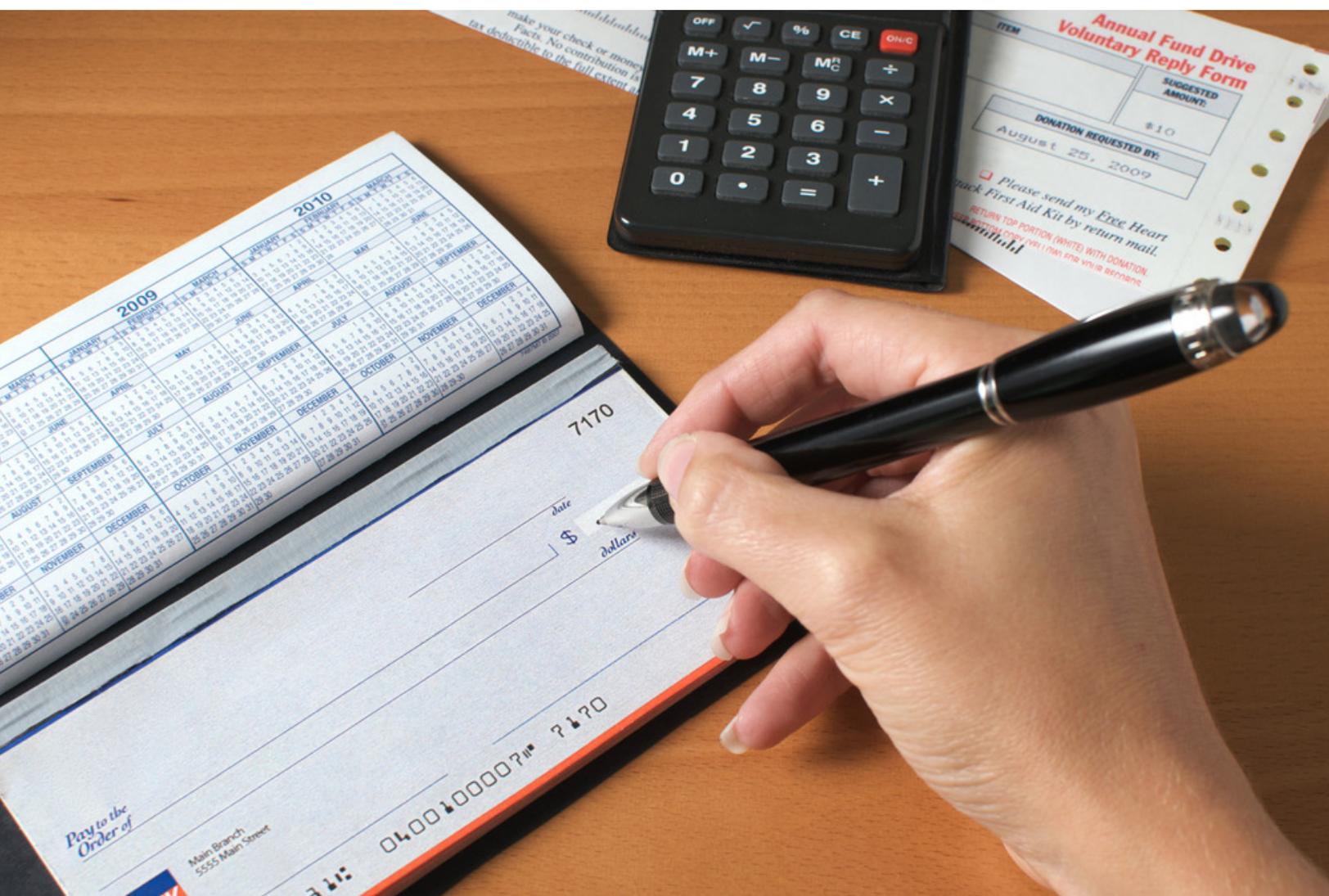


# CHECKBOOK IRA INVESTING GUIDE

Find out about  
Checkbook IRA  
Investing



New Direction  
TRUST COMPANY

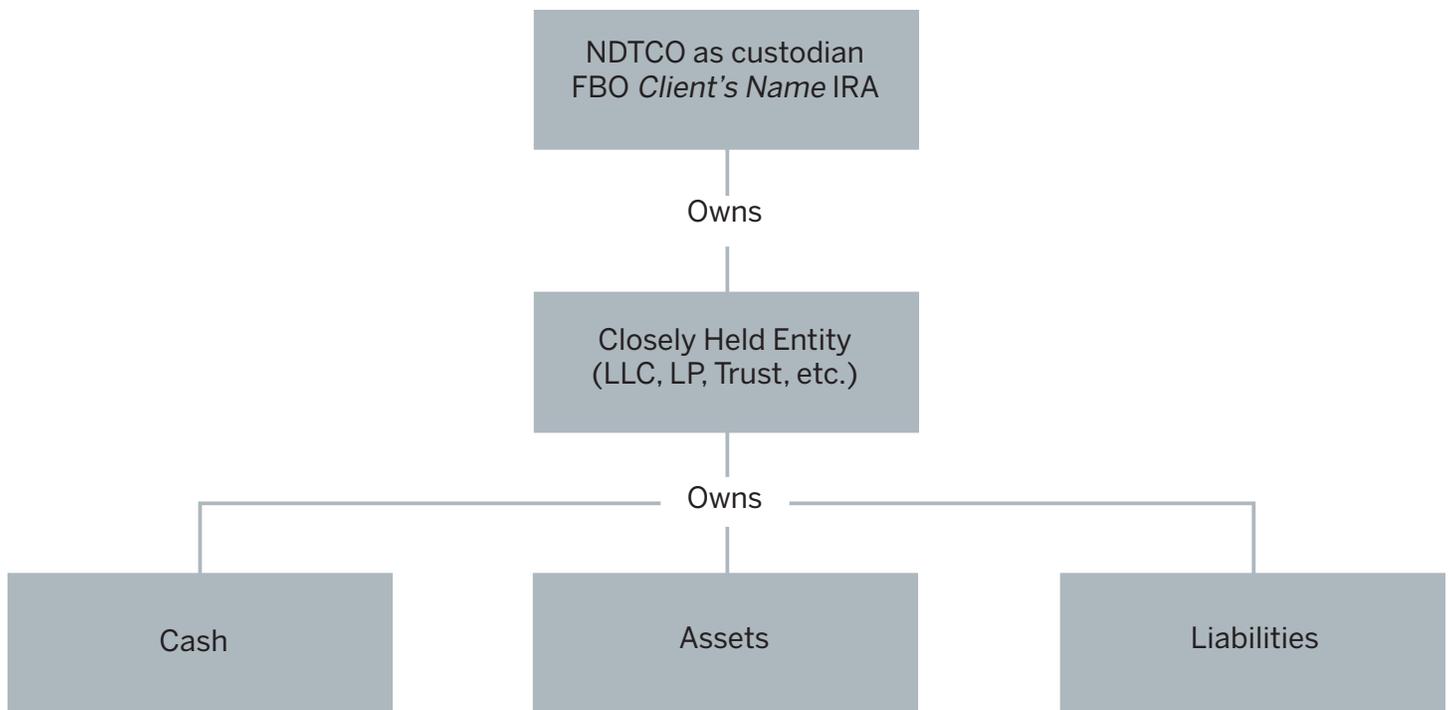


# Checkbook IRA

## Introduction

Some IRA investment strategies require a large number of disbursements from the IRA and/or the need to disburse funds quickly. To achieve this level of flexibility, some IRA investors choose a strategy called *Checkbook Control* which creates the ability of the IRA holder to write checks with IRA money. This structure is sometimes referred to as a Checkbook Control IRA, a Checkbook IRA, or a Checkbook LLC. Compared to a direct IRA investment, the LLC approach will likely involve additional set-up time, expenses (ideally offset by fee savings), operational responsibilities, and risk tolerance.

The set-up of Checkbook Control, starts with the fact that the IRS allows an IRA (Traditional or ROTH, SEP or SIMPLE), Solo 401(k), HSA, or ESA to invest in an entity (in any percentage), as an investment while keeping the tax benefits associated with that account type. This entity can be a “closely-held” entity, meaning that the IRA holder or another disqualified person is the manager of the entity.



The most common iteration of Checkbook Control starts with the IRA holder having an entity created such as an LLC, C-Corp, Limited Partnership, or Trust. The IRA can't be a member of an S-Corp or be a General Partner in a partnership. The IRA then buys 100% interest in the entity (let's call it an LLC), meaning the IRA provider sends a check made out to the LLC. With the funding check and applicable documents in hand, the IRA holder then opens a checking account on behalf of the LLC. Once open and funded, the entity may access the checking account to initiate investment activities.

