SIMON LETTER

A Publication of Live and Invest Overseas™

Multiply Your Purchasing Power With A Self-Directed 401(k)

By Lee Harrison

I recently received a letter from a Member of *Global Property Advisor*, my elite property intelligence service, asking who I recommended for setting up their self-directed 401(k).

At first I thought they meant an IRA, which many folks have been using to make alternative investments such as offshore real estate. But the self-directed 401(k) that he referred to can make these investments too… and can often do so more-easily.

To learn more about the Solo 401(k) structure, I turned to Lee Harrison, Live and Invest Overseas Latin America Correspondent and the only person I know who has done this himself.

— *Lief Simon*

Staff

Lief Simon has been quoted by many publications, including *The New York Times*, *International Herald Tribune*, *USA Today*, *Miami Herald*, and even *Outdoor Magazine*. But the best stuff is in *Simon Letter*.

Lief Simon does not provide any personal investment advice, as he's not a registered financial advisor. Seek professional counsel for any investment opportunities mentioned in this e-letter and do your own due diligence.

Lief Simon does offer tax advice and was an enrolled agent with the IRS (until his certificate of enrollment expired in 2013). Being an enrolled agent means you can represent clients in front of the IRS because you passed a test. The test isn't easy, but it doesn't mean you know anything about preparing U.S. tax returns. Still, Lief passed the test, and, in fact, years ago, back during his U.S. working life, Lief did prepare tax returns for a living, both corporate and personal.

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In 2012, I purchased an income property in Medellín. It's a two-story condo on the 17th and 18th floors of a new building on Medellín's Golden Mile. Since closing, it's generated around US$1,900 per month... about 8.5%.

That same year, I invested in a foreign stock exchange, opened accounts in foreign currencies, and even opened a cash savings account that generates 5% interest.

In 2012, I purchased an income property in Medellín. It was a two-story condo on the 17th and 18th floors of a new building on Medellín's Golden Mile. After closing, it generated around US$1,900 per month... about 8.5% net return, based on what I paid at the time.

That same year, I invested in a foreign stock exchange, and opened accounts in foreign currencies. In 2019, I opened a foreign currency savings account in Mexico that pays over 8% interest.

What these transactions all have in common is that I used my tax-deferred retirement funds—money from a 401(k) plan provided by my former employer—which I'd converted to a self- directed retirement plan.

By using a self-directed retirement account, you can really put your retirement funds to work on the overseas property market, as well as overseas financial markets. You can personally control the funds and invest them as you see fit while preserving your tax-deferred status on the principal and gains.

Originally, I believed that the only way to do this was to set up a self-directed IRA, so I set out to create one. And in hopes of avoiding a financial planner's large setup fees and annual charges, I decided to do it myself.

Setting Up A Self-Directed IRA Was Not As Easy As I'd Hoped

Trying to set this up myself was *way* more difficult than I thought. After two weeks of research, here's some of what I learned...

<u>It's hard for do-it-yourselfers</u>. There are scores of companies out there that can set up a self-directed IRA for you... but the knowledge of exactly how to do it yourself is very hard to come by.

Determined to do it myself anyway, I spent a hundred bucks on a special report on how to set up a self-directed IRA from a well-known e-letter publisher.

What a sucker I was. Instead of telling me how to set up the IRA, my "special report" gave me 30 pages of narrative on why it was a good idea... and a reference to their partner financial advisor, *who I could pay to set it up*.

<u>IRAs require custodians, by law</u>. Usually this is a bank or trust company, and *it's in addition* to any facilitator or advisor that you employ. So even after setting up a self-directed IRA, there's still a custodian that needs to approve each investment—an approval that takes valuable time.

<u>Facilitators and advisors are not custodians</u>. When I use the term "facilitator," I'm referring to financial service companies or individuals who bring "account administration services" to the table and provide an interface between you and the custodian. These advisors, of course, charge for their services, too.

Real custodians have the word "bank" or "trust" in their name. Facilitators sometimes have names that sound like "trust" but aren't—maybe something like "Safetrust." Don't be fooled; they're not custodians.

