Quest IRA, Inc.

SDIRA GUIDE

By Nathan Long

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Most people have been taught to do certain things in order to attain a high quality of life. We've been taught to get a good education, work hard, put away 10% of our earnings, invest intelligently, and not to worry about the ups and downs of the market. The idea is that in time, one will have a large sum of money to invest with and to retire comfortably. These principles, taught by our parents and savvy business individuals, have shaped the way that many have lived their lives. The only problem with this way of life is that over the last 20 years, this concept has proved ineffective in a changing economy.

It is time that we, as Americans, become responsible for our own saving and investing. We are entering an era that requires not only savings, but applied skills, knowledge and time to acquire the lifestyle that encompasses the American dream. Most people don't take a lot of time to think about or try to understand money, but rather view money as something to save or spend. Through reading this book you will learn how to use Self-Directed Individual Retirement Accounts to increase your personal wealth, how to use other people's IRAs to fund your investments, and where to find the best information and educational resources. My hope is that this book will expand the way you think about money, use money, and hopefully have life changing effects on your thought process.

Who is Quest?

Quest IRA is a premiere Self-Directed IRA custodian. Our job is to hold private assets, including real estate, notes, private placements and more. Though Quest IRA does not give tax, legal or investment advice, you will find our staff highly educated and willing to share their time and knowledge. Quest IRA never charges for our education services and we fund twice a day, meaning we can expedite your transactions faster than anyone. Educated staff, fast funding, no extra charge for education and exceptionally quick service should be expected from an IRA custodian, not be considered an extra. Our staff understands your needs and our funding process allows for quick, immediate change. These are just a few of the things that set Quest apart from other Self-Directed IRA companies.

Quest IRA, Inc.

Chapter 1

What it means to be an Investor

Being an investor means understanding the use of money and what this money can do or mean. Money means different things to people as they progress through various stages of their lives. When we are young, money is easily expendable, primarily focusing on earning money in order to acquire things that we may want or desire such as clothes or a new car. As we get older, we add more responsibilities and the focus of money changes to allocating money for healthcare, daily needs, and simply for a rainy day. By putting your money away for a rainy day, you are able to increase your quality of life and take away much of the stress associated with preparing for retirement.

In order to understand different uses of money, we will be visualizing money in various buckets, each associated with specific needs. Once we have identified a person's needs, we will identify the tool that goes with that need to best expand the use of that money. This book is not a book that will teach you how to get rich quick, but rather a book that will teach you how to use skills you may have learned elsewhere such as how to invest in real estate, notes, banking, private stock, oil and gas, and more. Regardless of what your expertise may be, you can take your skills and apply them to the correct tools to yield success

Quest IRA advocates strongly for education and encourages all staff to further their knowledge both in and out of the classroom. Nonetheless, education expenses are always increasing, making it essential to begin saving for your child's future education immediately. Educating your child is an investment that can not only better that individual, but can also have a positive impact on the community. It should be noted that 529 plans cannot be used in association with the ESA account. For more information please reference the Coverdell Education Savings Account Article, located in the back of the book.

The Eats Bucket

This is the most expensive bucket that people have, as it pays for things such as social security, taxes, and more. One of the concepts we are trying to explain is to remove money from this bucket and add it into other buckets, as anything we can spend less and put into another bucket that is tax free or tax deferred. Through moving funds into other buckets you will increase wealth, as you will be paying fewer taxes on that sum of money. In today's world, tax avoiding is a necessary element to gaining wealth and independence.

Retirement Bucket

This bucket contains money that we diligently put away for the day we are no longer able or have the desire to work. By saving money in this bucket, you do not have to rely on Social Security or any other type of pension plan upon retirement age. The larger this bucket grows, the greater your quality of life will become.

Education Fund Bucket

Quest IRA advocates strongly for education and encourages all staff to further their knowledge both in and out of the classroom. Nonetheless, education expenses are always increasing, making it essential to begin saving for your child's future education immediately. Educating your child is an investment that can not only better that individual, but can also have a positive impact on the community. It should be noted that 529 plans cannot be used in association with the ESA account. For more information please reference the Coverdell Education Savings Account Article, located in the back of the book.

Healthcare and Medical Needs Bucket

Inevitably, you or someone in your family will become ill at some point and need to receive some type of medical care. This bucket is vital to provide both security and peace of mind that when an illness may arise now or in the future, you and your family will be financially ready. An excellent way to plan for future healthcare needs is to use a Health Savings Account which allows you to pay for all qualified medical expenses in a tax free manner through your account

Passing on Wealth Bucket

It is essential to learn how to save in order to successfully fund our children's education, pay for healthcare costs, and ultimately pass on wealth to our descendants. Having money in these different buckets will increase your quality of life as you will pay less in taxes and certainly worry less about your financial future.

Once we have matched a person's needs to the various buckets, we try to find the proper tool to maximize their use of that capital. After identifying some of the different uses for money, we can then apply the appropriate strategies and determine the best account type for that individual. From further understanding, this enables you to maximize the growth benefit of your money personally. Furthermore, it becomes possible to apply this knowledge correctly to people you may choose to invest with and potentially use other people's money to increase your wealth. The ultimate goal should not only be to have a strong eats bucket or retirement bucket, but to have healthy, growing buckets in all categories of life. It is only through a healthy relationship and understanding of money itself that we can further financial success, not allowing money to control us, but allowing it to be used as a tool to generate the lifestyle which we desire and earn. One of the most powerful accounts that can be used is the Roth IRA.

For more in depth information, please reference the Stretch IRA article located at the back of the book.

Chapter 2

What is a Self-Directed IRA?

Many people think that Self-Direction is not legal or do not understand the concept, however this little known secret could be the key to your comfortable lifestyle. A Self-Directed IRA is an individual retirement account where the owner directs all investments in the account. There is no legal distinction between a "Self-Directed IRA" and any other IRA, except that with a truly Self-Directed IRA, the account agreement allows the broadest possible spectrum of investments. It is important to understand the differences between a company like Quest IRA and a traditional advisor which are licensed securities agents that sell you investments, stocks, bonds and mutual funds. The aforementioned companies receive a commission when you purchase these licensed investments, while at Quest IRA, we make our money by charging fees, as we must maintain ourselves as a complete neutral party in any investment you make, thus barring any commission. As a result, many people have been misguided into believing that the only way you can invest your retirement funds is through a licensed securities agent and that buying real estate in your IRA isn't legal. The truth is, you can own any type of investment in your IRA as long as you can take title to it, or you can take title to it within your IRA, with very few restrictions that will be covered later.

At Quest IRA, we do not help you find the investment, though we hold many networking events to allow you to easily find your next investment on your own. In no way are traditional companies out of date or a bad idea, however their line of work is entirely different. We often educate our clients to have both an IRA with a traditional advisor as well as a Self-Directed IRA. With a Self-Directed IRA custodian, your unused cash earns no interest, so it is not effective to keep large cash balances with that custodian. Instead, it is most beneficial to transfer those funds into a traditional custodian in order to receive interest on that sum of money.

One of the major benefits to having a self-directed account is the ability for ***true diversification***. Many people feel that they are diversified; however most are actually entirely tied to the stock market. I strongly believe in the importance of investing in real estate, as it is one of the largest segments of the economy. However, I absolutely do not feel that direct ownership of real estate is a good decision for everybody. Sometimes, the effect of communicating with tenants or repairing broken toilets can actually lower certain individuals' quality of life, while others thrive in this type of environment and truly enjoy this work. Many of our clients like do things such as loans, LLCs, foreclosures, and so on. In all of the self-directed accounts mentioned, there is tax savings – tax free or tax deferred, both of which have major benefits that will also be covered in the upcoming chapters.

For me, arguably, the most important benefit of Self-Direction is ***social investing***. Ask the average American what exactly they are invested in and many will not be able to provide a firm answer. Sometimes people state things like "large caps," for example, but very few people know the actual company their mutual fund may hold. The problem with being unsure of what you may be invested in, is that if you do not know where your money is, then it may be doing something you do not want. I would venture to guess that most Americans are invested in things that are not aligned with their political or ethical beliefs. Once examining my 401K, I discovered it was invested in a construction company I would have chosen not to invest in due to my personal views, regardless of the possible returns. Many would likely be very surprised to find that they may be invested in companies that do not fall in line with their beliefs. If you choose to self-direct, you tend to be investing in something local, such as a small business or real estate, thus stimulating the economy in your community and potentially increasing jobs and growth. By self-directing, there is an important social benefit to your investment, in addition to the increased returns by investing in things you know or understand.

Another great benefit of Self-Direction is that you ***invest in what you know best***. If you understand how to invest in real estate and enjoy working with tenants, Self-Direction will likely be of much use to your investment future. Another option is to do a passive investment, such as lending money which is secured by real estate. This type of investment may require less personal time, but provides a safe return at much higher yields than other investment opportunities. Whether it is small businesses or oil fields, choose an area in which you are knowledgeable and you will likely gain a higher return based on personal skills and expertise. There are many different types of investments at Quest IRA, even some as specific as horse embryos that are used to create race horses. Personally, I know nothing about this area, but based on this investor's personal knowledge, they have become very successful by using their Self-Directed IRA.

Chapter 3

Types of Accounts

At Quest IRA, there are many self-directed account options available to our clients. All of the accounts offered at Quest IRA are self-directed and are divided into three categories – Personal, Employer and Specialty plans. The Personal Accounts include both the Traditional and Roth IRA, two of the most common accounts held at Quest. Within the Employer category, the accounts include the SEP, SIMPLE and 401(k). Finally, the Specialty plans consist of the Coverdell Education Savings Account (ESA) and the Health Savings Account (HSA). Through the use of these seven self-directed retirement accounts, over 6,079 clients of Quest IRA have been able to invest in what they know best and create financial security upon their retirement. Each of these accounts may not be a perfect match for you; however it is only through increased knowledge and understanding about each account that you too can select the appropriate Self-Directed account and take another step towards gaining financial security.

Traditional IRA

Established in 1986, the Traditional account remains one of the most popular retirement accounts in the U.S. and at Quest IRA. The Traditional account makes up the largest bucket of money and is widely known for its tax advantages, as the account owner does not pay taxes upfront, but rather in the future. One of the major advantages to owning a Traditional IRA is that by deferring the payment of taxes until a later date, the IRA owner may be in a lower tax bracket upon retirement. In 2014, the contribution limit for this account that grows tax-deferred is $5,500. Once over the age of 50, there is a "catch-up," amount of $1,000 added, bringing the total contribution limit to $6,500 for those who are 50 years or older.

Roth IRA

The Roth IRA falls under the personal account category and like the Traditional IRA, is one of the most popular accounts both at Quest IRA and in the nation. Owning a Roth IRA is often an excellent investment option, especially for the younger population. Unlike the Traditional IRA, the IRA owner must pay taxes upfront for all money contributed, however all growth within the account is tax free. This is a major advantage for the younger population, as they can make contributions over a lifetime and watch their funds grow. In 2014, the contribution limit for a Roth IRA is $5,500, and also allows for a $1,000 "catch-up" for those over the age of 50. As a single individual, the adjusted gross income must be less than $129,000 or $191,000 for a married couple. Though this may be a limitation for some, based on a new law created in 2010, individuals can do a Roth conversion and move from a Traditional IRA to a Roth IRA, regardless of their income. As Roth conversions are very common, the next chapter is devoted to explaining their benefits.