# Checkbook IRA

## Why is Checkbook Control Considered a Gray Area?

The court case that is most often pointed to when discussing the legality of a closely-held entity is *Swanson vs. Commissioner* 106 T.C. 76 (1996). Mr. Swanson was operating a closely-held LLC where his IRA was the sole shareholder, and he was named manager after creation. Mr. Swanson was suing over legal fees incurred when the IRS tried to claim that his IRA was involved in a prohibited transaction. While the lawsuit was mainly regarding repayment of attorney fees, it did raise questions as to whether this structure is allowable- can the IRA wholly own an entity; can the account holder act as the manager over their retirement funds, and can the asset retain its tax-free or tax-deferred status?

The IRS lost the lawsuit and later released documents affirming the ruling and expanding further on some of the rules about transactions that the entity can participate in. Much is left unknown as to some of the legalities of the structure. Though the structure is considered legal, it can be scrutinized on the dealings and purchases the entity makes. The flexibility of checkbook control will require additional care by the IRA holder in avoiding prohibited transactions, but it is important to remember that the closely-held entity is an asset among your portfolio of self-directed assets. As such, your responsibilities as the plan holder of a Checkbook IRA will be no different than the custodian that typically holds the investments made by the entity. The account holder will have to understand that the rules remain hard and fast, regardless of the structure being used for the investment.

## Benefits of Checkbook IRAs

- Having a bank account set up in the name of the closely-held entity allows for quicker reactions and more control for paying expenses and making investments.
- Lower fees from IRA Custodians, but bank and bookkeeping fees may or may not outweigh IRA provider fees.
- The manager of the entity has power over signing investment documents for any purchases that the entity makes with the IRA funds.

## Titling Instructions

When the IRA becomes a member/partner/etc. of the entity, the membership is titled in the name of the IRA.

NDTCO as custodian FBO *John A. Smith* Trad IRA (or NDTCO as custodian FBO Account Number 123456)  
Address: 1070 W. Century Drive  
Louisville, CO 80027

Once the entity is in place and active, all investment documents will be in the entity's name. The designated business address, contact information, and Tax Identification Number will be unique to the entity as well.

## Cash Flow

All expenses related to the setup of the entity (including Attorney Opinion Letter) are paid by the IRA. If UBIT is due on the IRA investments made by the LLC or entity, that tax is paid by the IRA.

Should the account holder want to take a distribution from the IRA, the funds must be at NDTCO to be properly recorded and reported. Any distributions taken directly from the entity's bank account is considered a prohibited transaction and could have tax consequences and the possibility of penalties from the IRS.

# Checkbook IRA

## Capital Calls & Additional Fundings

A capital call, installment or additional funding is very similar to the initial purchase process. Should your Checkbook IRA investment require a capital call or additional funding, New Direction Trust Company can assist with the process. Please note that additional funding depends on whether or not the operating agreement of the company allows for it. Please contact our offices with any questions regarding this matter.

## Important Things to Know

The entity manager will be tasked with the creation of the entity and filing all of the necessary documentation for the entity. It is highly recommended that you consult a competent attorney or tax professional that is familiar with retirement accounts, tax law and IRS rules to create the entity documents, although this is not a requirement.

New Direction Trust Company requires an *Attorney's Opinion Letter* be provided for these structures, if you, the IRA holder, or another disqualified person will be appointed manager of the entity after the funding. The Attorney's Opinion Letter must affirm that, according to IRC 4975, the funding of this structure does not constitute a prohibited transaction.

