WELLS FARGO Advisors

Any Questions?
Call (949) 862-1233

WELLS FARGO Advisors

Real estate in your IRA

We find that some IRA owners are looking for non-traditional investments to hold in their retirement accounts. According to a 2017 Investment Company Institute study, an estimated 42.5 million U.S. households own IRAs; however, only 3% of IRA assets are in alternative investments such as real estate. Because of the issues involved—from the choice of the investments, property management, collection of rents, payment of bills, and tax issues—this is not an investment choice that should be made without expert counsel.

Can I purchase real estate?

One question that we're asked is, "Can I buy real estate in my Wells Fargo Advisors IRA?"

The answer to this is a simple "Yes"—and—"No".

Your Wells Fargo Advisors IRA allows you to hold real estate in the form of certain real estate investment trusts (REITs), mutual funds, and limited partnerships. As with stocks, bonds, annuities, and other investments permitted in an IRA, all earnings from these investments stay in the account on a tax-deferred basis until distributed, or they may be tax-free if you have a Roth IRA.

The answer is "No" at Wells Fargo Advisors when it comes to individual parcels of real estate—whether improved or vacant, investment, or rental.

Concerns with real estate in your IRA

There are several rules to understand regarding real estate within your IRA. While the IRS may allow real estate investments in an IRA, these investments are strictly regulated. The complexity of an IRA investment in real estate and the severe tax consequences for violations of tax laws are some of the reasons why we are wary of including these assets in our acceptable investment menu.

Arms-length transaction

First, the real estate investment must be one that is an "arms-length" transaction. This means that the IRA owner or IRA beneficiaries, as well as certain family members, cannot live in a property or be involved in transactions in which the IRA buys or sells the property. Any violations of these rules can result in a prohibited transaction. In this case, the entire account, not just the portion invested in real estate, ceases to be an IRA. The result is the entire IRA is treated as being distributed at the fair market value as of the first day of the year with the taxable amount included in the owner's income.

Property-related expenses

The second challenge is that the IRA must hold a cash reserve, not only to purchase a property, but also enough cash available to operate it. This could include expenses associated with ownership of the property, such as taxes, repairs, management fees, and insurance. Additionally, you cannot fund the operation of the property from another source if your rental income is not sufficient to pay your expenses. For example, what would happen if the property needed a new roof? If eligible, you can make a contribution, but only up to the annual maximum. Taxes would generally apply on any additional money you'd need to contribute to pay for a new roof. Remember, too, that once a Traditional IRA owner reaches their Required Beginning Date (generally April 1 following the year they turn 72), they must have liquid or distributable assets available to make their required minimum distributions (RMDs). Without enough cash reserve, the entire real estate holding might have to be distributed or sold in order to meet this requirement. Any failure to withdraw these amounts is costly—a 50% IRS excise tax for every dollar under distributed.

Unplanned tax situations

A third issue is that investors who are ill advised may find themselves in an unplanned tax situation. The requirement to pay tax on some of the income generated by investments in your IRA may occur in two ways. When a tax exempt entity (including an IRA) engages in a business unrelated to its primary purpose, any income derived from such business may be subject to tax on its unrelated business taxable income (UBTI). The second way is that any income or gain from debt-financed property held by the exempt entity, called unrelated debt financed income (UDFI), must also be treated as UBTI. A prorated portion of the income may be taxed. The amount taxed is based on the amount of debt relative to the adjusted basis of the investment. For instance, any leveraged property in an IRA can trigger UBTI. Also, when income from unrelated businesses is more than $1,000, the excess may be taxed at a rate as high as 37%. It is important to note that this tax is paid from the IRA, not by the IRA owner out of their personal funds.

Avoid prohibited transactions

Last, it is critical that the property remains strictly an investment. Be sure to avoid any prohibited transactions, including self-dealing. Self-dealing means that the IRA is engaged in transactions that in some way benefit any disqualified person. The definition of a disqualified person is complex. It includes, but is not limited to the following:

- The IRA owner
- The IRA owner's spouse
- The IRA beneficiary
- The IRA owner's ancestors and lineal descendants (i.e., parents and children)
- Spouses of the IRA owner's lineal descendants (i.e., son- or daughter-in-law)
- Investment managers and advisors
- Anyone providing services to the IRA (i.e., IRA custodian/trustee)
- Any corporation, partnership, trust, or estate in which the IRA owner or disqualified person has a 50% or greater interest

Key considerations

Here are a few questions to ask before investing in real estate in your IRA:

- What are the fees charged by the custodian holding this asset?
- What is the value of the real estate?
- How much real estate exposure do I need, if any?
- Are the tax benefits better to hold the real estate in an IRA or outside of the IRA?
- Do I need to have the property appraised every year?
- What happens if I need to sell the property in an unfavorable market?

Talk to Wells Fargo Advisors

So for those thinking about holding real estate in their IRA, our response is: buyer beware. We look forward to working with you to help assure your retirement future at Wells Fargo Advisors. Wells Fargo Advisors does not provide legal or tax advice.

With you every step of the way

Everyone has a different vision of retirement that requires a unique financial strategy. Wells Fargo Advisors can support you in your retirement planning process by providing the guidance needed to make informed choices. We will meet with you and help create a comprehensive plan that takes into account your complete financial picture. Your Financial Advisor will be with you every step of the way to meet to review your progress and adapt your plan as needed. Working together, we'll design and implement an investment plan that can help you live out your unique vision of retirement.

Any Questions?
Call (949) 862-1233
WELLS FARGO Advisors

Traditional IRA distributions are taxed as ordinary income. Qualified Roth IRA distributions are not subject to state and local taxation in most states. Qualified Roth IRA distributions are also federally tax-free provided a Roth account has been open for more than five years and the owner has reached age 59½ or meets other specified requirements. Both may be subject to the IRS 10% additional tax if distributions are taken prior to age 59½.

REITs are required to pay 90% of their taxable income to investors; therefore, they rely upon external funding as their main source of capital. Investors must consider a REIT's potential for success, determining whether individual REITs have access to debt or equity capital adequate to fund their future growth plans. Real estate values tend to fluctuate with current market conditions. There are special risks associated with an investment in real estate, including credit risk, interest rate fluctuations, and the impact of varied economic conditions.

Please Note: This material has been prepared for informational purposes only and is not a solicitation or an offer to buy any security or instrument or to participate in any trading strategy. Since each investor's situation is unique, you need to review your specific investment objectives, time horizon, risk tolerance, and liquidity needs with your financial professional(s) before an appropriate strategy can be selected. Also, since Wells Fargo Advisors does not provide tax or legal advice, investors need to consult with their own tax and legal advisors before taking any action that may have tax or legal consequences.

Wells Fargo Advisors is a trade name used by Wells Fargo Clearing Services, LLC and Wells Fargo Advisors Financial Network, LLC, Members SIPC, separate registered broker-dealers and non-bank affiliates of Wells Fargo & Company.