SEP IRA

The SEP IRA falls under the employer category, as all contributions are made by the employer, to a maximum of 25% of the employee's salary. Contributions made to employee SEP plans must be in equal percentages for all employees who qualify. In addition, a self-employed individual can contribute up to approximately 20% of their net earnings (Schedule C). For more information or exact calculations, it is suggested that you consult your financial planner. Though there is not a catch-up contribution permitted for SEP IRAs, one of the major benefits to this type of account is that the employer receives a tax deduction for the money they contribute and said contribution grows tax deferred. In 2013 the contribution limit was $51,000, however in 2014 it has been increased by the IRS to a total of $52,000.

Simple IRA

The SIMPLE IRA is another type of employer plan, though it is more appropriate in a situation where an employer has non-owner employees who must be covered or for a self-employed person with fewer earnings. Within this type of account, the employer matches up to 3% of compensation and the contribution also grows tax deferred. The contribution limits for this retirement account remain the same from 2013 to 2014, with the maximum of $12,000. For those individuals 50 years or older, there is a "catch-up" of $2,500, bringing the total contribution to $14,500.

401(k)

This type of account is one of the most common retirement accounts in the United States, which takes funds pretax from an employee's wages. For an employee who files a W2, up to 25% can be contributed or for a Schedule C filing individual, up to 20% of their net earning can be contributed. Unlike other accounts, you can borrow money from your 401(k) plan, in the amount of up to 50% of the account value or a maximum of $50,000. The contribution limit for a 401(k) is $17,500 and for individuals 50 years or older, they are granted a "catch-up" amount of $5,500. Due to the popularity of this type of account, chapter 6 of this book is devoted entirely to discussing the benefits of owning a 401(k).

Coverdell Education Savings Account (ESA)

The ESA is an excellent choice for those individuals who are trying to send a beneficiary to school. The account can be used for all qualified educational expenses until the beneficiary reaches the age of 18. The contribution limit for an ESA is $2,000 and though contributions are not tax deductible, all gains and qualified expenses are tax free. For further information on using small accounts, please reference the Education Savings Account Article, located in the back of the book.

Health Savings Account (HSA)

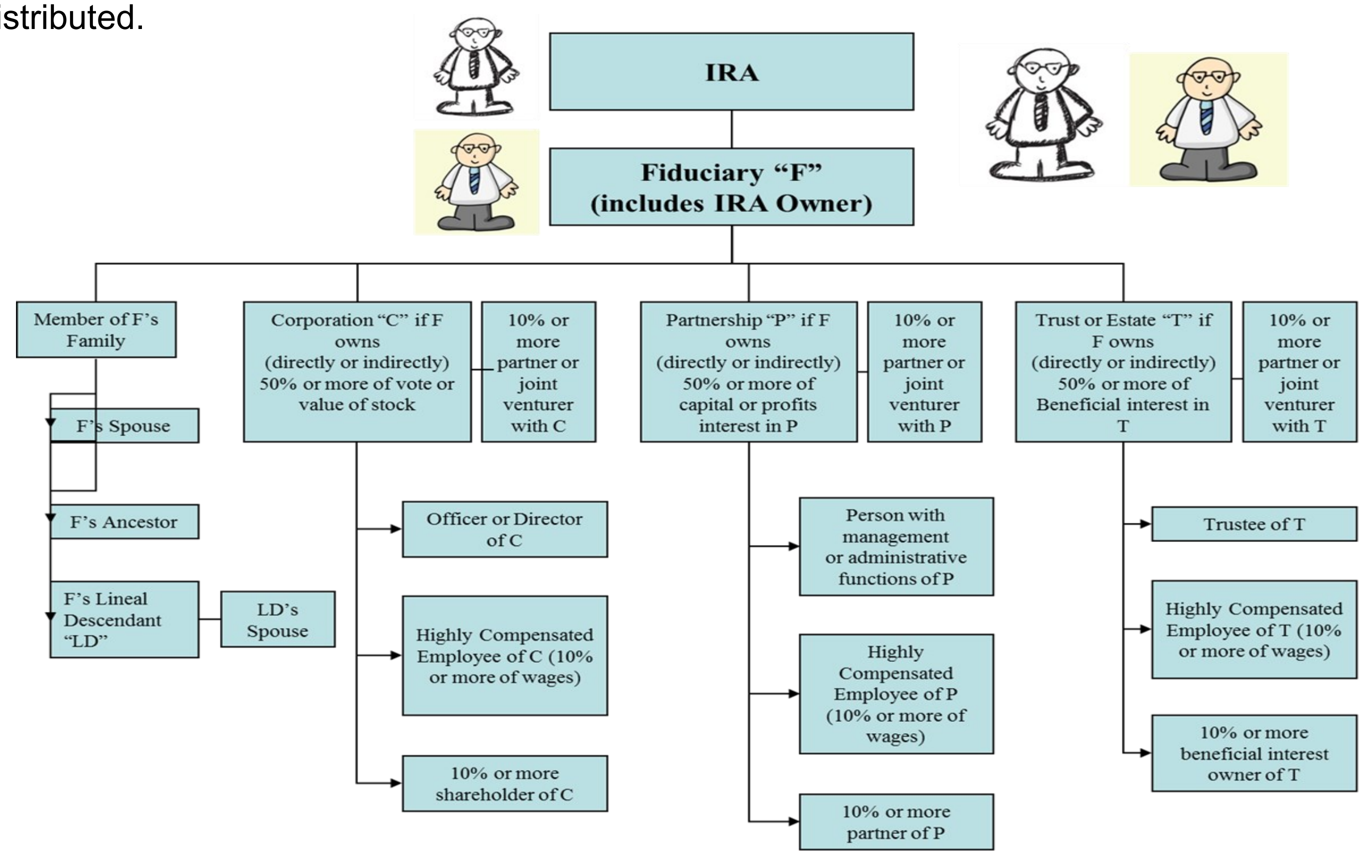
In order to qualify for an HSA, the individual must have a High Deductible Health Plan, not be enrolled in Medicare and cannot claim a dependent on their tax returns. The money contributed to this account goes in tax deductible and is tax free for qualified distributions. In 2014, the maximum contribution limit has been increased to $3,300 for an individual and $6,550 for a family, with a "catch-up" of $1,000 for individuals over the age of 55. Due to the many advantages to owning a Health Savings Account, chapter 7 goes into depth about the benefits of owning this type of account.

It is important to understand that there are restrictions regarding IRAs and through studying concepts related to IRAs it becomes possible to understand the terms that impact the accounts listed above. Not understanding or abiding by restrictions can result in a prohibited transaction and can potentially yield high fines. These fines make up one of the largest areas of penalties to individuals by the IRS code. One does not need to be an authority or expert in this area, however understanding the rules and regulations of investing will ultimately produce more success. Quest IRA is proud to have several Certified IRA Services Professionals (CISP), all of whom possess a wealth of knowledge that they are eager to share with clients. We urge you to contact us for a free consultation with a member of our highly educated staff to increase your knowledge and understanding about the world of IRAs and investing.

There are three major types of restrictions:
People, Transaction and Investment

People Restrictions

It is essential to understand that you are your IRA are two different persons, a concept that many individuals find confusing. A person can be an individual, but a person can also include a corporation, limited partnership, LLC or another entity like a trust or an individual retirement account. Your IRA contains money, however that money does not belong to you…"Say what?!" This money is being held in trust for you until you ask for the funds back in the form of a distribution from your IRA. You, the individual, have the fiduciary responsibility to your IRA that contains funds which will be either tax deferred or tax free. It is your job to oversee the account and manage it with the best financial interest. Nonetheless, you are to receive no benefit from the investing the IRA makes, aside from the benefit of distribution in the future. So, as your IRA invests, you cannot receive benefits either directly or indirectly as there is a line specifically drawn to separate you from your IRA. In addition to you, there is a group of people who are also disqualified from your IRA. Below is a chart to help explain the relationships for people who are disqualified, however, in short, these people are: you, your spouse, any lineal ascendants or descendants, their spouses and any companies they may own, control, manage or are highly compensated by. All of these people are equally disqualified, regardless of the relationship. If you or any of the disqualified persons receive a benefit, regardless if it is a good decision or beneficial towards to the IRA, this can be deemed a prohibited transaction and cause the account or asset to be distributed.



Transaction Restrictions

So what are the restrictions for the disqualified individuals? To put it simply, there are two major conflicts that can arise: not providing goods or services to the IRA, versus being a good fiduciary to the IRA. An individual cannot buy, sell, trade or provide goods or services. If you or any disqualified individuals own a house, you cannot sell it to your IRA and likewise, if your IRA owns a house it cannot be sold to you or any disqualified persons. Your IRA cannot loan you or the disqualified persons money and vice-versa. Finally, disqualified persons cannot extend services to or from the IRA. All investments must be for the purpose of growing the IRA, that being said, this does not mean you cannot bring to bare all of your abilities that are associated with being a good fiduciary to the IRA. The line between providing goods or services and being a good fiduciary to your IRA can easily become blurry within a real estate transaction. When it comes to buying real estate, as a good fiduciary, you can search for deals on properties, locate deals on contractors, find renters for your property, find investors to do business with, oversee minor repairs and more. All of your skills as a fiduciary can and should be implemented once you feel confident in your understanding of the restrictions in relation to your IRA. It is possible for a real estate agent to represent a property owned by his or her IRA, however they are restricted from receiving any type of commission or personal gain from this transaction. It is vital to be well versed in the rules and regulations associated with your IRA, so that you are able to make savvy investing decisions without violating any of the IRS guidelines.

As you go through these responsibilities, at no time should you be holding the checkbook, with the exception of owning an Individual 401(k). In an upcoming chapter regarding checkbook control IRAs, different ways to deal with the problem of paying contractors, appropriate funds and managing rents and sales of property will be further discussed.

Investment Restrictions

Finally, there is the category of investment restrictions. These restrictions do not impact investors very often, however it is necessary to mention. By law, you are not permitted to invest in collectibles or life insurance. A collectible includes, but is not limited to: coins, stamps, works of art, gems, metals, etc.

For more information regarding restrictions or any IRA related topic, we ask that you contact one of our IRA specialists for a free consultation.

Chapter 4

Roth Conversions: Quincy's View

Would you like to have tax free income when you retire? Would you like to have the ability to have a legacy of tax free income to your heirs when you die? The great news is that there is a way to achieve these goals – it is through a Roth IRA.

Historically, because of income limits for contributions to a Roth IRA and for converting a Traditional IRA into a Roth IRA, high income earners have not been able to utilize this incredible wealth building tool. Fortunately, the conversion rules are changing so that almost anyone, regardless of their income level, can have a Roth IRA. But is it really worth converting your Traditional IRA into a Roth IRA and paying taxes on the amount of your conversion if you are in a high tax bracket? For me, the answer is a resounding yes. I firmly believe it is worth the pain of conversion for the tremendous benefits of a large Roth Ira, especially given the flexibility of investing through a Self-Directed IRA.

