



**Understanding  
Self-Directed IRAs**



## About Midland

The Midland family of companies is a leading custodial services provider in the United States focused on self-directed IRA accounts, 1031 exchanges, and private fund custody services. In business for over 25 years, Midland prides itself on being the most responsive company in its industry.

Midland is focused on providing clients with as many opportunities as possible to defer or eliminate taxes through both self-directed savings plans and 1031 exchanges.

Midland's services give our clients complete control over their investment decisions by allowing them the ability to self-direct their retirement plan into real estate, notes, private placements or other alternative investments. Our 1031 services focus on tax-free exchanges for real estate investors.

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### Serving Clients Nationwide

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Midland Trust is an administrator.



## Why Choose Midland

### Experience

With tens of thousands of clients nationwide and over \$2 billion in client assets, Midland gives you the peace of mind you desire in choosing an experienced administrator for your self-directed accounts. Many of our staff members have also achieved the designation of Certified IRA Services Professional (CISP).

### True Self-Direction

Midland is not a fiduciary. We make no commission. We do not sell investments. We do not give legal, tax or investment advice, but our offices are operated by individuals with backgrounds in the legal and tax fields. We work at your direction to fully administrate the needs and requirements of investments you choose.

### Education

Midland IRA offers cutting-edge educational curriculum designed for all types of investors to learn about self-directed accounts as well as the types of investments that are and are not permitted inside retirement plans.

### Experience the Difference

Between dedicated client service representatives and robust technological efficiencies, Midland can perform transactions on your behalf within 24-48 hours in most cases. Our online client portal, [Midland360.com](http://Midland360.com), provides clients 24 hour access to make contributions, request distributions, view statements and tax documents, and pay bills associated with assets held in their retirement plan.

## **What is a Self-Directed IRA**

**A self-directed IRA is not a special type of IRA.**

The term self-directed simply refers to the way the account is administrated and the greater choice of investment options available to the account owner. More conventional retirement accounts involve a third party, such as a broker or other account administrator, who assists in the purchase of various publicly traded assets. Self-directed IRAs are invested solely at the discretion of the owner of that account who directs the account administrator (such as Midland IRA) to purchase assets that are outside of the norm when it comes to retirement plans. Investment accounts that can be self-directed include: traditional, Roth, SEP and SIMPLE IRAs, as well as educational and health savings plans.

### **Who should consider a self-directed IRA?**

Anyone who wants to take control of his/her retirement investments, or who is unhappy with their current retirement plan returns, should consider a self-directed account. Most typical IRA custodians (like banks and brokerage firms) only allow you to invest in the products they sell. These include more "traditional" investments such as stocks, bonds, and mutual funds. Non-traditional or alternative investments commonly acquired with self-directed IRAs are not widely known because the majority of IRA custodians do not offer these assets as investment options, so they do not promote them.

The IRS permits a wide variety of assets, but each custodian decides which assets it is willing to hold. Midland IRA does not sell products or offer financial advice, and therefore, does not limit your investment decisions. In fact we exist as an IRA administrator to encourage people to take control and self-direct their retirement accounts.

**Alternative investments permitted within a self-directed IRA include:**

- ▶ Real estate
- ▶ Notes and mortgages
- ▶ Partnerships/LLCs
- ▶ Private placements and private stock
- ▶ Single-member LLCs (checkbook IRAs)
- ▶ Futures and foreign exchange (forex) trading
- ▶ Precious metals and more



## The Advantages of Investing with IRA Funds

There are three primary reasons people invest with self-directed IRAs:

### **Alternate source of funding**

When you are considering investments in real estate, private loans, or private companies, you may not realize that IRA funds can facilitate those investments. You may simply look to your personal savings accounts to acquire these assets. However, you are allowed to use funds from a self-directed IRA to make these investments and more. By doing so, you may find a potentially large source of additional monies to make these different types of investments.

### **Looking for higher returns**

Most retirement funds (close to 95 percent) are invested in accounts through a brokerage firm or bank, which offers limited investment choices. Most people have been conditioned to think that only securitized investments like stocks, bonds, and mutual funds are the only options for investing their retirement dollars. Individuals who are unsatisfied with the returns these accounts earn often look for alternative investments, leading them to discover the self-directed IRA. Additionally, individuals learn that by using self-directed IRAs, they can invest in other types of assets they possibly understand much better than those offered at more traditional institutions. Investing in what you know and understand can lead to higher returns within the retirement account.

