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Buyer Beware:
Purchasing Real Estate Within Your Self-Directed IRA

BY NICHOLAS A. REISTER, ATTORNEY

Over the past few years, you may have heard about people purchasing real estate (among other unconventional assets) within their self-directed IRAs. This strategy is different than investing in real estate investment trusts (REITs) in that the IRA assets are used to purchase specific properties rather than a diversified portfolio of real estate. This trend seems to correlate with reduced access to bank financing and investors looking to capitalize on depressed property values, thus they are turning to the assets shown on their IRA statements. Although this is not a new strategy, you should consider the risks and drawbacks which may be the reasons for its historical obscurity before dipping your toes into the tempting waters touted by financial "gurus" and IRA custodians engaged in this market.

The risks associated with owning real estate in your IRA are not for the faint of heart. The IRS prohibits certain transactions, including anything that is deemed 'self-dealing'. Self-dealing includes transactions involving you or a family member selling real estate to, or buying real estate from, your IRA. Self-dealing also includes personal or family use and management of the real estate as well as buying real estate, such as adjoining parcels, to control who uses it or how it's used. If the IRS determines that you have engaged in self-dealing, your entire IRA (including conventional IRA assets) loses its tax-exempt status and will be taxed immediately. In addition, if you're under age 59 ½, you likely will also have to pay a 10% early distribution penalty on the value of the prohibited investment.

Although IRAs are typically believed to be free of taxes, income generated by the real estate within the IRA

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Speaking Engagements

ICLE's 53rd Annual Probate & Estate Planning Institute

Estate Planning for Remarrying Seniors, by George F. Bearup

When & Where:

May 10, 7:30 a.m. - 3:30 p.m.
Traverse City, MI

June 14, 7:30 a.m. - 6 p.m.
Plymouth, MI

Sponsored Events

Traverse City Senior Expo - 2013

When & Where:

May 15, 10 a.m. - 3 p.m.
Grand Traverse Civic Center,
Traverse City, MI

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Welcome Mike Shelton

Michael Shelton is an attorney in West Michigan where he practices estate planning, real property law, and business law.

Mike began at the law firm as a summer associate in 2010, after serving over six years in the United States Army, and the Michigan National Guard.

As an estate planner, Mike prepares wills, trusts, and powers of attorney for families which help relieve some of the pressure and anxiety that often accompany the unexpected death or incapacity of a loved one.

In addition to estate planning, Mike advises business owners on all matters from entity formation, corporate due diligence, and corporate maintenance to employment law, licensing, and asset and business acquisition matters.

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is subject to unrelated business income taxation (UBIT). In addition, if the IRA borrows money to purchase real estate, then a portion of the profit that is attributable to the borrowed money is subject to Unrelated Debt Financed Income (UDFI) tax. Finally, all such financing must be via non-recourse loans (not personally guaranteed) or it will be deemed self-dealing.

A number of drawbacks apply to a self-directed IRA owning real estate as well. Real estate owned by an IRA may not be depreciated and when the real estate is sold, the proceeds distributed from the IRA are taxed as ordinary income rather than capital gains, resulting in a higher tax bill. Other drawbacks arise during the life of the IRA in that the real estate must be appraised on several occasions and annually. Once required minimum distributions (RMD) begin, the real estate must be managed independently with its attendant costs and the IRA must maintain enough liquid assets to be able to make the RMD.

With the numerous pitfalls associated with this investment strategy, you are wise to engage legal counsel as well as a qualified CPA and investment financial professional to ensure that it is structured and managed in a way that prevents negative tax consequences while meeting your retirement objectives and risk tolerance. Safer yet, if you are looking to diversify your self-directed IRA by investing in real estate, consider doing so by buying shares in a REIT.

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Paying Family Caregivers:
A Medicaid Minefield

BY GREGORY R. KISH, ATTORNEY

Michigan's Medicaid rules contain several traps for the unwary that can result in denial of needed benefits. One of these traps relates to applying for long-term care Medicaid benefits after paying a family member to provide care at home.

WHAT IS DIVESTMENT?

Medicaid divestment policy seeks to discourage people from giving away assets in order to qualify for long-term care Medicaid, which is a means-tested program. Stated simply, if a Medicaid applicant or spouse gave away money or other assets within five years of needing long-term care Medicaid benefits, the gift will be considered divestment. Divestment results in a divestment penalty, which is a period of time during which the applicant meets all of the eligibility requirements for long-term care Medicaid, but during which the Medicaid program will not pay for the person's long-term care. The penalty lasts for the number of days, months, or years of long-term care that the gift could have paid for. Outright gifts, bargain sales, annuity purchases, and some other types of transfers may constitute divestment.