For Traditional to Roth IRA conversions in tax year 2009, the Modified Adjusted Gross Income (MAGI) limit for converting to a Roth IRA was $100,000, whether you were single or married filing jointly. However, the Tax Increase Prevention and Reconciliation Act (TIPRA) removed the $100,000 MAGI limit for converting to a Roth IRA for tax years after 2009. This means that beginning in 2010 virtually anyone who either has a Traditional IRA or a former employer's retirement plan or who is eligible to contribute to a Traditional IRA will be entitled to convert that pre-tax account into a Roth IRA, regardless of income level.

Even better, for conversions done in tax year 2010 only you were given the choice of paying all of the taxes in tax year 2010 or dividing the conversion income into tax years 2011 and 2012. If you converted on January 2, 2010, you would not have to finish paying the taxes on your conversion until you filed your 2012 tax return in 2013 – more than 3 years after you converted your Traditional IRA! One consideration in deciding whether to pay taxes on the conversion in 2010 or dividing the conversion income into 2011 and 2012 was that 2010 was the last tax year in which the tax rates were at a maximum of 35%. Tax rates were scheduled to return to a maximum tax rate of 39.6% in 2011, and other tax brackets were scheduled to increase as well, so delaying the payment of taxes on the conversion cost you some additional taxes in 2011 and 2012. The benefit of delaying payment of the taxes is that you had more time to invest the money before the taxes needed to be paid, whether the payment came from the Roth IRA or from funds outside of the Roth IRA.

The analysis of whether or not to convert your Traditional IRA to a Roth IRA is a complex one for most people, because it depends greatly on your personal tax situation and your assumptions about what might happen in the future to your income and to tax rates, as well as on how you invest your money. From my own personal perspective, the simple assumption is that tax free income in retirement is better than taxable income. If you can afford to pay your taxes now and you would like to worry less about taxes when you retire, then the conversion makes sense. In my opinion, tax rates won't be going down in the future. The decision comes down to whether you want to pay taxes on the "acorn" (your Traditional IRA balance now) or the "oak tree" (your much higher future IRA balance as I you make withdrawals).

The way to analyze whether or not to convert to a Roth IRA is to calculate your "recovery period" – that is, the time it takes before your overall wealth recovers from the additional taxes paid on the conversion. If you can recover the cost of the taxes on the conversion before you might need the money in the Roth IRA, then it is worth doing, especially since the gains after the conversion are tax free forever. Fortunately, with a Self-Directed IRA you are in total control of your investments, and the recovery period can be quite short. There may also be a benefit if you are able to convert an asset now that may have a substantial increase in value later.

Using my own situation as an example, the plan was to do a conversion in 2010 ever since the passage of TIPRA was announced in 2006. The first step was to immediately begin making non-deductible Traditional IRA contributions. Even though

I am covered by a 401(k) plan at my company and earn more than the limits for making a deductible Traditional IRA contribution, this did not prevent me from making a *non-deductible* contribution since I was under age 70 ½. The main reason to make non-deductible contributions to my Traditional IRA was to have more money to convert into a Roth IRA in 2010. The best thing about this plan was that only the gains made on the non-deductible contributions to the Traditional IRA were taxed when I converted to a Roth IRA, since I had already paid taxes on that amount by not taking the deduction.

I planned on converting approximately $100,000 in pre-tax Traditional IRA money in 2010. The actual amount converted was more like $150,000, but, as noted above, my wife and I had been making non-deductible contributions to our Traditional IRAs since 2006, so the actual amount we paid taxes on was less than the total conversion amount. This meant that my tax bill on the conversion would have been $35,000 if I paid it all in tax year 2010 or $39,600 divided evenly between tax years 2011 and 2012, assuming I remained in the same tax bracket and Congress didn't make other changes to the tax code.

In order to analyze the conversion, some calculations were made on how long it would take to recover the money paid out in taxes at various rates of return, assuming a taxable conversion of $100,000 and a tax bite of $35,000. The recovery period was calculated based on payment of the taxes with funds outside of the IRA (which was my preference) and by paying taxes from funds withdrawn from the Roth IRA, including the early withdrawal penalty I had to pay since I was under age 59 ½.

If taxes were paid with funds outside of my Roth IRA and a 12% return compounded monthly was achieved, my Roth IRA would grow to $135,000 in only 30 months, at which point the cost of the conversion would be fully recovered. A 6% yield on my investments would cause my recovery period to stretch to 60 months, while an 18% yield would result in a recovery period of only 20 months! Of course paying taxes with funds outside of the IRA reduced my ability to invest that money in other assets for current income or to spend it on living expenses. However if I had to withdraw the money from the Roth IRA to pay taxes and the early withdrawal penalty, the recovery period for my Roth IRA to achieve a $39,000 increase ($35,000 in taxes and a $3,900 premature distribution penalty) would increase to 50 months at a 12% yield and 99 months for a 6% yield. Paying the taxes from funds outside of my Roth IRA resulted in a much larger account in the future since the full $100,000 could be invested if taxes were paid with outside funds, while only $61,000 remained in the Roth IRA after withdrawal of sufficient funds to pay the taxes and penalties.

Since my IRAs are all self-directed the cost of the conversion (i.e. the taxes paid) would be easily recovered in less than 3 years based on my investment strategy. From that point forward tax free wealth for me and my heirs was being built. How could the taxes be recovered so quickly? It's easy! Self-Directed IRAs can invest in all types of non-traditional investments, including real estate, notes (both secured and unsecured), options, LLCs, limited partnerships and non-publicly traded stock in C corporations. With a Self-Directed IRA you can take control of your retirement assets and invest in what you know best.

My retirement plan has a large investment in real estate secured notes, mostly at 12% interest with anywhere from 2-6% up front in points and fees. Some stock is also owned in a 2 year old start up bank in Houston, Texas which is doing very well, and a small amount of stock is in a Colorado bank. As the notes mature the plan is to purchase real estate with my accounts, because, in my opinion, this is the best time to buy. In some cases the real estate itself may be purchased and in other cases an option on real estate might be purchased. The bank stock was converted at the market price in 2010, but when the banks sell in a few years a substantial boost in my retirement savings is expected since banks most often sell at a multiple of their book value. In the meantime, the notes and the real estate will produce cash flow for the IRA, and, if my investments were done correctly, the real estate will also result in a substantial increase in my Roth IRA when it is sold in a few years.

Note that this article was written from the perspective of someone who is in a high tax bracket. A lower tax bracket will reduce the recovery period and is an even better bargain, especially if you can afford to pay the taxes from funds outside of the Roth IRA. If you take advantage of the opportunities afforded to you by investing in non-traditional assets with your self-directed Roth IRA, you can truly retire wealthy with a pot of tax free gold at the end of the rainbow.

H. Quincy Long, President of Quest IRA Inc.

Chapter 5

401 (ks)

Self-Directed IRAs are one of the most powerful tools for increasing retirement accounts.

There are many advantages associated with 401(k)s, however these accounts are often misunderstood, misused and can potentially be one of most dangerous categories of retirement accounts. Some of the requirements to possess this type of account is to qualify, legitimize the account and to fully understand the rules and requirement associated with the account. Due to the extensive nature of this subject, we can only touch upon some of the basics related to a 401(k), however at Quest IRA, we insist upon a consultation with one of our IRA specialists to ensure that this type of account is the most appropriate and that our clients are well versed in how to use this account. As always, all consultations at Quest IRA are free of charge, as our main priority is to assist our clients in their retirement savings by educating them as much as possible on any related topics.

So, let us start with the basics and determine good candidates to have a 401(k). One group of individuals who are excellent candidates to own a 401(k) includes currently self-employed persons with no common law employees. Another category includes owners of small corporations who receive W-2 wages and have no common law employees. One of the major advantages of possessing a Quest Individual 401(k), you control the checkbook. Essentially, this means that you can hold funds for investment purposes in a local bank account and write checks for investment expenses. Some of the other advantages is a larger contribution limit at a lower level of income. You, as the employee, can make a salary deferral contribution.

Contribution 2014	Catch Up (Age 50)	Maximum Contribution 2014
$17,500 $23,000*	$5,500	$52,000 $57,500*

***Catch up Included**

Your salary deferral contribution can be pre-tax or Roth 401(k), meaning that you can choose to deduct your salary deferral contribution or you can have a Roth 401(k), regardless of your income. In addition, unlike your IRA, you can borrow money from your 401(k) plan in the amount of up to 50% of your account or a maximum of $50,000, whichever amount is less. Finally, another advantage of the Quest IRA Individual 401(k) is the exemption from UDFI taxation. For non-dealer property, 401(k) plans are exempt from taxation for debt-financed property in certain circumstances. Combine this with the power of the Roth 401(k) and watch your retirement wealth grow using other people's money! Some investments into a retirement account create taxation due to the fact that they are debt leveraged. For more information on this subject, reference chapter seven, which discusses UBIT and UDFI. As the topic of 401(k)s is extremely lengthy and complex, an article written by the President of Quest IRA, Inc., H. Quincy Long is featured in the appendices at the back of this book and provides more in depth information on this subject matter.

Inside of the Individual 401(k), there are buckets so to speak, and four different ways to get funds into your account – employer profit sharing contributions, tax-deferred employee contributions, tax free employee contributions and rollover contributions. Profit sharing is the portion of the contribution which is paid by the employer. If you are self-employed, you are considered the employer and are eligible for profit sharing. This amount will always be tax-deferred and the calculation for it is similar to the SEP IRA calculation, or approximately 20% of your net income. If you have a Traditional 401(k), you are able to deduct all or part of the $17,500 or $23,000 (age 50+) salary deferral portion of your contribution. If you have a Roth 401(k), you can also contribute the money after taxes. Like a Roth IRA, you cannot deduct the contribution, however you may take qualified distributions tax free, forever! One unique component about the Quest IRA, Individual 401(k), is your ability to rollover from previous plans in and out, as needed. It is important to note that you cannot roll Roth IRAs into a Roth 401(k), as the only way to make money in a 401(k) is to make Roth employee contributions (tax-deferred employee contributions). Remember, each of these four different sub-accounts can be invested individually, in any combination or as a whole.

One of the most key things to remember about a 401(k) is the necessity to legitimize. I have seen situations where clients have Individual 401(k)s, though they are unable to make current contributions. It is possible and quite likely that the IRS would treat any money rolled into an illegitimate account as a sum that would incur taxation and penalties, accumulated over years. Current contributions must be made the first year that you have the account where you have self-employed income. There are companies that sell 401(k)s at a very high price so that you can have checkbook control without ever legitimizing the plans by making your contributions. By doing this, you are therefore de-legitimizing your 401(k) plan, including whatever you may rollover, potentially causing high rates of taxation. It is essential to be leery when considering a 401(k) account as it is absolutely necessary to legitimize within the first year of having this type of plan. Remember to be cautious, as there are individuals who sell plans and state that you are able to take the money and disregard the rules since “nobody will notice, anyway.” All IRA rules apply to 401(k)s, with limited exceptions, including checkbook control and UBIT.