### **Tax-free or tax-deferred growth (time value of money)**

The time value of money simplified is the assumption that at the present time, money is worth more than the same amount will be worth in the future. Why would you want to pay the IRS capital gain taxes after each investment sale when you have the ability through an IRA to pay taxes later? The money you save in taxes can be invested to create even higher wealth. By choosing to invest in alternative assets, an IRA owner can potentially earn greater returns through these assets that may help the IRA grow at a fast pace, resulting in higher account values within a shorter time frame.

## What Plans are Available for Self-Direction?

### **Traditional IRA**

A tax-deferred retirement savings plan for individuals. Contributions and earnings are only taxed when distributions are taken. Former employer plans can be directly rolled into a traditional IRA without tax consequences.

### **Roth IRA**

A retirement savings plan for individuals based on tax contributions, not tax-deferred contributions. The earnings are tax-free once distributions begin provided the IRA owner is over the age of 59 1/2 and has had a Roth IRA for at least five years.

### **Simplified Employee Pension (SEP) IRA**

A SEP IRA allows an employer (typically a small business or self-employed individual) to make larger retirement plan contributions into a traditional IRA established in the employee's name.





## **Savings Incentive Match Plan for Employees (SIMPLE) IRA**

The SIMPLE IRA is available to employers with 100 or fewer employees and allows for both employer and employee contributions, similar to a 401(k) plan.

## **Qualified Plan**

Qualified plans, such as employer 401(k), 403(b), profit sharing plans, or individual 401(k) accounts for the self-employed can be self-directed in many cases.

## **Health Savings Account (HSA)**

An HSA is the only type of savings plan that offers three tax advantages: a deduction for contributions, tax-free earnings, and tax-free withdrawals.

## **Educational Savings Account (ESA)**

ESAs are savings accounts for your child's (or grandchild's) higher education. The money you put into this account is taxed but the earnings are not taxed.



## What Type of Investments Qualify for a Self-Directed IRA?

### ● Real Estate

An investor can purchase vacant land and residential or commercial property with an IRA. Income (profits from a sale or rental proceeds) flows back to the IRA, tax-deferred. Expenses (such as property taxes, association maintenance dues, etc.) are paid by the IRA. Rehab properties, as well as properties in the foreclosure process, can be purchased as assets in an IRA.

### ● Notes and Mortgages

Many of our clients use their IRAs to lend money to third parties. All loan payments (principal and interest) flow back into the IRA, tax-deferred. The majority of lending we see are safe, secured loans with the property used as collateral. An IRA can also loan money via an unsecured promissory note. Secured notes are backed by collateral, such as property and deeds of trust providing the lender additional assurance of the return of the loan amount and interest. Unsecured notes are not backed by collateral, and as such, constitute a higher risk - and sometimes reward - than a secured note.

### ● Partnerships/ LLCs

Often, individuals want to make an IRA investment in conjunction with several other investors. In many cases, the group of investors will form a partnership or LLC to make things easier to combine funds. The partnership or LLC can be formed for a number of reasons (holding real estate, making private loans, creating a private hedge fund, etc.) and the IRA can join as a partner in that entity. The IRA then shares in the profits and losses of the entity in accordance with its percentage of ownership. In most cases, the returns are not taxable to the IRA, although depending on the type and purpose of the entity, the IRA may be subject to unrelated business income tax (UBIT).

### ● Private Placements and Private Stock

Private or closed corporation stock offerings are not available to the public on the open market. Normally, they are made to pre-qualified individuals, referred to as "accredited investors."

Often, many community banks or start-up companies seek to raise capital by offering stock. IRAs can be used to purchase these shares. Recently, crowdfunding opportunities that carry less risk have become available to investors of all levels of experience who do not have to meet qualification terms to participate.

### ● **Single-Member LLCs (Checkbook IRAs)**

Also known as a single-member LLC, the checkbook IRA is an investment strategy by which the IRA owner elects to form an LLC to be entirely owned by his/her IRA account and the IRA owner is elected to manage that asset. This gives the IRA owner a greater deal of control over the investments held by that IRA. Individuals considering the checkbook control LLC are strongly encouraged to consult with legal and tax professionals on how to best form and operate the entity without running afoul of IRS rules.

### ● **Futures and Foreign Exchange (Forex) Trading**

IRAs can be used to set up brokerage accounts with a futures or foreign exchange (forex) trading company. The client either makes trades himself/herself, or the client gives power of attorney to someone who specializes in trading these assets.

### ● **Precious Metals**

Certain gold bullion, U.S. treasury coins or palladium are allowed by the IRS for IRA investments. Typically the coin or bullion must be 99.5 percent pure metal in order to qualify as an IRA investment. The IRA owner must make sure the coin's value is not deemed collectible in nature, but instead determined by the value of the metal on the open market.