FAMILY CAREGIVERS

Payments made to family members who provided care for the Medicaid applicant or spouse may result in a penalty. Oftentimes, a person who would otherwise need long-term care in a nursing

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home, assisted living, or at-home, would prefer to have a familiar face provide the needed care. A family member might take on that significant responsibility, and the person needing care would like to compensate the family member for the care.

Unfortunately, Medicaid's divestment policy currently sets a trap for unwary families. Under the policy, any family member who provides care is presumed to do so only "for love and affection." Therefore, any compensation paid to that family member is considered a gift. If the person pays a family member to provide care and later applies for Medicaid assistance for long-term care, any payments made will be considered divestment and result in a penalty.

WRITTEN CARE AGREEMENTS

A written care agreement that conforms to the Medicaid policy's requirements provides protection from this trap. If the family implements a written agreement outlining the services to be provided, the rate of pay, and several other specific aspects of the arrangement, the payments to the family caregiver will not be considered divestment. However, the requirements for these agreements are so specific that even those few families who prepare their own written agreements usually run afoul of the policy.

For example, the agreement must contain a physician's certification that the services to be provided meet a certain standard. The agreement must be notarized, the payments may only be made to the family member after he or she provides the care, and the agreement must be in place before the caregiver provides care or receives payment.

Of course, the DHS does not publicize this policy well, and most families do not consult with an elder law attorney until it appears that the senior's need for Medicaid benefits is imminent. By then, the family caregiver may have been providing needed care for months or years and may have been paid a substantial sum.

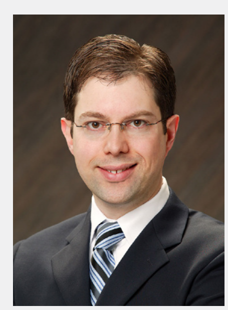
PENALTY LEAVES FEW OPTIONS

Consider the situation of a senior who has paid a family member $50,000 over the past eighteen months to provide needed care in the senior's home. That senior's need for care has now progressed to the point where the senior needs skilled nursing care in a nursing home. The senior owns only a bank account now valued at less than $2,000, which is the Medicaid countable asset limit for a single person. Unless the family had a conforming care agreement in place before the caregiver provided services or received payments, the senior (who now needs nursing home care and has no money with which to pay for it), will face a penalty. The Medicaid program will not pay for the person's nursing home care for the next six and a half months, leaving the senior with no way to pay for the needed care.

TIPS FOR AVOIDING THE PENALTY

Before paying a family caregiver, consult with an elder law attorney who can help prepare and implement a personal care agreement that meets Medicaid requirements. If the family caregiver has already provided the services and/or received payments, an elder law attorney can advise on the best way to present information to the Medicaid program so as to minimize or eliminate the penalty. In addition, the elder law attorney may advise implementing a care agreement for future services as to minimize the affect of the divestment penalty.

Medicaid policy should be designed to help seniors in need, not to penalize well-meaning families who are simply unfamiliar with some of the technical requirements of the Medicaid rules. Nevertheless, until the state changes this policy, families should exercise caution and consult an elder law attorney to avoid an unfortunate trap.



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Kish Earns Designation as Certified Elder Law Attorney

NELF
National Elder Law Foundation
Certified Elder Law Attorney

Greg is one attorney among only 15 in Michigan to hold the Certified Elder Law Attorney designation from the National Elder Law Foundation. To earn this designation, licensed attorneys must meet elder law involvement and education requirements by having practiced elder law for a certain number of years, handled a specific number of elder law matters, and participated in continuing elder law education for the minimum number of hours. Additionally, attorneys must participate in a peer review process and pass a rigorous certification examination.

Greg is an experienced attorney in Smith Haughey's Traverse City office, where he practices primarily in the areas of elder law, estate planning, long-term care planning, probate, trust administration, special needs planning, and real estate law. Greg's holistic approach to elder law focuses not only on the legal and financial issues of maintaining independence, long-term nursing home or home-based care, assisted living, Medicare, and Medicaid, but also on the need to be mindful of the emotional aspects of these difficult family decisions.

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