Within your 401(k), it is possible to invest in real estate, including foreign property, real estate notes, secured notes, unsecured notes, limited liability companies, limited partnerships, private stock and much more. Throughout the process of investing with your Self-Directed IRA, it is necessary to understand how to correctly vest, to avoid any confusion and ensure accuracy. The correct Quest IRA vesting is as follows:

401(k) Plan Name; Trustee’s Name, Trustee
Example: Jones Consulting 401(k) Plan; Bob Jones, Trustee

Vesting essentially means that you are taking title to something. In addition, you can also vest the Roth rollover portion and the traditional portion separately by adding an undivided interest.

What happens if you have employees? Don’t worry, you can still have a 401(k) plan, including a Roth 401(k). The cost is higher in some circumstances and you must have actuaries to help you with the testing requirements. It is important to note that if you own two companies, you must provide equally for employees of both, due to grouping rules. The 401 (k) offered at Quest IRA is a do-it-yourself model, meaning that you pay for the initial set-up and document processing. For this model, you simply pay $300 per year for Quest IRA’s plan document after the initial set up, however we do not do record keeping or hold the funds.

What are some of the disadvantages to a 401(k)?

1. It is necessary to legitimize the plan
2. You must file your own tax forms, including 5500 and 1099 upon distribution
3. You must fully understand prohibited transactions and proper vesting

So, to quickly recap what we have covered in this chapter…

1. You can have checkbook control if you want it
2. You can make higher contributions including Roth 401(k) contributions
3. There is availability of loans from your 401(k) to yourself
4. Exemption on UBIT on long-term hold investment real estate that are debt leveraged
5. Ability to roll in other traditional IRAs, SEP IRAs and former employer plans (not a Roth IRA)

401(k)s can be extremely powerful, but like all powerful financial tools, they can also be dangerous. Most prohibited transactions occur in these types of accounts, due to the fact that the account administrator is not viewing each investment. Though 401(k)s are a complex type of account, Quest IRA is here to help you make the process simple and easy to understand. All you have to do is pick up the phone and call us, as you are in charge of your investment.

Chapter 6

Health Savings Accounts

By now you have probably heard of the Health Savings Account (HSA). What you may not know is just how amazing this type of account actually is, in terms of premium savings, tax savings and most importantly, what you can invest in with your HSA.

Qualification Requirements

In order to have a Health Savings Account, you must be an "eligible individual." To be an eligible individual, you must 1) have a High Deductible Health Plan (HDHP); 2) have no other health coverage, with certain exceptions; 3) not be enrolled in Medicare; and 4) not be claimed as a dependent on another person's tax return. More complete information of the requirements may be found in IRS Publication 969, which is freely available at *www.irs.gov*.

While a full description of a HDHP is beyond the scope of this chapter, its key features are a higher deductible than many insurance policies and a maximum limit on the out-of-pocket expenses (including the deductible and co-payments, but excluding the premium payments). For 2014, the minimum deductible is $1,250 for self-only coverage and $2,500 for family coverage, and the maximum out-of-pocket expense is $6,350 for self-only coverage and $12,700 for family coverage. All major insurance companies offer HSA compliant plans. Employers may also offer an HSA compliant plan, since these policies tend to be less expensive. If the employer makes contributions to your HSA it is excluded from your income.

Premium Savings

Because of the higher deductibles and plan features, HSA compliant plans tend to cost less. When I switched from a policy with a $2,000 general deductible and a $200 drug deductible to an overall deductible of $2,200, the premiums for my family were reduced from $754 per month to $450 per month. That's a total premium savings of $3,648 per year!

Tax Savings

One of the best features of an HSA is the tax savings for contributing to the account. Beginning in 2007, the contribution limit is no longer tied to the deductible. The contribution limit for 2014 is $3,300 for self-only coverage and $6,550 for family coverage. To the extent you make the contribution (as opposed to your employer), these amounts are fully tax deductible, no matter what your income level. If you are age 55 or older, you may contribute an additional $1,000 for 2014. There is even a one time ability to take a distribution from your IRA to fund your HSA with no taxes or penalty.

In my tax bracket, the ability to deduct my contributions is significant. I contributed $6,150 for 2011 and will save approximately $2,030 on my taxes. If you add the premium savings over a traditional health plan to the tax savings from contributing to an HSA, the total benefit to me goes a long way towards covering the cost of my contribution.

Distributions from an HSA for "qualified medical expenses", which are broadly defined and include expenses for yourself, your spouse and your dependents, are tax free forever! Because the expenses only have to occur after the HSA has been established, virtually everyone will end up with qualified medical expenses at some point in their life. You can take a qualified distribution at any point after the expense is incurred, even in later years, provided you keep track of the expenses.

For more detailed information on Health Savings Accounts, please reference the article located in the back of the book.

Investment Opportunities

Even better than the premium and tax savings is the ability to invest your HSA funds in non-traditional investments, just as you would in a Self-Directed IRA. Many banks and other companies offer the convenience of an HSA account with a debit card for you to pay medical bills with. However, if you are healthy and don't have a lot of expenses or you can fund the expenses out of pocket, you can make your HSA account grow much faster with investments other than mutual funds or savings accounts which may pay very little.

With a self-directed HSA, you choose your HSA's investments. Common investment choices made by self -directed HSA participants at Quest IRA Inc. in Houston, Texas include real estate, both domestic and foreign, options, secured and unsecured notes, including first and second liens against real estate, C corporation stock, limited liability companies, limited partnerships, trusts and much more. In my own HSA I have a portion of two hard money loans generating yields of 12%, a portion of a shared appreciation mortgage which generates 10% in addition to a share of profits when the property is eventually sold, and a membership interest in an LLC owning a debt-fee rental unit.

The Health Savings Account is truly the best of all worlds. It can significantly reduce your health care premiums, reduce your taxes, and produce tax free wealth through non-traditional investments in a self-directed HSA. With a self-directed HSA (or IRA), you don't have to *"think outside the box"* when it comes to your HSA's investments. You just have to realize that the investment box is much larger than you think!

Chapter 7

What can you invest in?

Clients regularly ask "What can I invest in?" At Quest IRA, our response is usually, "What are you knowledgeable about?" If you can take title to it, then you can probably own it in an IRA. The investment possibilities are almost limitless, based on guidelines from the IRS. Some common examples of assets based on real estate include: single family homes, multi-unit homes, apartments, condominiums, commercial property, unimproved land, foreclosures, limited liability companies, limited partnerships, unsecured loans, secured loans, joint ventures, foreign property investments, deeds of trusts, mortgages, tax liens, options, and debt financed property.

Other not so common investments are those in small companies that may be operating as a business and not just an investment entity. In this case, it may trigger unrelated business income tax, also known as UBIT. Many people are surprised to learn that, as discussed below, there are 2 ways in which an IRA or 401(k) investment in an entity may cause the retirement plan to owe tax on its income or profits from that investment. This does not necessarily mean that you should not make an investment which subjects your retirement plan to taxation. It does mean that you must evaluate the return on the investment in light of the tax implications.

Unrelated Business Income (UBI)

The first situation in which a retirement plan might owe tax on its investment is if the entity invested in is non-taxable, such as a limited partnership or an LLC treated as a partnership for tax purposes, and the entity operates a business. Although investment in an entity which is formed for the purpose of capital investment, such as the purchase and holding of real estate, should not generate taxable income for the retirement plan (unless there is debt financing, as discussed below), any income from business operations would be considered Unrelated Business Income (UBI) for the plan. UBI is the income from a trade or business that is regularly carried on by an exempt organization and that is not substantially related to the performance by the organization of its exempt purpose, with the exception that the organization uses the profits derived from this activity. Exclusions from UBI include dividends, interest, annuities and other investment income, royalties, rents from real property (but not personal property), income from certain types of research, and gains and losses from disposition of property (except property which is considered to be inventory).

Example:

Ira N. Vestor has a large rollover IRA from a former employer and wants to help out his friend, Will B. Richer, who is starting a new restaurant business. Will offers Ira a 25% ownership interest in his new business, Eat Richer Restaurants, LLC. Ira believes Will is going to be a huge success, and wants to grow his IRA. The LLC will be taxed as a partnership. Ira will not be paid and will have no part in the management or operation of the business. Because the LLC is taxed as a partnership, the IRA must pay taxes on its share (whether or not distributed) of the gross income of the partnership from such unrelated trade or business less its share of the partnership deductions directly connected with such gross income.

Unrelated Debt Financed Income (UDFI)

A second situation in which a retirement plan may owe tax is when the plan or an entity invested in by the plan owns debt financed property. Anytime a retirement plan owns debt financed real estate (with a possible exception for 401(k) plans, discussed below), either directly or indirectly through a non-taxable entity, the income from that investment is taxable to the retirement plan as Unrelated Debt Financed Income (UDFI). The amount of income included is proportionate to the debt on the property. Your retirement plan is only taxed on the debt financed portion and not the entire amount of income.

Definition of "Debt Financed Property."

In general, the term "debt-financed property" means any property held to produce income (including gain from its disposition) for which there is an ***acquisition indebtedness*** at any time during the taxable year (or during the 12-month period before the date of the property's disposal if it was disposed of during the tax year). If your retirement plan invests in a non-taxable entity and that entity owns debt financed property, the income from that property is attributed to the retirement plan, whether or not the income is distributed.

Calculation of UDFI.

For each debt-financed property, the Unrelated Debt Financed Income is a percentage of the total gross income derived during a tax year from the property. The formula is as follows:

Average Acquisition Indebtedness ***x*** *Gross Income from Average Adjusted Basis Debt-Financed Property.*

Once the gross UDFI is calculated as above, your retirement plan is entitled to most normal income tax deductions including expenses, straight line depreciation and similar items that are directly connected with income from the debt financed property, plus an automatic deduction of $1,000.

Capital Gains Income.

The good news is that if there has been no debt owed on the property for at least 12 months prior to the sale, there is no tax on the capital gains. However, if a retirement plan or a non-taxable entity owned by the retirement plan sells or otherwise disposes of debt-financed property and there has been acquisition indebtedness owed within 12 months prior to the date of sale, the retirement plan must include in its taxable income a percentage of any gain or loss. The percentage is that of the ***highest*** acquisition indebtedness with respect to the property during the 12-month period preceding the date of disposition in relation to the property's average adjusted basis. The tax on this percentage of gain or loss is determined according to the usual rules for capital gains and losses. This means that long term capital gains are taxed at a lower rate than short term capital gains. 2 See 26 USC 512(c). 3 The rules specifically relating to Unrelated Debt Financed Income are found in 26 USC 514.

Example:

Ira N. Vestor wants to use his IRA to invest in a limited partnership, Pay or Go, L.P., which will purchase an apartment complex. The lender requires a 20% cash down payment, and will not permit subordinate financing. Because the property is 80% debt financed, Mr. Vestor's IRA will owe a tax on approximately 80% of its net profits from the limited partnership (the percentage subject to tax changes as the debt is paid down and the basis is adjusted). When the property sells, Mr. Vestor's IRA will have to pay capital gains tax on the debt financed portion of the profits. Only the profits from the rents or capital gains from the sale that are attributable to the debt financing are taxable to the IRA. For example, if the gain on the sale of the apartment complex is $100,000, and the highest acquisition indebtedness in the 12 months prior to the sale divided by the average adjusted basis is 75%, then $25,000 of the gain is tax deferred or tax free as is normal with IRA's, while the IRA would owe tax (not Mr. Vestor personally) on $75,000.

