CONSIDERATIONS FOR REAL ESTATE INVESTING

Although a pension plan is permitted to acquire real estate, there are an alarming number of issues to consider. My intent is to make you aware of the considerations before you purchase real estate for your pension plan, so you can ask the appropriate questions, and then make a more educated decision.

- **Are the transactions properly structured?** The pension plan trust must be the owner of the real estate, with the plan's Trust ID# used as the appropriate Tax ID#. All income and expenses associated with managing the property must pass directly into and out of the plan trust. Financing can be obtained, but once again, the plan trust must be the note holder. However, since a financial institution is not permitted to stake a claim against assets of a pension plan, collateral for the loan will likely need to be provided from a source outside of the plan.

- **Is there a Prohibited Transaction (or "self-dealing")?** Transactions between a pension plan and any of: you, your business, or most of your family members, business partners and financial advisors, are prohibited. Similarly, these people can't make use of your plan-owned property, either. For example, your parents can't live in a house owned by your pension plan, even if they pay reasonable rent. Further, since property cannot be "contributed" to a pension plan, once you personally own the real estate, it's very difficult to get it into the plan.

- **What happens when the plan terminates?** You'll probably roll your pension account over to an IRA once you terminate your plan. However, due to complicated requirements, you may not be able to find an affordable financial institution willing to be the trustee for an IRA that holds real estate. While it may be possible to simply keep the pension plan intact (a Defined Benefit plan, however, would have to be rolled into a different kind of pension plan to do this), the IRS discourages the existence of a pension plan solely for this purpose. Further, since a business, as opposed to an individual, must sponsor a pension plan, you'll need to sponsor a business for as long as you're maintaining your plan.

- **Can an accurate market value be periodically assessed?** At least once annually, there needs to be an accurate accounting of all plan assets, to ensure that all participants' interests can be properly evaluated. All assets must be reported at market value, which may be difficult to assess for some properties. Although getting an independent appraisal every year would satisfy the government, that could be impractical and costly. However, if the IRS successfully challenges the accuracy of your reported property values, you could be subject to penalties and excise taxes.

- **How will gains be taxed?** Funds that will eventually be withdrawn from your pension plan (or your subsequent IRA) will be taxed as ordinary income. Thus, although you'll likely be in a lower tax bracket when you start drawing down your pension than you are now, the capital gains rates will probably be even lower. Thus, consider the tax implications of purchasing real estate inside the plan, as opposed to keeping it outside of the plan.

- **Is there Unrelated Business Income Tax (UBIT).** Another tax consideration depends on what you do with the real estate your plan purchases. For example, if your plan purchases raw land, then you develop the land and sell houses, then you're essentially running a business through your pension plan. To keep you from gaining a competitive advantage, solely due to the tax advantages of running the business through your plan, your income will be subject to UBIT.

- **Will your plan assets need to be independently audited every year?** If you have plan participants other than you and your spouse, you must ensure that you maintain fidelity bond coverage for at least as much as the combined value of all of your "non-qualifying assets", such as property, limited partnership interests, mortgages and other notes, etc. If you fail to keep up your fidelity bond coverage, you lose your "small plan" exemption from requiring an annual audit of your plan's assets.

- **Does your plan discriminate against employees?** If you have the type of plan in which each participant can direct how their account will be invested, then, technically, all investment options available to you must also be made available to all participants. Again, this is an impractical situation for owning real estate in a pension plan.

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In summary, although investing in real estate has increased in popularity in recent years, a wide array of issues must be considered that don't typically factor into the decision to purchase stocks, bonds and mutual funds. Please address these issues <u>before</u> purchasing real estate for your pension plan.

These guidelines are not intended to provide a detailed analysis of the laws affecting pension plan investing. Although I'm available to discuss how the relevant issues impact your particular situation, if there's any uncertainty as to the legality of your situation, I recommend you contact a pension attorney for a second opinion. I also recommend that you contact your accountant for tax advice.