operating a business then a 990T form will have to be filed if there is any net income or capital gains
- Or, simply provide information passively to maintain good will of your clients by being value-added

What happened in January that is the most important event in the retirement industry since 1974?

- The first day that an individual could contribute to a Solo Roth 401(k)
- Why is this so important?
 - Let me count the ways

How can you learn more?

- Read information and listen to audio conferences on www.PENSCOTrust.com
- LISTEN TO OUR UPCOMING Monthly Webinars. We will e-mail you with all the details in advance, now that you have registered with us.
- Sign up for our "Preferred Professional Program" at www.penscotrust.com
- Read "IRA Wealth" by Pat Rice.
- Buy First National Self-Directed IRA Symposium CDs (call ???????).
- Review all the educational material on our website (www.PENSCOTrust.com), including our free **E-book**.
- Register for our free IRA Alert for new changes affecting the IRA industry and sign up for Tom's free Blog at our web-site.

Guest Speaker:

Franklin H. Federmann, MS (Taxation),
CFE, CPA / PFS President of
Federmann Financial Advisors, Inc.

Federmann Financial Advisors, Inc.

631-981-1904

federmanncpa@msn.com

What does Financial Planning entail in these times?

- What is “comprehensive financial planning”?
- When and how have CPAs begun to practice financial planning?
- Why are CPAs interested in financial planning?
- How is a CPA’s role different than traditional financial planners?
- Why the concepts of diversification and the modern portfolio theory support the incorporation of real estate in IRA portfolios

Why don't more professionals know about the benefits of self-directed IRAs?

- What do you do if your advisor says "I don't know about that"?
- What do you think is the best way to spread the word about the benefits of self-directed IRAs amongst professionals like CPAs?

What is wealth management?

- Who practices wealth management?
- How does a CPA or financial planner become qualified as a wealth management advisor?
- Who needs a “wealth manager”?
- How much do wealth managers cost?
- What model should I follow regarding wealth management?

Asset Management vs. Money Management

- What is the difference?
- What is asset allocation and how does it apply to IRAs?
- What are some of the short, intermediate, and long term investment issues to be considered?
- How do you control volatility?

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Picker & Weinberg, CPAs, P.C.

718-336-8842

barry@pandwcpa.com

www.pandwcpa.com

What are the exit strategies for IRAs?

- What do you do when you reach 70.5 to satisfy your required minimum distribution and you hold real estate in your IRA?
- An IRA as a non-probate asset
- IRA vs. wills or revocable living trust
- How does an IRA relate to an overall estate and wealth management plan?

Should you designate your will, trust or an individual beneficiary for your IRA?

- Why is it important to get it right when determining a beneficiary for your IRA?
- How should you complete your beneficiary forms from your IRA custodian?
- What is “Per Stirpes”?

Who should be the Beneficiary?

- Providing for surviving spouse
- Utilizing Estate tax credit shelter
 - Retirement assets or other assets
- Stretch IRA
 - Let it ride!

A Taxing Situation

- Double Taxation – Estate tax and Income Tax
- Which should come first?
 - Distributing IRA to reduce the tax
- Roth Conversion
- Sec. 691(c) deduction
 - \$\$\$\$ left on the table

Upcoming Webinar:

Wednesday, March 1st

**“How to Invest Your IRA into Private Placements,
Businesses, Pre-IPOs and more”**

Guest Expert, Ami Givon, Attorney

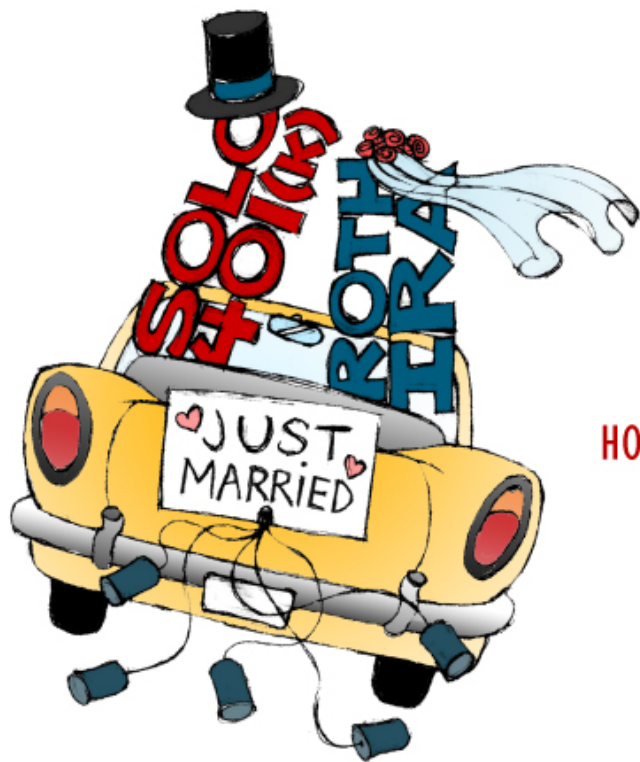
For more information and to register, go to:

<http://www.penscotrust.com/events/WebAndTeleseminars.asp>

Missed last month's webinar?

Go to this webpage to listen to the recording and download the corresponding worksheets:

<http://www.penscotrust.com/education/webandaudioconferences.asp>



The Solo 401(k) and the **NEW** Solo Roth 401(k)

HOSTED BY TOM ANDERSON, PRESIDENT & CEO, PENSICO TRUST COMPANY



If you're a professional and you're interested in adding Self-Directed IRAs as part of your business practice contact us:

Phone: 866-818-4IRA (4472)

Email professionals@pensco.com

Or go to this webpage for more information:

http://www.penscotrust.com/brokers/preferred_professionals.asp

Contact **PENSCO** Trust at:

Business Development Center:

866-818-4IRA(4472)

takecontrol@pensco.com

For more information:

www.PENSCOTrust.com

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