Exemption From Taxes on UDFI for 401(k) Plans

One piece of great news for those with self-directed 401(k) plans is that plans under §401 of the Internal Revenue Code (IRC) enjoy an exemption from the tax on UDFI in certain circumstances. This exception to the tax is found in IRC §514(c)(9), and applies only to “qualified organizations.” Qualified organizations include certain educational organizations and their affiliated support organizations, a qualified pension plan (ie. a trust qualifying under IRC §401), and a title-holding company under IRC §501(c)(25), but only to the extent it is owned by other qualified organizations. IRAs are trusts created under IRC §408, not IRC §401, so the real estate exception to the UDFI tax does not apply to IRAs. The good news is that plans such as the Quest Individual 401(k) Plan do qualify for this exception under the right circumstances.

There are six basic restrictions which must be met for the exemption from the UDFI tax to apply. They are:

1) **Fixed Price Restriction**. The price for the acquisition or improvement must be a fixed amount determined as of the date of the acquisition or the completion of the improvement.

2) **Participating Loan Restriction**. The amount of any indebtedness or any other amount payable with respect to such indebtedness, or the time for making any payment of any such amount, must not be dependent, in whole or in part, upon any revenue, income, or profits derived from such real property.

3) **Sale and Leaseback Restriction**. The real property must not at any time after the acquisition be leased by the qualified organization to the seller of the property or to certain related persons, with certain small leases disregarded.

4) **Disqualified Person Restriction**. For pension plans, the real property cannot be acquired from or leased to certain disqualified persons described in 4975(e)(2), with certain small leases disregarded.

5) **Seller Financing Restriction**. Neither the seller nor certain related disqualified persons may provide financing for the acquisition or improvement of the real property unless the financing is on commercially reasonable terms.

6) **Partnership Restrictions**. Partnerships must meet any one of three tests if the exemption from the tax on UDFI is to apply to the qualified organizations who are partners. First, all of the partners can be qualified organizations, provided none of the partners has any unrelated business income. Second, all allocations of tax items from the partnership to the qualified organizations can be "qualified allocations," which means that each qualified organization must be allocated the same distributive share of each item of income, gain, loss, deduction, credit and basis. These allocations may not vary while the qualified organization is a partner in the partnership, and must meet the requirement of having a "substantial economic effect." Third, and perhaps most commonly, the partnership must meet a complex test called the "Fractions Rule" (or the "Disproportionate Allocation Rule"). Even with the restrictions, there are circumstances where this exemption can work. For example, one client rolled over her IRA into a 401(k) plan she created for her home based interior decorator business. The 401(k) plan then purchased 2 apartment buildings with nonrecourse seller financing (which was on commercially reasonable terms). Not only is the 401(k)'s rental income exempt from the tax on UDFI, but so will the capital gains be exempt. If there is a concern about asset protection, a title holding §501(c)(2) or §501(c)(25) corporation can be formed, and the exemption will still apply. But the best news of all is that we now have the Roth 401(k). Starting in 2006, if your plan allows it, you can defer part of your salary into a Roth 401(k). For 2007, the maximum salary deferral into a Roth 401(k) plan is $15,500 ($20,500 if you are 50 or over). This doesn't include the profit sharing contribution of the plan which can be up to 25% of the wages or net income from self-employment. Although the salary deferrals are post tax (meaning you still have to pay income, social security and Medicare taxes on the amount deferred into the plan), qualified distributions from the account are tax free forever. Unlike the Roth IRA, there is no maximum income restriction. Combining the power of an Quest self -directed Roth 401(k) and the real estate exception for 401(k) plans under IRC §514(c)(9) means you can use Other People's Money.

Case Study: Rental Property

This case study is a cash partnership between two IRAs that demonstrates a partnership and how the cash flows are handled. John Wood and his business associate, Jay Wright recently purchased an Office Condo for their dental practice which is located in an "up and coming" business district. John and Jay also purchased another unit across the street in their retirement plans as a way to diversify their stock heavy portfolios. Both John and Jay transferred $150,000 from their brokerage accounts over to their Quest IRA SEP IRAs. John and Jay made an offer to purchase the office condo in the name of their SEP IRAs, as follows:

Quest IRA, Inc. FBO John Wood SEP IRA# 12345-31
Quest IRA Inc. FBO Jay Wright SEP IRA# 23456-31

John and Jay initiated a purchase contract for $250,000 in the name of their SEP IRAs with each IRA as a 50% undivided interest. The offer was accepted and a $10,000 escrow deposit was needed to finalize the deal. John and Jay completed a *Buy Direction Letter* (Real Estate). They sent the Buy Direction Letters and the contract to Quest IRA which had been "read and approved." Quest signed the contract and sent it to the title company along with an earnest money deposit of $10,000, $5,000 from each account. At closing, John and Jay reviewed and approved all closing documents, and then the title company sent them to Quest IRA for signatures. Quest IRA signed the closing documents and wired the SEP IRA funds to the title company to close, with half from each account. The title company recorded the deed and the two IRAs became the owner of record, as follows:

> Quest IRA, Inc. FBO John Wood SEP IRA account #12345-31 (as to an undivided 50% interest)
>
> **And**
>
> Quest IRA, Inc. FBO Jay Wright SEP IRA account #23456-31 (as to an undivided 50% interest)

John and Jay hired a property management company to oversee the unit, though this was optional. The rent and expenses were handled by the property manager, who located a tenant to lease the unit for 3 years at $1,500 a month. The property management company handled the monthly recording for the office condo with had a positive monthly cash flow of $850, or $425 for each SEP IRA, which was tax deferred. The property management company submitted the net rent proceeds to Quest IRA for the benefit of John and Jay's SEP IRAs, and the two were able to track their accounts via their online statements. Two years later, once the lease had expired, the tenants offered to purchase the property for $395,000. John and Jay accepted the offer so a sales contract was submitted to Quest IRA for signatures after having been "read and approved" by John and Jay, along with a Sell Direction Letter. On the day of closing, John and Jay reviewed and approved all of the closing documents, then allowing for Quest IRA to sign the documents and return them to the title company. Proceeds, after closing costs, were then wired back into their SEP IRA accounts.

There was a tax deferred gain of $73,550 (59%) over 26 months! John and Jay's IRAs paid no taxes on the gains, allowing them to reinvest the full amount of their profits on the next deal. If the accounts involved were Roth IRAs, Roth 401(k)s, or in some cases a Coverdell ESA or an HAS, the gain is tax free forever. John and Jay were in total

control of the process from beginning to end, but Quest IRA was the actual buyer and seller of the property. In addition, John and Jay did not take money from their IRAs to buy property and put money back into the IRAs, but rather the IRAs simply bought an asset and later sold it at a profit.

Initial Investment	**$125,000**
Cash flow over 26 months ($425 x 26)	$11,050
Gains from sale ($187,000 - $125,000)	$62,500
Proceeds to each SEP IRA after sale	**$198,550**

Key Points to Remember:

1. IRAs can partner with other IRAs or even non-IRA money
2. All expenses and proceeds must be split in accordance with their ownership percentages
3. John and Jay could have had the checks deposited directly into their IRAs instead of hiring a property management company

Remember that IRAs have the ability to partner with other IRAs or with non-IRA money, including with disqualified persons. A husband and a wife could partner their IRAs to invest, provided that they keep a completely parallel transaction. Upon purchasing an asset, the percentages of ownership are developed. As expenses are incurred, the IRAs must pay according to the specified percentages. Likewise, as profit is made from things such as rent, interest or sale of the asset, it must be split according to the percentages determined upon the purchase of the asset. This means that you could not, for example, purchase a house in your wife's IRA and have your IRA pay for the rehab on the house. Instead, a more appropriate transaction would be to purchase 60% of the house in the name of your IRA and 40% in the name of your wife's IRA. By doing this, it would then be possible to split the rehab for the house 60% and 40%, and also split the profits that go into the IRA based on these percentages. These types of partnering transactions can be complicated, so we strongly encourage our clients to meet with one of Quest IRA's IRA specialists for a consultation to review the potential transaction. Like all of our education, consultations with our IRA specialists are free and are very beneficial in gaining knowledge about IRAs and investing. The average person will not tell you how much they have to lend, instead you must explore your options and ask if they have retirement accounts, a 401(k), a Coverdell Education Savings Account, health accounts, so on and so forth. You can make the most of accounts with small balances by partnering them with bigger accounts. This type of strategy will educate many people and will also create a larger sum of money.

Knowing that you can sell real estate and other assets to retirement accounts should increase the amount of possible sales. If you are a real estate investor, one successful exit strategy for an investment property is to buy low, do rehabilitation on the property, locate a renter and finally sell the property to an IRA investor. For realtors or other real estate professionals, just knowing you can sell properties to IRAs will increase the amount of possibilities and chance for success.

In starting your own business, private money is often an excellent way to come up with capital. Using an IRA for this process would be the number one way to achieve this type of benefit. Private money and the education that Quest IRA provides will allow you to spread the knowledge, and then use their money!

Common objections we hear from clients:

Q: "I make too much money to contribute to an IRA."

A: This is not true, as anyone can contribute to an IRA, however it may not be tax deductible. If you make a non-deductible contribution it can be converted to a Roth IRA with no tax.

Q: "I don't have any earned income that qualifies for an IRA and I don't have any old retirement plans."

A: Your spouse can have earned income that you could use to qualify. If not, you can use a Coverdell Education Savings account or a Health Savings Account.

Q: "I only have a small amount in my IRA."

A: One possible option would be to use wholesaling. In addition, you could buy subject to or partner your IRA.

Chapter 8

O.P.I and the "Eats Bucket"

Learning how to use other people's money, or as we like to call it – O.P.I., is a necessary measure to increase your wealth. From a borrower's perspective, this is an efficient way to make money immediately and create your own private financing source, as there are trillions of dollars in retirement accounts. At many of the Quest IRA events, there are literally millions of dollars available for investments from attendees that have not yet been used. Let's take a constructive look at how to take knowledge from previous chapters regarding growing money tax deferred or tax free, by using skills we already possess.

This chapter will cover ways to apply your skills to make more money for yourself and fill up the eats bucket. Many Quest IRA clients are real estate investors who professional invest in real estate by buying rental properties, fix and flip properties, commercial properties, new construction or retail space. By understanding that IRAs can place themselves in the lender's position, it becomes possible to fund many transactions without the assistance of a bank, thus creating your own private bank simply through the development of relationships with people who have IRAs. Many people do not want to invest directly in real estate as they may not possess the skills or time deal with tenants or a leaky toilet. By acting as a lender, this allows people to invest in non-traditional assets, but does not require the time or skill set. When you demonstrate that it is possible to receive a higher than average return, secured by tangible investments that can be seen, touched or felt, potential lenders become interested. By making socially conscious investments such as investing in local real estate or a business, this will aid in the improvement of a community.