So even after setting up a self-directed IRA, you can still find yourself working through a facilitator (and the custodian) in a cumbersome process.

<u>You can pair your IRA with an LLC</u>. In order to circumvent the custodian, you can form a limited liability company (LLC) and then invest your IRA funds in the LLC, with custodian approval. Thereafter, as manager of the LLC, you can make the actual investments via the LLC *without* custodian approval.

This gives you what the industry calls "checkbook control" of your retirement funds. But, unfortunately, the LLC brings an added layer of expense, complexity, and reporting requirements.

An Alternative To The Self-Directed IRA: The Solo-401(k)

Here's why I like the Solo 401(k) better than the self-directed IRA:

- Unlike IRAs, 401(k)s do not require a custodian. You can set up a Solo 401(k) plan, and name yourself the plan's trustee. Then you've got complete "checkbook control" of all the plan's assets, with no intermediaries.
- There's no need to establish a workaround LLC since you are approving your own transactions. (Keep in mind though, that you may have other reasons why an LLC makes sense.)
- The annual contribution limit is almost 10 times that of an IRA, so you can legally put far more money into tax-deferred status. For 2023, you can defer $66,000 if you're under 50, and $73,500 of you're 50 or older. (Although you can't defer more than you're earned income.)
- Solo 401(k)s are now available in a Roth version, so you can fund it with after-tax dollars and let it grow tax-free (instead of tax-deferred).
- Also, you can borrow money from a 401(k) plan—up to US$50,000 or 50% of the plan's balance.
- Reporting requirements are minimal: just one form, once per year, and only when the plan's assets are more than US$250,000.
- Setup is fast. I had my plan up in a couple of days.
- Best of all, it's inexpensive to set up and maintain going forward.

As with IRAs, the Solo 401(k) will accept rollovers from your present plans (except Roth IRAs). So you can take control of as much (or as little) of your present retirement funds as you want.

But The Solo 401(k) Is Not For Everyone

Remember that self-directed plans are higher-risk plans. This is because *you're* in control of your own retirement funds... not a professional custodian or professional plan manager. This means that you need to come up to speed with any required restrictions on its use, and any recordkeeping requirements.

Also, the Solo 401(k) plan is for people with at least *some* self-employment income.
This can be from a part-time endeavor, like freelance travel writing, consulting, photography, or anything else you do to earn money *aside* from regular employee wages. This self-employment income can be in addition to your regular full-time job, and there's no minimum income amount.

There are certain prohibited transactions when using any retirement funds, restricting you from using them for immediate personal benefit. Follow the link to see the IRS's explanation of prohibited transactions. Note that prohibited transactions *do not apply* to money that you may borrow from your 401(k).

How To Get Started With A Solo 401(k)

A few traditional institutions offer Self-Directed 401(k) plans (like Fidelity), but these so-called self-directed plans aren't what you want. You can invest only from their offerings; you can't do things like buy property abroad.

For real control, you need a specialist in this type of individual plan. I've worked with Jeff Nabers, of Nabers Group for my Solo 401(k). I've been happy with their support, training materials, and customer service. They had the plan set up in a day, ready for rollover. Check them out here.

To put the pricing into perspective, using my Solo 401(k), I made more during my first month with an income property abroad than it costs to set the whole thing up.

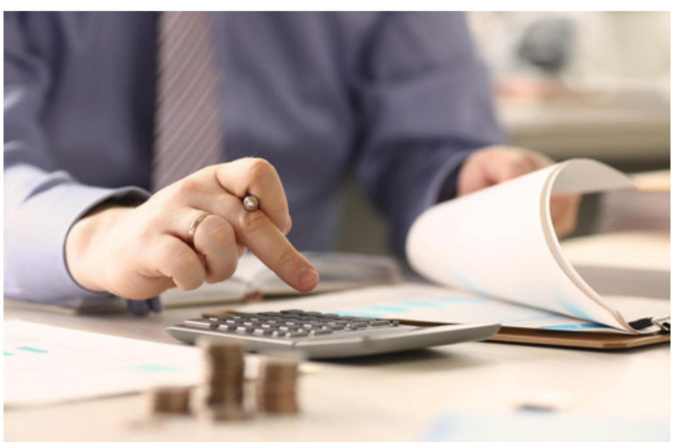
A Word Of Caution For Do-It-Yourselfers

I like to do things myself, even though it often involves a learning curve. But before you undertake the management of your own retirement plan, understand this:

