Ep #211: Bernard Reisz - The Advantages and Caveats of Checkbook Control IRA and QRP Investing

Full Episode Transcript

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Dr. David Phelps

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David Phelps: Good day, everyone. This is Dr. David Phelps at the Freedom Founders Mastermind Community and the Dentist Freedom Blueprint Podcast, bringing back Mr. Bernard Reisz this week to talk about a little more in-depth into self-direction of alternative investments. Bernard, how are you doing, sir?

Bernard Reisz: I'm doing great. Last episode was really exciting. I enjoyed it so much. So I'm even more excited and hyped about doing this one.

David Phelps: Well, we'll take it to another level. So, if you missed last week's I would really advise you to go get it, because it really sets a foundation for something we'll talk about today. But just to let you know briefly, Bernard is a licensed CPA. He also has securities licenses. He also is licensed to sell insurance. But all of that is to be said he is really, I would say, a person who is able to bring a lot of diversity and a lot of tax advantage opportunities to his clients. Bernard, what's your idea client mix look like, if there is one? How would you define an ideal client that you work with today?

Bernard Reisz: Yes. So we can say there are two segments of the business. One is when we do these checkbook control retirement accounts, we set those up for people all over the country, whether or not they're our clients for any other services. So that's a real niche service, and it's important to work with a provider that will guide you to the plan that's best-suited to you.

Something that we'll touch upon today, although there is incredible opportunity and flexibility, there are rules, and you've got to know the rules, and you've got to work with somebody that's not going to just give you enough rope with which to hang yourself. They're going to educate you and make sure they're going to steer you to the plan that suits you, and we do that for people all over the country.

David Phelps: Yeah. The education part is very, very important, and we didn't touch, really, on the rules. Maybe we'll touch a little bit on it today. But, you know, compliance is a big part of what you provide, because you can't just go out there and have the Wild Wild West, be self-directing your money. The point is to be in charge of your money, but you have to follow some rules otherwise you get into trouble.

Bernard, I want to also make sure people know how to find you and spell your name. So, it's Bernard Reisz, R-E-I-S-Z, and you can find him at Resure, R-E-S-U-R-E, Financial.com, 401kCheckbook.com, and AgentFinancial.com.

All right, so Bernard, last week we got into a little bit of the self-direction of alternative investments through a custodian that would allow one to set up those accounts. Could be a traditional IRA, Roth IRA, savings account, many types of accounts will be self-directed, and there's constructs to do that which have a custodian setup, there's protocols that each custodian has when you want to go invest in a real estate property, equity property, or you want to do private lending or whatever. There's some paperwork documents that have to be done.

Takes a little bit of time. It's a process of compliance on their end, and there are rules to follow. Prohibited transactions which are part of the, go to the disqualified parties. You can touch on that if you want to. Again, there's a whole lot, but that's part of your education. You are going to talk a little bit today about more expediency of using checkbook control in some of these accounts, and why that can be of benefit, and who might benefit from that? So I'll let you pick it up from there.

Bernard Reisz: Yeah. Let's do this. So, checkbook control is about maintaining the tax advantage status of the account but giving you direct access to it. Rather than have the funds sit at custodian and having you instruct the custodian to fund the deals, you get the money in a bank account, and you get to fund it yourself. Now, in order to do that there are a couple different structures that we implement. That depends whether we're going to be using a qualified retirement plan or an IRA.

From an IRS perspective, or tax code, because there is no IRS code. That's one of the things, perhaps, as a tax professional, somebody that lives in tax code, rubs me the wrong way a bit when I hear somebody say, "IRS code." There is no IRS code. Congress writes a tax code. The IRS is the enforcer. They do propagate regulations, but code is Congress, not IRS. And in the code it says that an IRA needs a custodian. However, for qualified retirement plans that are governed by Section 401 of the tax code, no custodian is required. A trustee is required.

You do not have to have a financial institution to act as your custodian. Perhaps there may be some benefit to that, but Congress didn't ask for it.