Often, these types of investments are successful and ultimately cause lenders to spread the word to their friends, family or coworkers, and increase the likelihood that they ill invest several times. Through a successful investment, you will find more funding than you ever thought possible for your endeavors, and all without the use of a bank.

To hear Quincy's thoughts on this matter, reference his article, "Either a Lender or a Borrower Be," featured below

Chapter 9

Small Accounts

People will often ask me, “How can I use small accounts to invest in Self-Directed IRAs. I don’t have enough money to self-direct.” True, there are accounts where the contribution limits are small, however this does not mean they should be overlooked or cannot be used to the fullest extent to invest. Small accounts can be used for Self-Direction, though this type of work often requires a greater knowledge or skill set.

A friend of mine, let’s call him Andy, is a wholesaler in real estate. Andy also has a young daughter with a Coverdell Education Savings Account. After finding a great deal, Andy pays $100 in earnest money, ultimately selling the contract to an investor for $13,400. Immediately, Andy withdrew $8,500 from the account, tax free and penalty free to pay for his daughter’s tuition at a private school. With the balance in the account, Andy reinvested in the hopes of making more money for his daughter’s college education in the future. He could have done this type of deal outside of his IRA, however Andy possessed the skills and ability to do this wholesale deal and avoid taxation through creativity with his money. Andy was able to take money from his “eats bucket” and put it into his daughter’s Coverdell ESA, ending up with more money and spendable income in the current year. When people think of retirement accounts, they consider it saving for the future, however with Self-Direction, it possible to not only save for the future, but also to have more money, right now. These types of deals are possible in other small accounts such as Health Savings Accounts, mentioned in a previous chapter.

In addition, it is possible to partner your IRA with a smaller account that may own a smaller percentage of the asset. So, if you found a house that is attractive in price or cash flow, you could partner your IRA with your child's Coverdell ESA, for example, with the smaller account perhaps only owning 10% of the property. Cash flow would then be dispersed accordingly, with cash payments going into each account based on the percentages that were specified. This method is not only a great way to get money into a smaller account with a lower contribution limit, but it also an excellent method of passing on knowledge to children who are often very unknowledgeable regarding investments. Young adults usually do not think about what it is like to retire, so teaching when your child is young is a vital tool to their future success. I cannot emphasize enough, the importance of saving over a long period of time, as opposed to trying to save large amounts in a small amount of time. By taking small amounts and partnering your investment, your children will be able to see the growth and get excited about their investing futures.

Conclusion

We sincerely thank you for taking the time to read this text that we worked diligently on in the hopes of providing you with the necessary tools to become a successful investor. It is our hope that you will have a prosperous investment future, and we are confident that through the expert knowledge and world famous customer service provided at Quest IRA, we can help make your investment dreams a reality. This text is a general guide to Self-Direction and does not cover all aspects of investing or individual retirement accounts. As always, we encourage everyone to explore each investment option thoroughly and do your due diligence. For more information, we ask that you contact our office to schedule a free consultation with one of our IRA Specialists.

Quest IRA, Inc.

Reference Articles

Quest IRA, Inc.

How to Pay for Education Expenses With Tax-Free Dollars

By: H. Quincy Long

Many people are under the mistaken impression that a Roth IRA is the only type of self-directed account from which tax free distributions can be taken. However, distributions from Health Savings Accounts (HSAs) and Coverdell Education Savings Accounts (ESAs) can be tax free if they are for qualified expenses. In this article we will discuss the benefits of the Coverdell Education Savings Account and, more importantly, what investments you can make with a self-directed ESA.

Contributions. Contributions to a Coverdell ESA may be made until the designated beneficiary reaches age 18, unless the beneficiary is a special needs beneficiary. The maximum contribution is $2,000 per year per beneficiary (no matter how many different contributors or accounts) and may be made until the contributor's tax filing deadline, not including extensions (for individuals, generally April 15 of the following year). The contribution is not tax deductible, but distributions can be tax free, as discussed below. Contributions may be made to both a Coverdell ESA and a Qualified Tuition Program (a 529 plan) in the same year for the same beneficiary without penalty.

To make a full contribution to a Coverdell ESA, the contributor must have Modified Adjusted Gross Income (MAGI) of less than $95,000 for a single individual or $190,000 for a married couple filing jointly. Partial contributions may be made with MAGI as high as $110,000 for an individual and $220,000 for a married couple filing jointly. Since there is no limit on who can contribute to a Coverdell ESA, if your MAGI is too high consider making a gift to an individual whose income is less than the limits, and they can make the contribution. Organizations can make contributions to a Coverdell ESA without any limitation on income.

Tax Free Distributions. The good news is that distributions from a Coverdell ESA for "qualified education expenses" are tax free. Qualified education expenses are broadly defined and include qualified elementary and secondary education expenses (K-12) as well as qualified higher education expenses.

Qualified elementary and secondary education expenses can include tuition, fees, books, supplies, equipment, academic tutoring and special needs services for special needs beneficiaries. If required or provided by the school, it can also include room and board, uniforms, transportation and supplementary items and services, including extended day programs. Even the purchase of computer technology, equipment or internet access and related services are included if they are to be used by the beneficiary and the beneficiary's family during any of the years the beneficiary is in elementary or secondary school.

Qualified higher education expenses include required expenses for tuition, fees, books, supplies and equipment and special needs services. If the beneficiary is enrolled at least half-time, some room and board may qualify for tax free reimbursement. Most interestingly, a Qualified Tuition Program (a 529 plan) can be considered a qualified education expense. If you believe that contributing to a 529 plan is a good deal, then contributing that money with pre-tax dollars is a great deal!

One thing to be aware of is that the money must be distributed by the time the beneficiary reaches age 30. If not previously distributed for qualified education expenses, distributions from the account may be both taxable and subject to a 10% additional tax. Fortunately, if it looks like the money will not be used up or if the child does not attend an eligible educational institution, the money may be rolled over to a member of the beneficiary's family who is under age 30. For this purpose, the beneficiary's family includes, among others, the beneficiary's spouse, children, parents, brothers or sisters, aunts or uncles, and even first cousins.

Investment Opportunities. Many people question why a Coverdell ESA is so beneficial when so little can be contributed to it. For one thing, the gift of education is a major improvement over typical gifts given by relatives to children. Over a long period of time, investing a Coverdell ESA in mutual funds or similar investments will certainly help towards paying for the beneficiary's education. However, clearly the best way to pay for your child's education is through a self-directed Coverdell ESA.

With a self-directed Coverdell ESA, you choose your ESA's investments. Common investment choices for self-directed accounts of all types include real estate, both domestic and foreign, options, secured and unsecured notes, including first and second liens against real estate, C corporation stock, limited liability companies, limited partnerships, trusts and much more.

With the small contribution limits for Coverdell ESAs, you might wonder how these investments can be made. Often these accounts are combined with other self-directed accounts, including Traditional, Roth, SEP and SIMPLE IRAs, Health Savings Accounts (HSAs) and Individual 401(k) plans, to make a single investment. For example, I combined my daughters' Coverdell ESAs with our Roth IRAs to fund a hard money loan with 2 points up front and 12% interest per year.

One client supercharged his daughter's Coverdell ESA by placing a burned down house under contract in the ESA. The contract price was for $5,500 and the earnest money deposit was $100. Since the ESA was the buyer on the contract, the earnest money came from that account. After depositing the contract with the title company, the client located another investor who specialized in rehabbing burned out houses. The new investor agreed to pay $14,000 for the property. At closing approximately one month later, the ESA received a check for $8,500 on its $100 investment. That is an astounding 8,400% return in only one month! How many people have done that well in the stock market or with a mutual fund?

But the story gets even better. Shortly after closing, the client took a TAX FREE distribution of $3,315 to pay for his 10 year old daughter's private school tuition. Later that same year he took an additional $4,000 distribution. Assuming a marginal tax rate of 28%, this means that the client saved more than $2,048 in taxes. In effect, this is the same thing as achieving a 28% discount on his daughter’s private school tuition which he had to pay anyway!

The Coverdell ESA may be analogized to a Roth IRA, but for qualified education expenses only, in that you receive no tax deduction for contributing the money but qualified distributions are tax free forever. Investing through a Coverdell ESA can significantly reduce the effective cost of your child or grandchild’s education. As education costs continue to skyrocket, using the Coverdell ESA as part of your overall investment strategy can be a wise move. With a self-directed ESA (or a self-directed IRA, 401(k) or HSA for that matter), you don’t have to “think outside the box” when it comes to your ESA’s investments. You just have to realize that the investment box is much larger than you think!

How to Stretch a Roth IRA to Last More Than 150 Years

By: H. Quincy Long

I have a philosophy, which is that if you can create win-win situations you should always do so. My daughter, Briana, is 12 years old and has been invited to travel to Europe next summer to be a Student Ambassador through the People to People program (www.studentambassadors.org). One of the requirements I am making for Briana to go is that she must raise one-half of the finds for the trip. Since Briana needs funds for her trip, and my company, Quest IRA, Inc. needed help stuffing envelopes to send out our quarterly statements, Briana came to work for us to help stuff envelopes. This earned her money for her trip and at the same time reduced my taxable income – a definite win-win scenario.

You may be asking, "What does this have to do with IRAs?" As her father and as a professional in the area of self-directed IRAs, of course it immediately struck me that Briana now has earned income and is therefore eligible for a Roth IRA, even at age 12. This got me thinking about how long a Roth IRA could last under a certain set of circumstances.

The original owner of a Roth IRA never has to take distributions from that Roth IRA. Briana can therefore accumulate funds in her Roth IRA for her entire life without ever having to take a distribution. This is one of the benefits of a Roth IRA over a traditional IRA. With a traditional IRA distributions must begin no later than April 1 of the year following the year the IRA owner reaches age 70 1/2. When she dies, Briana can leave the Roth IRA to anyone she wants (although she may need her spouse's consent in certain circumstances if she lives in a community property state). An IRA inherited by someone is sometimes referred to as a "Beneficiary IRA" or a "Stretch IRA," especially if the person is very young.

Unlike Briana, who never has to take distributions during her lifetime, if a non-spouse beneficiary inherits her Roth IRA they must take required minimum distributions (RMDs) based on the beneficiary's life expectancy as determined by the IRS. The good news is that if Briana has had a Roth IRA for at least 5 tax years when she dies, required minimum distributions from the inherited Stretch Roth IRA to the beneficiary who inherits the account will be tax free, even if they are under age 59 1/2 at the time of the distributions.

So how might this work out in Briana's situation? Let's assume Briana makes exactly $1,000 in earned income for tax year 2008. Roth IRA contributions can be made based on the amount of her earned income (her investment income, if any, doesn't count), up to a maximum of $5,000 for people under age 50 by the end of the year for 2008. In Briana's case, since she earned less than the $5,000 contribution limit, she can only contribute $1,000.

