UDirect IRA

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# Self-Directed IRA Investments

An IRA can be a very tax-efficient method for saving for retirement and beyond. Moreover, a self-directed individual retirement account, or SDIRA, can provide significant flexibility in investing the assets of an IRA. For example, a SDIRA is not limited to investments such as stocks, bonds, and mutual funds, but can include assets such as real estate, limited partnership interests, closely-held stocks, and more. Before making an investment with a SDRIA, however, it is extremely important to understand the rules and restrictions surrounding IRAs. This summary is intended to provide a very brief description of some of the rules and restrictions that apply to SDIRAs and other types of IRAs. ***Please note, however, this summary is for informational purposes only, and it is not intended to provide, and should not be relied upon for, tax, legal, accounting, or investment advice. In addition, United Bank serves only as a neutral SDIRA custodian. It does not provide tax, legal, accounting, or investment advice, and is not a fiduciary. Any individual considering a SDIRA is encouraged to consult with his or her own tax, legal, accounting, and investment advisors before engaging in any transaction or making any investment involving a SDIRA.***

## Prohibited Investments

As an initial matter, the law outright prohibits certain investments by a SDIRA. These investments include:

- Life insurance.
- Collectibles, such as works of art, rugs, stamps and antiques.
- Gems and jewelry.
- Coins (with certain exceptions).
- Alcoholic beverages and other tangible personal property.

Also, due to the shareholder restrictions imposed on S-Corporations, a SDIRA cannot own S-Corporation stock. IRS Publication 590 contains further information on prohibited SDIRA investments.

## Prohibited Transactions

In addition to restricting certain investments, the law prohibits certain transactions between a SDIRA and a "disqualified person" (described below). These transactions are referred to as "prohibited transactions." A prohibited transaction includes, for example:

- A sale or exchange, or leasing, of any property, or a loan or extension of credit, between the SDIRA and a disqualified person.

- The furnishing of goods, services, or facilities between the SDIRA and a disqualified person.

- The transfer to, or use by or for the benefit of, a disqualified person of any assets of the SDIRA.

For this purpose, a “disqualified person” includes (but is not limited to) the SDIRA owner and members of his or her family (spouse, ancestor, lineal descendant, and any spouse of a lineal descendant), any business owned 50% or more by any of these individuals; and any service provider to the SDIRA, such as a financial planner, accountant, or attorney.

Prohibited transactions also include other actions and investments that do not necessarily involve a disqualified person. These are sometimes referred to as “self-dealing” or “indirect benefit” prohibited transaction, and can result from the following situations:

- If the SDIRA owner deals with the SDIRA assets in his or her own interest or for his or her own account.

- If the SDIRA owner receives any consideration for his or her own personal account from any party dealing with the SDIRA.

Examples of prohibited transactions include:

- Buying a home for your parents with your SDIRA.

- Purchasing a personal vacation property with your SDIRA.

- Making a loan to your son with your SDIRA funds.

- Personally receiving a commission on the sale of property from your SDIRA.

- Pledging your SDIRA account as security for a personal loan.

- Selling an asset held by your SDIRA to your son.

Again, these are only examples; there are many other types of transactions and investments that can result in a prohibited transaction. For example, it would also be a prohibited transaction for a SDIRA owner to personally make a significant repair or improvement to property owned by the SDIRA, and then to seek reimbursement from the SDIRA for that repair or improvement. Generally, in these situations, repairs or improvements should be made by independent third-party service providers, who are then paid from the SDIRA.

**Consequences of Prohibited Transactions**

The consequences of engaging in a prohibited transaction can be significant. If a SDIRA owner, or his or her beneficiaries, engages in a prohibited transaction at any time during a year, the SDIRA account stops being an IRA as of the first day of that year, and the SDIRA is treated as if it had distributed all of its assets to the SDIRA owner at their fair market values on the first day of that year. Thus, the SDIRA owner will have taxable ordinary income to the extent the value of the SDIRA is greater than his or her basis in the SDIRA (although generally there is no "basis" in an IRA unless after-tax contributions were previously made to the IRA). A 10% premature distribution excise tax may also apply if the SDIRA owner is under age 59½.

Prior to entering into any transaction or making any investment suspected to be prohibited, a SDIRA owner should seek legal advice to determine whether a prohibited transaction may occur; and if the transaction or investment is statutorily exempted from the prohibited transaction rules (or whether an individual prohibited transaction exemption may be obtained from the Department of Labor).

**Unrelated Business Taxable Income**

Another area which can affect a SDIRA is "unrelated business income tax," or UBIT. Generally certain investments can generate UBIT, causing such income to be taxed. The purpose of the UBIT rules is to place tax-exempt entities, such as SDIRAs, on a "level playing field" with taxable businesses. UBIT can be generated from an activity if all of the following conditions apply to the activity:

- It is a trade or business,
- It is regularly carried on, and
- It is not substantially related to furthering the tax-exempt status.

However, many activities, including traditional investing in stocks, bonds, etc. generally are exempt from UBIT. Traditional income from real estate is also exempt (although see below).

Generally, SDIRA investments that can generate UBIT include:

- Limited Partnerships, and
- Limited Liability Companies.

(A SDIRA investing in a trade or business using a C-Corporation generally will not have UBIT.) Also, generally, any investment that incurs debt financing (resulting in unrelated debt financed income, or UDFI) effectively results in UBIT. So, for example, rental income from real estate produced via debt financing ordinarily would be UDFI (and UBIT). UBIT is reported on IRS Form 990-T.

**Appraisal Requirements**

Certain SDIRA investments may also be subject to appraisal requirements. These would generally include investments that are not traded on a national securities exchange (such as the NYSE), quoted on the National Association of Securities Dealers Automated Quotations System (NASDAQ) or reported on the NASDAQ OTC Bulletin Board Service. In general, all SDIRA assets must be valued annually, and an appraisal is required when an in-kind distribution is made from the SDIRA or when a minimum required distribution (which begins when the SDIRA owner attains age 70½) is made. Importantly, the cost of any appraisal or valuation method should be paid from the SDIRA itself, and not from the personal funds of the SDIRA owner. United Bank has adopted an appraisal policy which sets forth the appraisal requirements, the minimum qualifications of the appraiser in various situations, circumstances in which reliance on other valuation methods may be acceptable, etc. A copy of this policy is available upon request.