Facilitators and custodians actually earn their fees, despite my personal reluctance to pay them. It takes work to do this on your own and to keep things in order. And the penalties for misuse of your plan are severe. With a single mistake, you can lose tax-deferred status and end up (immediately) paying income tax on the entire plan's balance. In fact, some people who have Solo 401(k)s will still employ a facilitator or advisor to keep the records straight, manage distributions, and do any required filings.

So managing a 401(k) is fine… as long as you're willing to learn the rules, and carefully keep the required records.

Tips For Buying Property Overseas With Tax-Deferred Funds



The ability to buy property with an IRA or a 401(k) is a huge breakthrough for investors seeking opportunities overseas. It has allowed people to "unleash" their retirement plans and give them access to the full potential of the world's opportunities.

The IRA and the 401(k) are different vehicles, but what you can do with them is exactly the same... as are the restrictions placed on the investments you can make.

I've purchased overseas property with my 401(k), and I've met many readers over the years who have done the same thing with great success.

But I've also met quite a few who missed lucrative opportunities and a handful who gave up on the idea altogether after getting off to a clumsy start.

Here are a few lessons I've learned along the way...

Set Up Your IRA Or 401(K) Well Before You Need It

Years ago, I was traveling in southern Ecuador with my friend Steve. He had been planning for quite a while to buy an overseas property with a self-directed IRA.

After exploring the area for a few days, we found the perfect property. Hidden away at the far end of a quiet valley was a large, modern home with an attractive wraparound porch. At less than US$50,000, it was a steal.

Steve contacted the owner, and they agreed on terms. He returned to the States to set up his self-directed IRA.

Two months later the house was sold... to someone else. Steve was still in the process of setting up his IRA and its companion LLC.

And Steve's story is a common one. Every year I see at least a dozen people who miss good moneymaking opportunities because they don't set up their plan ahead of time, or they underestimate how long it takes.

If you look around you'll find dozens of IRA-setup guys telling about how fast they can set one up. And it's true; not every self-directed IRA will take two months to get going. And while a 401(k) can be set up in a day, it took me several weeks to complete the rollover and get it funded.

I guarantee you this: You will *never* set one of these up fast enough to take advantage of a true, time-sensitive offer if you haven't started ahead of time.

And what's more, it's illegal to use your non-IRA funds to hold the property while your IRA is being set up.

You have to set up your self-directed IRA or 401(k) *before* you need it, so you're ready so strike when an offer presents itself.

Once You Have Your IRA Or 401(K) In Place, Choose The Opportunity

You've probably read a good deal about how to choose an overseas property. But it's different when you buy it with an IRA or 401(k). In fact, it's easier.

Since you can't use the property for personal use, you won't have the normal conflict that comes when trying to balance the attributes of a good second home with a good rental property. When buying with your retirement plan, remember that its only purpose is to generate income or realize a capital gain.

For a few tips on choosing a property, see this essay on [how to get the most from your overseas rental].

How You Title The Property Can Cause Delays... Or Stop You Altogether

You can't use retirement funds to buy a property and then title the property in your own personal name; it must be in the name of your IRA, its LLC, or your 401(k) trust. This can be a problem if the country doesn't recognize as entities the LLC or 401(k), and therefore won't put it on a property title.

If you have an LLC, titling is often not a problem; many countries recognize the LLC and will put them on a property title. And you can create LLCs cheaply and easily in the United States, even doing so online.