If we assume that Briana will live to age 87, and she never makes another contribution to that Roth IRA, the value of the Roth IRA upon her death (75 years from the start of the Roth IRA) would be as follows:

Initial Contribution	**Annualized Yield**	**Result after 75 Years**
$1,000	6%	$89,013.00
$1,000	12%	$7,748,834.00
$1,000	18%	$659,839,065.00

For purposes of our discussion, I will assume an annualized yield of 12%. Some may argue that this isn't realistic, but in fact at Quest we see much higher yields in self-directed IRAs than just 12%. For example, my Mom's self-directed IRA has achieved a yield of more than 13% per year over the last couple of years by simply doing hard money lending (but that is the topic of a different article). If your calculator holds enough numbers, multiply the appropriate amount from the above chart times 5 or 6 for a full single year contribution depending on the age of the contributor (ie. $5,000 for those under age 50, and $6,000 for those age 50 or older). Of course the results on the chart above do not even account for continuous contributions during Briana's lifetime, which she will almost certainly make based on the financial education she is going to get from me!

If Briana has a daughter at age 31 (although how she is going to have a child before she's ever allowed to date I'm not sure), and her daughter delivers her granddaughter at age 31, who in turn gives birth to her great granddaughter at age 31, Briana will be age 81 when her great granddaughter is born (we'll call her Samantha). If Briana updates her beneficiary designation to leave Samantha her huge Roth IRA, Samantha will be age 6 when Briana dies at age 87. By December 31 of the following year, when Samantha is age 7, required minimum distributions must begin from the inherited Stretch Roth IRA.

To calculate Samantha's required minimum distributions, her life expectancy must be determined from the IRS Single Life Expectancy Table (Table 1 in the back of IRS Publication 590). Once the appropriate Life Expectancy Factor is found on the table, Samantha must take the value of the account as of December 31 of the prior year and divide it by the factor. For a beneficiary who must begin distributions from an inherited IRA at age 7 the Life Expectancy Factor from the IRS table is 75.8. Samantha's first year distribution is calculated as follows:

$$\frac{\text{Prior Year End Balance } \mathbf{(\$7{,}748{,}843)}}{\text{Life Expectancy Factor } \mathbf{(75.8)}} = \text{Required Minimum Distribution } \mathbf{(\$102{,}227.36)}$$

In subsequent years the factor is reduced by 1, and in each year the balance on December 31 of the prior year is divided by the new factor (ie. the Life Expectancy Factor is 74.8 in year 2, 73.8 in year 3, etc.). Since the original Life Expectancy Factor was 75.8, after a total of 76 years the inherited Stretch Roth IRA must be completely distributed, either to Samantha or to Samantha's heirs if she doesn't live that long.

The best part is that Samantha is not required to just let the money sit there earning nothing for the 76 years of required minimum distributions. As long as there is sufficient funds in the account to meet the annual required minimum distributions, the account can continue to be invested in real estate, notes, private company stock and limited partnerships, among many other choices, so that it continues to grow. In Samantha's inherited Stretch Roth IRA, for example, during the first year of distributions if the account earns a 12% annualized yield, the income will be $929,860, while Samantha's required minimum distribution would only be $102,227, resulting in an increase in the account balance of $827,633.

The following chart shows how powerful an inherited Stretch Roth IRA of just $100,000 can be if distributed over a long period of time:

Starting Principal	Beginning Life	Yield	Total Distributions
$100,000	75.8	6%	2,033,743
$100,000	75.8	12%	80,496,367
$100,000	75.8	18%	3,420,454,810

If an annualized yield of 12% can be maintained for the entire life of Briana and Samantha so that the beginning balance of Samantha's inherited Stretch Roth IRA is $7,748,834.00, total distributions from the account for Samantha and her heirs would be a staggering $6,237,497,033 – and under current law it is all TAX FREE! This is obviously an incredible estate planning tool. A lifetime of tax free income is quite a gift to leave to your heirs.

It should be noted that I have ignored for the purposes of this article the estate tax and generation skipping tax issues in order to illustrate the power of an inherited Stretch Roth IRA. No one can predict what tax law changes will take place over the next 75 years, or what the estate tax and generation skipping tax limitations will be if they continue to exist for that long. However, you should never avoid estate and tax planning simply because the law might change. We can only plan based on what we know right now. One thing is for sure – to fail to plan is to plan to fail.

Do Roth Conversions Make Sense?
How to Analyze the 2010 Roth Conversion Opportunity

By: H. Quincy Long

How would you like to have tax free income when you retire? Would you like to have the ability to leave a legacy of tax free income to your heirs when you die? The great news is that there is a way to achieve these goals – it is through a Roth IRA.

Historically, because of income limits for contributions to a Roth IRA and for converting a Traditional IRA into a Roth IRA, high income earners have not been able to utilize this incredible wealth building tool. Fortunately, the conversion rules are changing so that almost anyone, regardless of their income level, can have a Roth IRA. But is it really worth converting your Traditional IRA into a Roth IRA and paying taxes on the amount of your conversion if you are in a high tax bracket? For me, the answer is a resounding yes. I firmly believe it is worth the pain of conversion for the tremendous benefits of a large Roth IRA, especially given the flexibility of investing through a self-directed IRA.

For Traditional to Roth IRA conversions in tax year 2009, the Modified Adjusted Gross Income (MAGI) limit for converting to a Roth IRA is $100,000, whether you are single or married filing jointly. However, the Tax Increase Prevention and Reconciliation Act (TIPRA) removed the $100,000 MAGI limit for converting to a Roth IRA for tax years after 2009. This means that beginning in 2010 virtually anyone who either has a Traditional IRA or a former employer's retirement plan or who is eligible to contribute to a Traditional IRA will be entitled to convert that pre-tax account into a Roth IRA, regardless of income level.

Even better, for conversions done in tax year 2010 only you are given the choice of paying all of the taxes in tax year 2010 or dividing the conversion income into tax years 2011 and 2012. If you convert on January 2, 2010, you would not have to finish paying the taxes on your conversion until you filed your 2012 tax return in 2013 –

more than 3 years after you converted your Traditional IRA! One consideration in deciding whether to pay taxes on the conversion in 2010 or dividing the conversion income into 2011 and 2012 is that 2010 is the last tax year in which the tax rates are at a maximum of 35%. Tax rates are scheduled to return to a maximum tax rate of 39.6% in 2011, and other tax brackets are scheduled to increase as well, so delaying the payment of taxes on the conversion will cost you some additional taxes in 2011 and 2012. The benefit of delaying payment of the taxes is that you have longer to invest the money before the taxes need to be paid, whether the payment comes from the Roth IRA or from funds outside of the Roth IRA.

The analysis of whether or not to convert your Traditional IRA to a Roth IRA is a complex one for most people, because it depends so much on your personal tax situation and your assumptions about what might happen in the future to your income and to tax rates, as well as how you invest your money. From my own personal perspective, I make the simple assumption that tax free income in retirement is better than taxable income. I can afford to pay my taxes now (not that I like it), and I would like to worry less about taxes when I retire. I also don't believe that tax rates will be going down in the future. For me, the decision comes down to whether I want to pay taxes on the "acorn" (my Traditional IRA balance now) or the "oak tree" (my much higher IRA balance years in the future as I make withdrawals).

The way I analyze whether or not to convert to a Roth IRA is to calculate my "recovery period" – that is, the time it takes before my overall wealth recovers from the additional taxes I have to pay on the conversion. If I can recover the cost of the taxes on the conversion before I might need the money in the Roth IRA, then I say it is worth doing, especially since the gains after the conversion are tax free forever. Fortunately, with a self-directed IRA you are in total control of your investments, and the recovery period can be quite short. There may also be a benefit if you are able to convert an asset now that may have a substantial increase in value later.

Using my own situation as an example, I have been planning on doing a conversion in 2010 ever since the passage of TIPRA was announced in 2006. My first step was to immediately begin making non-deductible Traditional IRA contributions. Even though I am covered by a 401(k) plan at my company and earn more than the limits for making a deductible Traditional IRA contribution, this does not prevent me from making a non-deductible contribution since I am under age 70 ½. The main reason I have been making non-deductible contributions to my Traditional IRA is to have more money to convert into a Roth IRA in 2010. The best thing about this plan is that only the gains I make on the non-deductible contributions to the Traditional IRA will be taxed when I convert to a Roth IRA, since I have already paid taxes on that amount by not taking the deduction.

I plan on converting approximately $100,000 in pre-tax Traditional IRA money in 2010. The actual amount converted will be more like $150,000, but as I noted above my wife and I have been making non-deductible contributions to our Traditional IRAs since 2006, so the actual amount we pay taxes on will be less than the total conversion amount. This means that my tax bill on the conversion will be $35,000 if I pay it all in tax year 2010 or $39,600 divided evenly between tax years 2011 and 2012, assuming I remain in the same tax bracket and Congress doesn't make other changes to the tax code.

To help analyze the conversion, I made some calculations of how long it would take me to recover the money I had to pay out in taxes at various rates of return, assuming a taxable conversion of $100,000 and a tax bite of $35,000. I calculated my recovery period based on paying the taxes with funds outside of the IRA (which is my preference) and by paying taxes from funds withdrawn from the Roth IRA, including the early withdrawal penalty I would have to pay since I am under age 59 ½.

If I pay taxes with funds outside of my Roth IRA and can achieve a 12% return compounded monthly, my Roth IRA will grow to $135,000 in only 30 months, at which point I will have fully recovered the cost of the conversion. A 6% yield on my investments will cause my recovery period to stretch to 60 months, while an 18% yield will result in a recovery period of only 20 months! Of course paying taxes with funds outside of the IRA reduces my ability to invest that money in other assets for current income or to spend it on living expenses. But if I have to withdraw the money from the Roth IRA to pay taxes and the early withdrawal penalty, the recovery period for my Roth IRA to achieve a $39,000 increase ($35,000 in taxes and a $3,900 premature distribution penalty) increases to 50 months at a 12% yield and 99 months for a 6% yield. Paying the taxes from funds outside of my Roth IRA will result in a much larger account in the future also since the full $100,000 can be invested if taxes are paid with outside funds, while only $61,000 remains in the Roth IRA after withdrawal of sufficient funds to pay the taxes and penalties.

I believe that since my IRAs are all self-directed I can easily recover the cost of the conversion (i.e. the taxes paid) in less than 3 years based on my investment strategy. From that point forward I am building tax free wealth for me and my heirs. How can I recover the taxes so quickly? It's easy! Self-directed IRAs can invest in all types of non-traditional investments, including real estate, notes (both secured and unsecured), options, LLCs, limited partnerships and non-publicly traded stock in C corporations. With a self-directed IRA you can take control of your retirement assets and invest in what you know best.

In my retirement plan I invest in a lot of real estate secured notes, mostly at 12% interest with anywhere from 2-6% up front in points and fees. I also own some stock in a 2 year old start up bank in Houston, Texas which is doing very well, and a small amount of stock in a Colorado bank. As the notes mature I plan on purchasing real estate with my accounts, because I believe now is the best time to buy. In some cases I may purchase the real estate itself and in other cases I will probably just purchase an option on real estate. The bank stock will be converted at the market price in 2010, but when the banks sell in a few years I expect to receive a substantial boost in my retirement savings since banks most often sell at a multiple of their book value. In the meantime, the notes and the real estate will produce cash flow for the

IRA, and if I have done my investing correctly the real estate will also result in a substantial increase in my Roth IRA when it sells in a few years.