### ● **Other Investments**

Aside from all of the investments listed above, an IRA can invest in lease options, tax liens/certificates, real estate options, structured settlements, foreign property, oil and gas options, and much more. In fact, so many different types of investments can be made, they are not all listed. Instead, the IRS only lists the limits of IRA investments to a few different types of assets.

## What Types of Investments are not Permitted within a Self-Directed IRA?

The IRS prohibits investments made in two categories. Your self-directed IRA may not invest in life insurance products or collectibles, which include:

- ▶ Works of art
- ▶ Metals other than certain gold, silver, and palladium
- ▶ Stamps
- ▶ Coins
- ▶ Alcoholic beverages
- ▶ Viaticals

### Prohibited Transactions

Self-directed IRAs provide a great deal of freedom, flexibility, and choice of potential investments. However, they are also governed by a set of rules self-directed investors must be aware of and follow. In addition to the prohibited investments above, there are certain transactions (and more specifically, individuals) that can disqualify an investment within your IRA. These prohibited transactions can defeat the tax benefits your IRA offers and can subject the IRA to fines and penalties, as well.

Your retirement account is intended to benefit you when you retire and not before. Transactions that can be interpreted as providing immediate financial gain to account holders are not allowed. Many of these arrangements are laid out in Section 4975 of the IRS code.

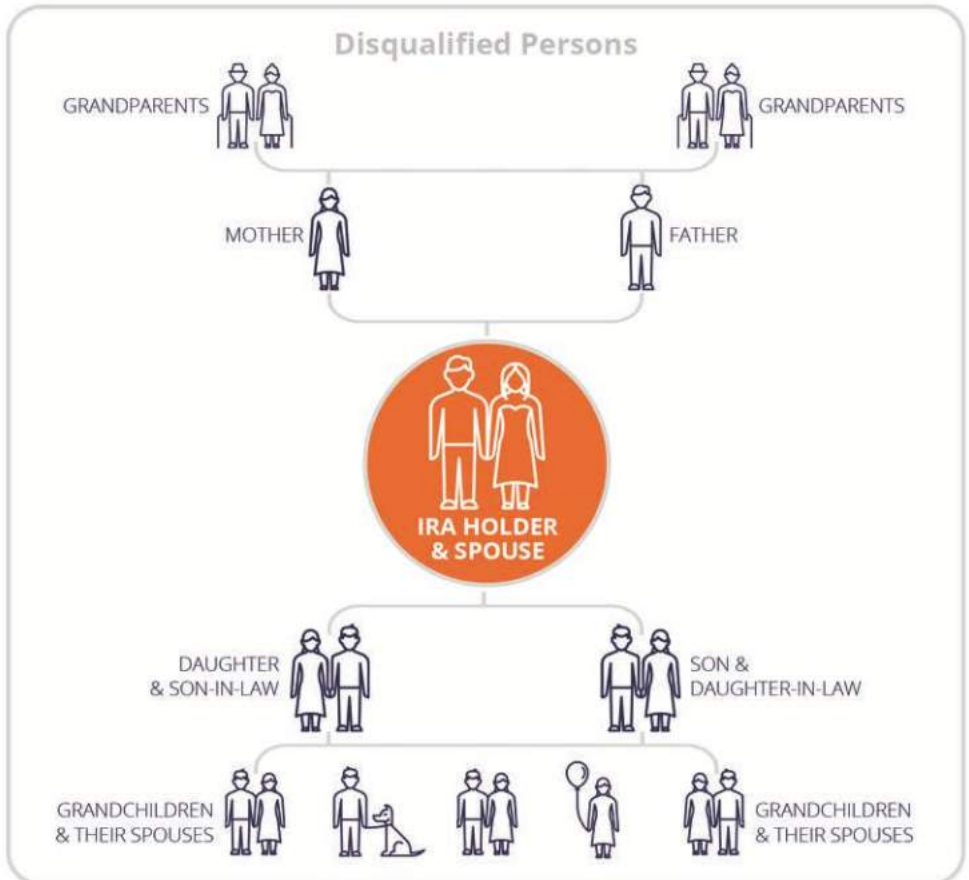
For example, IRA holders may not:

- ▶ Borrow money from their IRA
- ▶ Sell, exchange or lease property to their IRA
- ▶ Receive compensation for managing property in their IRA
- ▶ Use their IRA as security for a loan
- ▶ Transfer plan income or assets to disqualified persons
- ▶ Lend money to disqualified persons
- ▶ Extend credit on their IRA to disqualified persons
- ▶ Furnish goods, services or facilities to disqualified persons
- ▶ Allow fiduciaries to obtain or use the plan's income or assets for their own interest