But if you're using a 401(k) (without an LLC), then I've found titling to be an issue. Colombia and Uruguay, for example, don't know what a "401(k) trust" is; they don't know how to hold it accountable to the law or how to tax it.

I tried to get my 401(k) trust recognized by Uruguay in order to take advantage of a terrific deal on a historic property in Colonia. The property was sold within two days... long before I was even close to setting up an entity that Uruguay would let me put on a title. I should have squared this away well before looking for a purchase.

And whatever entity you use (if it's not created where the property is), the country you're buying in will want evidence that you are empowered to sign for that entity. So if you're buying with an IRA and an American LLC, be prepared to bring documents showing that you are able to represent that LLC.

Finally, consider the tax consequences before setting up an entity with which to hold property. In Uruguay I was surprised to find that foreign corporations were taxed at a lower rate than local corporations in order to attract foreign investment.

Don't Go Overboard Setting Up Financial Structures And Companies

Men like to play with money. And one of the ways we do that is to create a mini-empire with different entities in different countries, among which we can move that money. We not only get to play with our money, but we feel worldly and financially sophisticated while we're doing it.

I've done this... and I've enjoyed it. I like setting up companies. But financially, I learned that there's no award given for complexity... and, in fact, there's a penalty in efficiency and cost.

So, in short, create only what you need in order to accomplish what needs to be done. Don't set up a Belizean trust and a Panamanian corporation with a Swiss bank, when a US$69 LLC from Nevada will do the job.

Here's The Trick That Will Allow You To Live In Your IRA/401(k) Property

This is a great headline, right? *But you can't do it*.

You cannot live in, use, or benefit from a property owned by a tax-deferred retirement plan. Only your IRA or 401(k) can benefit—not you personally.

You guys, our esteemed readers, have come up with some brilliant and creative workarounds... most of which are completely illegal.

My favorite was the guy (one of several) who wrote in claiming that he could take an IRA distribution valued at 1/12 the value of the property, and then live in the property one month per year. Clever... but I don't agree that he won't get into trouble if he gets caught.

As I mentioned, the penalties for stretching the law are severe. Here's what the IRS says:

> *…if an IRA owner or his or her beneficiaries engage in a prohibited transaction in connection with an IRA account at any time during the year, the account stops being an IRA as of the first day of that year.*

In other words, a fifty-dollar mistake can make a million-dollar IRA immediately taxable.

But there are a few tricks you can legally employ.

My favorite is the guy who wanted a country home on a large tract of land. So he bought a small plot and built

a home on it. And he also bought all of the surrounding plots with his IRA, creating a buffer between himself and the other property owners. His plan (at some time in the future) was to take an IRA distribution equal to the value of one plot, each year. This way he'd eventually own that large parcel, while not suffering the big tax hit all at once.

In the meantime, he could possibly lease the land out to someone else and let it earn some money for his IRA. I believe this plan is legal provided you don't actually use the IRA-owned properties.

It's Profitable And Easy To Manage, Once You Learn The Rules

My first 401(k) purchase was in Colombia... where I also had another property bought with personal post-tax funds.

I set up separate accounts with the property manager, separate bank accounts to receive rental income, and separate brokerage accounts to transfer money in and out of Colombia, to and from my separate accounts in the United States.

Make no mistake, this segregation and associated recordkeeping is a lot of work. But it kept my funds—and my records—clean, traceable, and above-board.

And it was worth it. That rental property in Medellín produced a higher return than any other investment I had.

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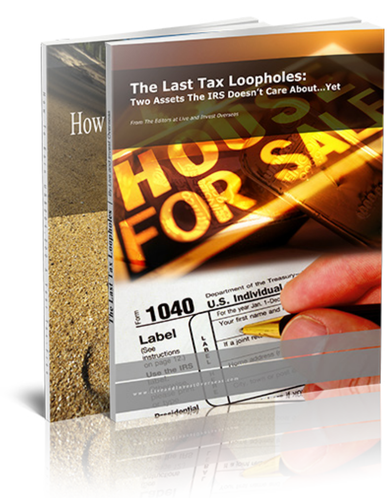

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