



Every few years we see renewed popularity of Self Directed Individual Retirement Accounts (SDIRA's) also known as Checkbook IRA's. To avoid confusion the "self directed" label is a bit of a misnomer in the sense that individuals investing in IRAs generally select their own investments from choices offered by their IRA custodian and thus self direct. Checkbook IRA is perhaps a better and more popular descriptor for such retirement vehicle.

In brief, the purpose for the checkbook IRA is to allow IRA owners access to a broader and, in some sense, less traditional investment choices. Choices include real estate, precious metals, private placements, debt instruments and other alternative investments. Other investments such as permanent life insurance and collectibles, some of which would be available investments in qualified retirement plans, remain ineligible investments with a checkbook IRA just as with any other form of individual retirement account.

The attraction with these vehicles lies in the fact that People want to control their investments to a greater extent than would be available with traditional bank or brokerage IRA's. Conceptually the IRA custodian allows your IRA to own all of the interests in an LLC and appoint you, the IRA owner, as the manager of the LLC.

Caveat: The problem with that structure is that it is an attempt to get around the statutory requirement that an IRA have a custodian or trustee. Importantly though, the IRA has not formally objected to qualification of Checkbook IRAs. Proponents cite Swanson case, 106 T.C. 76 (1996) as justifying the IRA owner serving as manager of the IRA's single member LLC. There are prohibited transaction and unrelated business taxable income issues to be addressed in each situation.

If there is a prohibited transaction in an IRA, you are immediately taxable on 100% of the account. By contrast with a qualified plan there is simply an excise tax, usually only 15% of the amount involved suggesting less risk in making these investments in a qualified plan if that is an option.

Perhaps the most important due diligence to perform is to investigate the background of the promoter and would-be custodian being considered. Remember that whenever granting custody of your assets, there is the possibility for fraud and embezzlement.

While not an investment vehicle to shy away from in the grand scheme of things, proper vetting and planning is the key to success or failure. If you decide to explore this option, give us a call. Sound tax law advice can make the difference between a good and a disastrous result.

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