6 Prohibited Transactions to Avoid with Self-Directed IRAs

Self-Directed IRA and Solo 401(K) accounts provide lots of flexibility. However, with this flexibility comes the added responsibility to understand IRS guidelines and stay aware of prohibited actions.

The following 6 transactions are prohibited for a self-directed IRA and should be avoided when building your investment strategy. It's important to note that under official IRS guidelines, a "disqualified person" is considered to be the IRA owner, their spouse, ancestors, descendants, investment advisors, fiduciaries, and any business with an interest of 50 percent or more of the entity.

✔ 1. SELLING, EXCHANGING, OR LEASING OF PROPERTY BETWEEN THE PLAN AND A DISQUALIFIED PERSON.

This means that you are not allowed to sell or lease any property purchased through an IRA to a family member or fiduciary.

FOR EXAMPLE:

Purchasing real estate through an IRA and leasing it to your daughter or using IRA funds to purchase an interest in a company owned by your parents.

✔ 2. LENDING MONEY OR OTHER EXTENSION OF CREDIT BETWEEN THE PLAN AND A DISQUALIFIED PERSON.

This implies that you are prohibited from loaning any money from your IRA to a family member, fiduciary, or financial advisor. You are also prohibited from pledging your assets as security for a debt of the IRA such as a mortgage.

FOR EXAMPLE:

Taking $10,000 from your IRA to make a loan to your father or lending money from your IRA to a business that a family member operates.

✔ 3. FURNISHING GOODS, SERVICES, OR FACILITIES BETWEEN A PLAN AND A DISQUALIFIED PERSON.

This explains that a disqualified person is prohibited from providing any supplies or helping with the property at any time.

FOR EXAMPLE:

Purchasing a rental property with IRA funds and performing the renovations yourself or using your IRA to buy an apartment building and hiring your husband to manage the property.

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4. TRANSFERRING INCOME OR ASSETS TO A DISQUALIFIED PERSON, OR USING THE PLAN'S INCOME OR ASSETS FOR THE BENEFIT OF A DISQUALIFIED PERSON.

This rule indicates that you cannot use money from your IRA to help family members or fiduciaries pay off debts or contribute to their income.

FOR EXAMPLE:
Using money from your IRA to pay off your son's student loans.

5. DEALING WITH THE PLAN'S INCOME OR ASSETS BY A DISQUALIFIED PERSON WHO IS A FIDUCIARY ACTING IN HIS OR HER OWN INTEREST OR FOR HIS OR HER OWN ACCOUNT.

This means that you are not allowed to have any family members work on accounts, properties, or businesses connected to your IRA.

FOR EXAMPLE:
Hiring your wife to provide administrative support for your IRA and paying her wages or using IRA funds to purchase real estate and paying yourself commission on the sale.

6. A FIDUCIARY WHO IS A DISQUALIFIED PERSON RECEIVING ANY CONSIDERATION FOR HIS OR HER OWN PERSONAL ACCOUNT FROM ANY PARTY DEALING WITH THE PLAN IN CONNECTION WITH A TRANSACTION INVOLVING THE INCOME OR ASSETS OF THE PLAN.

This implies that you are prohibited from using any money from your IRA to further your career or aid in your personal financial gain.

FOR EXAMPLE:
Using your IRA funds to lend money to a business that you work for in order to obtain a promotion.

Keep in mind that if the IRS were to audit your account, they would examine the facts and specific circumstances in order to determine whether a prohibited transaction has occurred. The best practice is to keep your IRA separate from your personal finances and keep records of all accounts and transactions. Working with a knowledgeable financial advisor will help you navigate your accounts and build the right investment strategy.