How to Make your IRA Work for You in Real Estate

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Last month I wrote about how you can use your IRA funds to obtain financing for the purchase of real estate. This is a continuation of that same theme with some variations. Let's presume, for a moment, that you don't have enough funds in your IRA account for the 30% to 35% down payment that most 'non-recourse' lenders require for that single family investment property you would like your IRA to purchase. Moreover, you know you're going to need to keep some reserve funds for property taxes, insurance, maintenance and any mort gage payment shortfalls.

Taking these factors into account, you can still make that investment property purchase by combining your IRA funds with other people's money (OPM). You can partner with relatives and/or friends to complete this purchase providing that it is an all cash transaction. You cannot procure a loan to make this purchase if you are combining your IRA funds with those of others.

However, you can combine your IRA funds with the funds of others and/or your own personal funds providing you establish a separate entity known as an LLC, a limited liability corporation. We live in corporate America and when you establish a corporation, suddenly you're able to do a lot of things you otherwise could not do. Once an LLC is formed, the IRA holder and the members of the LLC can combine to obtain that leverage you were originally seeking and obtain a non-recourse loan.

Your IRA custodian would go on title for the benefit of your IRA and your IRA would own that percentage of the property as represented by the amount it invested in relation to the purchase price of the property. The remaining down payment coming from the LLC would own its respective percentage of the property.

What about taxes when you sell the property owned by your IRA? This is a major benefit to having your IRA own real estate. The percentage of ownership that your IRA has in the property is the same percentage of profits that your IRA will retain without paying any taxes. Assuming that your IRA holds the property for a least one year, you will only have to pay a long term capital gains tax on the percentage of gains represented by the same percentage of financing that you obtained for the purchase of the property. This is called 'Unrealized Debt Financing' (UDFI).

For example, let's say that your IRA purchased a single family investment property eighteen months ago for $450,000. The down payment from your IRA was 30% or $135,000. The property is now worth $550,000; there's a $100,000 gain. Thirty percent of that gain returns to the IRA without any taxes owing. The remaining 70% of that $100,000 gain is taxed at the federal tax long term gain rate of 15% plus whatever your respective state tax long term gain rate might be. Please check with your tax advisor for that information. In summary, of the $100,000 profit your property earned, you will have only paid approximately $10,000 to $15,000 in taxes. The remaining profits go back into your IRA. Your IRA has now increased substantially in value and has a greater amount of funds for its next purchase.

Now you can see how much more beneficial it is to purchase property with your IRA. For more information on making your IRA funds work harder for you, please contact Mark Robbins at CTX Mortgage, 877-893-9100 or email at: ask.mark@ctxmort.com

Mark Robbins will be one of the featured speakers at East Bay Wealth Builders club meeting in July 2005 at the Fremont Marriott from 6 pm to 9 pm.