Note that I have written this article from the perspective of someone who is in a high tax bracket. A lower tax bracket will reduce the recovery period and is an even better bargain, especially if you can afford to pay the taxes from funds outside of the Roth IRA. If you take advantage of the opportunities afforded to you by investing in non-traditional assets with your self-directed Roth IRA, you can truly retire wealthy with a pot of tax free gold at the end of the rainbow.

Self-Directed Health Savings Accounts – Building Wealth Through Health

By: H. Quincy Long

By now you have probably heard of the Health Savings Account (HSA). What you may not know is just how amazing this type of account actually is, in terms of premium savings, tax savings, and, most importantly, what you can invest in with your HSA.

Qualification Requirements. In order to have a Health Savings Account, you must be an "eligible individual." To be an eligible individual, you must 1) have a High Deductible Health Plan (HDHP); 2) have no other health coverage, with certain exceptions; 3) not be enrolled in Medicare; and 4) not be claimed as a dependent on another person's tax return. More complete information of the requirements may be found in IRS Publication 969, which is freely available at www.irs.gov.

While a full description of a HDHP is beyond the scope of this article, its key features are a higher deductible than many insurance policies and a maximum limit on the out-of-pocket expenses (including the deductible and co-payments, but excluding the premium payments). For 2011, the minimum deductible is $1,200 for self-only coverage and $2,400 for family coverage, and the maximum out-of-pocket expense is $5,950 for self-only coverage and $11,900 for family coverage. All major insurance companies offer HSA compliant plans. Employers may also offer an HSA compliant plan, since these policies tend to be less expensive. If the employer makes contributions to your HSA it is excluded from your income.

Premium Savings. Because of the higher deductibles and plan features, HSA compliant plans tend to cost less. When I switched from a policy with a $2,000 general deductible and a $200 drug deductible to an overall deductible of $2,200, the premiums for my family were reduced from $754 per month to $450 per month. That's a total premium savings of $3,648 per year!

Tax Savings. One of the best features of an HSA is the tax savings for contributing to the account. Beginning in 2007, the contribution limit is no longer tied to the deductible. The contribution limit for 2011 is $3,050 for self-only coverage and $6,150 for family coverage. To the extent you make the contribution (as opposed to your employer), these amounts are fully tax deductible, no matter what your income level. If you are age 55 or older, you may contribute an additional $1,000 for 2011. There is even a one time ability to take a distribution from your IRA to fund your HSA with no taxes or penalty.

In my tax bracket, the ability to deduct my contributions is significant. I contributed $6,150 for 2011 and will save approximately $2,030 on my taxes. If you add the premium savings over a traditional health plan to the tax savings from contributing to an HSA, the total benefit to me goes a long way towards covering the cost of my contribution.

Distributions from an HSA for “qualified medical expenses”, which are broadly defined and include expenses for yourself, your spouse and your dependents, are tax free forever! Because the expenses only have to occur after the HSA has been established, virtually everyone will end up with qualified medical expenses at some point in their life. You can take a qualified distribution at any point after the expense is incurred, even in later years, provided you keep track of the expenses.

Investment Opportunities. Even better than the premium and tax savings is the ability to invest your HSA funds in non-traditional investments, just as you would in a self-directed IRA. Many banks and other companies offer the convenience of an HSA account with a debit card for you to pay medical bills with. However, if you are healthy and don’t have a lot of expenses or you can fund the expenses out of pocket, you can make your HSA account grow much faster with investments other than mutual funds or savings accounts which may pay very little.

With a self-directed HSA, you choose your HSA’s investments. Common investment choices made by self-directed HSA participants at Quest IRA, Inc. include real estate, both domestic and foreign, options, secured and unsecured notes, including first and second liens against real estate, C corporation stock, limited liability companies, limited partnerships, trusts and much more. In my own HSA I have a portion of two hard money loans generating yields of 12%, a portion of a shared appreciation mortgage which generates 10% in addition to a share of profits when the property is eventually sold, and a membership interest in an LLC owning a debt-fee rental unit.

The Health Savings Account is truly the best of all worlds. It can significantly reduce your health care premiums, reduce your taxes, and produce tax free wealth through non-traditional investments in a self-directed HSA. With a self-directed HSA (or IRA), you don't have to "think outside the box" when it comes to your HSA's investments. You just have to realize that the investment box is much larger than you think!

Either a Lender or a Borrower Be

By: H. Quincy Long

Personally, I think Shakespeare had it wrong when he penned this advice in Hamlet: "Neither a borrower nor a lender be; For loan oft loses both itself and friend, And borrowing dulls the edge of husbandry." Perhaps he may be forgiven for his error, however, since Shakespeare suffered from a lack of the tremendous benefits of a truly self-directed IRA.

Money in self-directed IRAs can be loaned out to any person who is not a "disqualified person." While this means that you cannot loan yourself or other related disqualified persons money from your self-directed IRA, you can loan the money to anyone else. Loans can be secured by real estate, mobile homes, equipment or anything you like. If you are really a trusting soul, you can even make a loan from your IRA unsecured (although in that case I personally would tend to support Shakespeare's advice).

First, let's look at it from the borrower's perspective. At our office we offer a seminar entitled "Make Money Now With Self-Directed IRAs." One of the ways you can make money for yourself right now with your knowledge of self-directed IRAs is by creating your own "private bank." To do this, simply share the news that an IRA can be a private lender, refer people with IRA money to Quest IRA to open a self-directed IRA, and then borrow their IRA money for your own financing needs.

With private financing the loan terms can be whatever the borrower and the lender agree to within the legal limits. If you know a person who is getting 5% in a "safe" IRA at a bank, and you can offer them 9% secured by a first lien on real estate with only a 70% loan to value, would they be happy with that? Even with a higher interest rate, private financing can work for you. IRA loans can be done quickly and without a lot of fees or fuss, which may mean you can get a deal which might be lost if you had to wait on the bank. This is especially true in distressed sale situations, such as a pre-foreclosure purchase.

From a lending perspective, your IRA can grow at a nice rate while someone else does all the work. In a typical hard money loan, the borrower even pays all of Quest's modest fees as well as any legal fees for preparation of the loan documents. True, you won't hit a home run with lending, unless you are fortunate enough to foreclose on the collateral. But the returns can be quite solid. For example, by making very conservative hard money loans my Mom's IRA has grown by about 10.5% in one year. This is much better than the amount she was earning in her money market fund before she moved her IRA to an Quest self-directed IRA.

Even small IRAs can combine with other self-directed accounts to make a hard money loan. My brother recently combined his Roth IRA, his traditional IRA, his wife's Roth IRA, his son's Roth IRA, his Health Savings Account (HSA), and 5 other IRAs to make a hard money loan. The smallest IRA participating in this loan was for $1,827.00! Each IRA made 2% up front and 12% interest on an 18 month loan, secured by a first lien on real estate with no more than 70% loan to value.

One thing to avoid in hard money lending is usury. Usury is defined as contracting for or receiving interest above the legal limit. The usury limit varies from state to state, with a few lucky states having no usury limit at all on commercial loans. Some people have the theory of "What's a little usury among friends?" However, if the investment goes bad and your IRA has made a usurious loan, the consequences of the borrower making a claim of usury could include the loss of all the principal of the loan plus damages equal to 3 times the interest. Some states even have *criminal* usury statutes. It is best to consult with a competent attorney prior to making a hard money loan to make sure your IRA does not violate any usury laws.

To see how well hard money lending can work, let me give you an actual example. One of our clients made a hard money loan from his IRA to an investor who purchased a property needing rehab. The terms of the loan were 15% interest with no points or other fees except for the attorney who drew up the loan documents. The loan included not only the purchase price but also the estimated rehab costs. The minimum interest due on the loan was 3 months, or 3.75%. The investor began the rehab by having the slab repaired, and before he could take the next step in the rehab process, a person offered him a fair price for the property as is. The investor accepted the offer, and they closed about 6 weeks after the loan was initiated.

From the investor's perspective, was this a good deal? Yes, it certainly was! True, he was paying a relatively high interest rate for the time he borrowed the money. However, he was able to purchase a property with substantial equity which a bank most likely would not have loaned him money to buy due to the condition of the property. Also, while the interest rate was high, the cost of financing was actually comparatively low. With a normal bank or mortgage company there are fees and expenses incurred in obtaining the loan. Common fees include origination fees, discount points, processing fees, underwriting fees, appraisal fees and various other expenses relating to the loan. On the surface an interest rate may be 8%, but the cost of the financing is actually higher than 8% since a borrower has to pay the lender's fees in addition to the interest on the loan. Spread out over a lengthy loan term these additional fees do not add much to the cost of the financing. However, if an investor has to pay all of these fees up front and then pays the loan off in only 6 weeks, the cost of the financing goes way up.

In this case the investor's total loan costs were limited to 3 months minimum interest at 3.75% plus $300 in attorney's fees for preparing the loan documents. Best of all, the investor walked away from closing with $20,000 profit and *no money out of his pocket!* Far from "dulling the edge of husbandry" this loan actually made the "husbandry" (ie. the purchase and resale of the property) possible. Incidentally, the purchaser of the property was absolutely thrilled to get the property at less than full market value so that they could fix it up the way that they wanted it.

What about the lender in this case? The lender was also quite happy with this loan. His IRA received 3 months of interest at 15% while only having his money loaned out for 6 weeks. For the 6 week period of the investment, his IRA grew at a rate of approximately 30% per annum! Although his yield was above the legal limit for interest in Texas on loans secured by real estate, prepayment penalties are generally not included in the calculation of usury here, so there was no problem. The investor was happy, the new homeowner was happy, and the lender was happy. Anytime you can create an investment opportunity with a win-win-win scenario, you should.

When I lecture about hard money lending, I ask the audience what they think is the worst thing that happens if you are a hard money lender. Invariably, most people in the audience answer that you have to foreclose on the property. Nonsense! If you are doing hard money lending correctly, the worst thing that can happen is that *the borrower pays you back!* Unfortunately, this is a common risk of hard money lending. Most hard money loans are made at 70% or less of the fair market value of the property. If you are fortunate enough to foreclose on a hard money loan, your IRA will have acquired a property with substantial equity while the investor did all the work of finding and rehabbing the property!

While it is true that foreclosing on a property owned by a friend may cause an end to that friendship, a properly secured hard money loan will at least not "lose itself" as Shakespeare asserts. In fact, it may lead to substantial profit for your IRA! To avoid losing a friend, simply don't loan money from your IRA to someone you would feel bad foreclosing on. In order to be a successful hard money lender, you do have to be prepared to foreclose on the property if necessary.

In modern times I believe the proper advice, at least in the right circumstances, is "Either a lender or a borrower be!" You can make more money for yourself right now by borrowing OPI (Other People's IRAs). Borrowing from someone else's IRA can even lower the total cost of your financing compared to a conventional loan from a bank or mortgage company, especially on short term financing. From a lending perspective, your IRA can make great returns by being a hard money lender, either through higher than average interest rates or, better yet, through foreclosing on property with equity. You may find that hard money lending from your self-directed IRA is a great way to boost your retirement savings without a lot of time and energy invested on your part.

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