## Disqualified Persons

For most of the disqualifying arrangements outlined, the transaction involves the IRA and a disqualified person. Therefore, it is important to understand who is considered a disqualified person for an IRA. These individuals include:

- ▶ IRA holder and his or her spouse
- ▶ The IRA holder's lineal ascendants, lineal descendants, and spouses of lineal descendants
- ▶ Investment advisors and managers
- ▶ Any corporation, partnership, trust or estate in which a disqualified person has 50 percent or greater interest or in which the disqualified person maintains control as a president manager, etc.
- ▶ Anyone providing services to the IRA such as the trustee or custodian



## What Documentation is Involved in Purchasing an Asset?

**Real Estate** ▶ With real estate, the contract must be listed in the name of the IRA and signed by Midland Trust as the administrator of the account. The contract and title include the name of Midland Trust. An example of how a title is held would be "Midland Trust Company as Custodian FBO John Smith, IRA #12345." Prior to closing, the IRA owner is required to review and approve all closing documents. Midland Trust signs the documents on behalf of the IRA.

**Notes and Mortgages** ▶ For notes and mortgages, Midland Trust needs to see the loan documents where the lender is listed as the IRA account (Midland Trust Company as Custodian FBO John Smith, IRA #12345). The IRA owner must read and approve the actual note as well as any mortgage or other agreement to secure collateral. If the loan is not being handled through an escrow agent (like an attorney or title company), Midland Trust must be in possession of the original signed note prior to funding.

**LLC, LLP, and Private Stock Investments** ▶ For newly formed LLCs or LLPs, generally the IRA is one of the members on the operating/partnership agreement. For example, there may be four equal owners to the LLC and one of the four will be: Midland Trust Company as Custodian FBO John Smith, IRA #12345-25 percent. Midland Trust signs the agreement on behalf of the IRA. The IRA owner is required to approve the operating/partnership agreement.

With some LLCs, LLPs, and private stock, there is a subscription agreement which the IRA owner must fill out to purchase an interest in the entity. The IRA owner fills out this agreement in the name of their IRA (Midland Trust Company as Custodian FBO John Smith, IRA #12345) and directs Midland to sign the document on behalf of the IRA.

## Frequently Asked Questions About Alternative Assets

### **Why haven't I heard about a self-directed IRA before?**

Most IRA administrators only offer products they sell, which typically involve stocks, bonds, and mutual funds. Self-directed IRA administrators allow you to choose alternative investments. When you self-direct you control your own investment choices and can potentially build wealth in your accounts by investing in what you know best.

### **If my IRA does not have any funds to purchase an investment outright, can I partner with my personal funds? Who else could I partner with?**

If your IRA cannot afford the investment you are interested in, you have several options:

- ▶ Partner your IRA funds with your personal funds. For example, your IRA can own 50 percent and you can personally own 50 percent of the asset(s), which would make you tenants in common.
- ▶ Your IRA can partner with funds you personally guarantee, that are secured by property other than the investment.
- ▶ Partner your IRA funds with someone else's personal or IRA funds. Please note: the disqualified persons rule may not apply here since you are not transacting with the individual. Therefore, it is possible to partner with your spouse, parent or child.

### **How are the assets managed?**

#### **How are income and expenses handled?**

You manage the asset by directing Midland's actions on your behalf. For example, in regard to real estate transactions, you would find the tenants, create rental agreements, decide on improvements, etc. Income must be deposited directly into the IRA. Midland as the administrator of the account will pay expenses related to the IRA asset from the cash held in the IRA. You cannot be reimbursed for any expenses the property may have, nor should you pay these expenses personally. You can either direct Midland to make a payment from your IRA or have a third-party property manager handle income and expenses. You can check your online statement to make sure your IRA received a payment. Midland's system also generates an automatic email when funds are deposited to the account.

## What's Next?

### **Open an Account**

Fill out an IRA account application by visiting [apply.midlandira.com](http://apply.midlandira.com) and submit the originals to Midland Trust. Application documents can be found on our website or you can contact us and we will send you the paperwork.

### **Fund the Account**

Transfer funds from an existing IRA or rollover funds from a former employer's plan. If you are eligible, you can also make an annual contribution to your IRA.

### **Start Investing**

Send Midland Trust a purchase authorization after an investment has been identified. Once an account is opened, we can immediately begin working with you on the investment paperwork.

### **Contact Midland to Get Started!**

[www.midlandtrust.com](http://www.midlandtrust.com)  
(239) 333-1032

### **Do you own investment real estate outside of your retirement account? Consider a 1031 exchange.**

Learn more by visiting: [www.midland1031.com](http://www.midland1031.com)