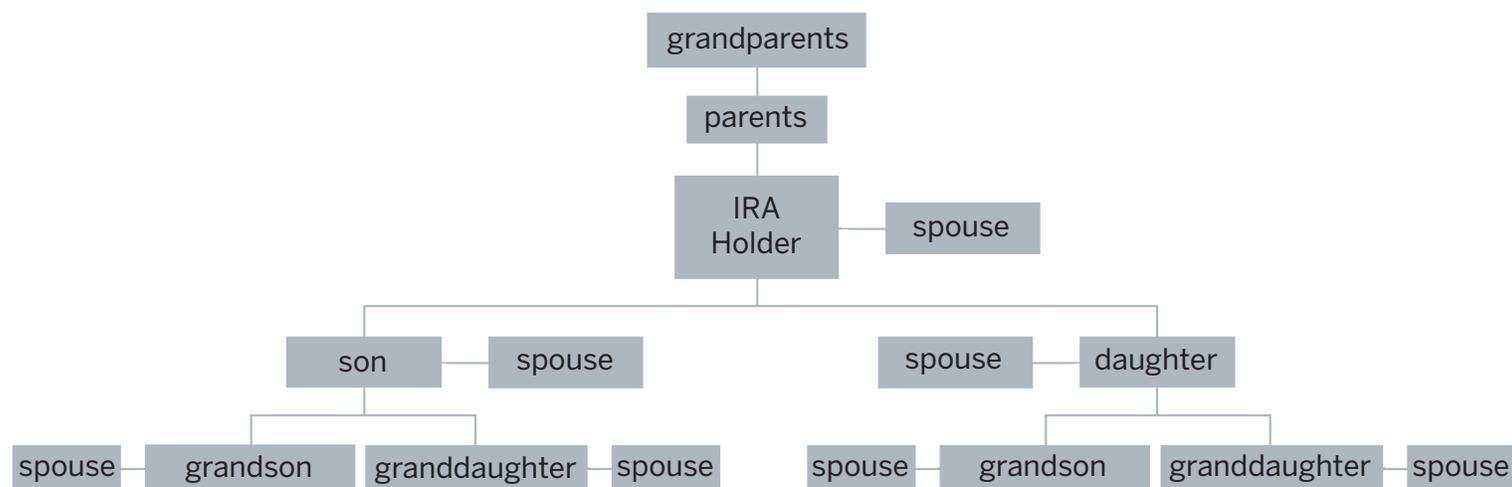
A Checkbook Control IRA that is managed by the IRA owner is considered a "high risk" investment because your IRA funds are in a checking account that you control. Not only is it important that these funds be used solely for the IRA and its assets, there can be absolutely no "self-dealing" with regard to the assets purchased or services provided to the asset. As the manager or trustee of the entity, it is also your responsibility to understand the Prohibited Transaction rules as stated in IRC 4975.

## IRC Section 4975: Prohibited Transactions

Because you are still using tax-advantaged funds for the entities investments, all of the rules do still apply for each asset class. IRC section 4975 applies to each investment the entity makes.

When an IRA buys into an entity, that entity is required to comply with the IRS prohibited transaction rules. These rules also apply to any entity that a disqualified person owns or controls.

### Disqualified Persons Includes:



# Checkbook IRA

## These Disqualified Persons Cannot:

- Directly or indirectly receive benefit from the investments that the entity makes with IRA funds. This can include:
  - Living or operating a personal company in a piece of real estate the entity owns.
  - Accepting investments from the entity by a company a disqualified person owns and controls.
  - Receiving a loan from the entity.
  - Doing any contract work for the entity and its investments.
- Purchase or sell shares of the entity between any of these persons and the IRA.
- Be employed by or receive compensation from the entity.
- Pay expenses on behalf of the entity or be reimbursed for any expenses by the entity.

Entering into a prohibited transaction, such as providing goods or services to your IRA-owned entity or making loans, advances or other transactions with your IRA-owned asset, will typically result in your IRA being distributed to you as of January 1st of that year.

A distribution results in you having to pay income tax and/or penalties and interest on the amount distributed effective that year. Because the prohibited transaction may not be discovered right away, penalties and interest can potentially go back multiple years.

## Due Diligence

Because neither the IRS nor NDTCO researches or endorses any investments, the IRA holder is responsible for performing due diligence on all their investments. Visit our website for more information on due diligence and ways to protect yourself from investment scams. A competent professional in the legal, financial, or accounting fields can also be engaged if you need additional advisement. Any of these legal professionals can assist in deciding if the investment being considered is legitimate, meets your risk tolerance parameters, and is right for your investment goals.

## Fair Market Valuations

The entity must be valued annually. The IRA holder is responsible for delivering this information from a third party.

A value of each asset within the entity is required in order to determine the value of the entity as a whole, as well as supporting documents showing that they are correctly titled to the entity.

Real estate assets owned in an entity must be evaluated by a third party using the same standards as if it were owned directly by the IRA.

Other assets such as bank or brokerage accounts should have year-end statements proving their value.

If you need further guidance on how to determine the value of the entity, consult your accountant.

K-1s are not acceptable valuations because they represent the book value of the company which is based on historical cost less depreciation.

# Checkbook IRA

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## Unrelated Business Income Tax (UBIT)

Earnings from some investments may be subject to Unrelated Business Income Tax or UBIT. If your closely-held entity has earnings from the sale of goods/services or earnings from debt, consult with your tax professional to determine if UBIT is owed. Your IRA (not the LLC or other entity) may need to file a Form 990-T with the IRS. If your tax professional is unfamiliar with filing Form 990-T, our sister company, IRA Tax Services, is available to help. Their contact number is 303-604-6466.