So on the QRP side, which is going to be, generally, the solo 401k, there's no requirement to have custodian involvement whatsoever. On the IRA side, where custodian requirement is dictated by Congress in the tax code, in order to get you direct control of your funds, we've got to implement certain advance structures. But they're really very easily understood when you give it the right context and the right perspective. What we essentially do is create a special-purpose business entity within the IRA, have the IRA own that entity, and have the account owner, or even better an unrelated party, be the manager of that business.

While that may sound novel, if you take a step back and you think about your traditional stock market investments, you're putting money into companies. You know, usually we're used to doing it on the secondary market, when you go to your Schwab and Fidelity, but you can have an IPO. You own a piece of Tesla or Amazon or Alphabet or whatever it is, you own stock in that company, and that company does whatever they think they have to do to generate the highest returns. Whatever the best thing for the company is.

Well, that's what we're doing here. We create a company, and shares in that company are bought by our IRA. And then, the funds of the IRA are now within that company to be directed in any way that the management of the company sees fit. Well, the management of that company, most of our clients choose to be their own managers. There is a benefit to having an unrelated party do it, but frankly most of our clients are choosing to be their own managers. They manage that business entity and they can direct that entity to buy real estate, to do hard money loans, to buy tax links, to buy cryptocurrency, merchant cash advance, litigation finance, life settlements, precious metals, and all sorts of other stuff. Who knows what they're doing? Because really it's all allowed. There are very, very few limitations on what you can invest in inside of an IRA or 401k.

David Phelps: You mentioned the solo 401k. So let's define solo 401k. Who's that for? Who qualifies for that?

Bernard Reisz: Yes. This is something I've seen a lot of confusion around this. An abundance of confusion. Some people that are actually being, I'd say, a little misinformed by promoters. The term we like to use is owner only. There are various other terminology that's out there. It's not terminology that's defined in the tax code. So, we call it an owner only trade or business, and the key thing to understand is that 401k plans we encounter at large corporations have lots of compliance burden, because Congress wants to protect employees. They want to make sure company owners don't create a 401k plan just to provide benefits to themselves and short-change the employees.

However, when the only participants in the plan are owners of the business, and/or spouses of those owners, then Congress says, "Hey, we don't have to regulate these guys too heavily, because they're all owners, or really closely aligned with the owners." And that's where we have an opportunity to create a 401k plan that gives you the full flexibility, from a tax strategy perspective, as well as from an investment strategy perspective, with very low maintenance costs and very little compliance burden because it's an owner only plan.

To be an owner only, so, we're looking for a plan that has eligible participants in the business are going to be the owners and/or their spouses. The spouses don't have to be owners. They can be employees in the business. So they'll have those owners and they will not have any full-time employees that Congress would require you to include in the plan. So a full-time employee from Congress' perspective is anybody that works more than 1,000 hours per year. They work fewer than 1,000 hours, they can be excluded. If they're under age 21, they can be excluded. If they're a leased employee, they may be able to be excluded.

Leased employee's a bit of a dicey area. Its own compliance question. Is it a leased employee? Is it a common law employee? So to simplify it, if there's fewer than 1,000 hours, then you can have this plan. And then you're an owner-only business and then you can have the money in a bank account. You'll be trustee, and you can go out and do your deals.

David Phelps: Bernard, if I don't meet that requirement of having no full-time employees, as you define, what if I have a dental or a medical practice, or a veterinary practice, or I do have employees? Can I set up a separate, sideline business that just my wife and I control and handle, that we can do this? Or is there some machinations the IRS would say, "No, no, no, no, no"?

Bernard Reisz: Yes. You got it. You hit the nail on the head. And this is something that we think is too often overlooked. There's something called Controlled Group Rules and then there's something else called the Affiliated Services Group Rules. These are some of the most complex areas of tax and labor law but that's exactly why they're in place, to keep you from saying, "Hey, I'll just create another company and put the 401k plan there, and this way I can keep all the benefits for myself, and exclude all the employees."

So, there are exceptions to those rules. It doesn't always apply. But any time you're thinking of doing that, you want to take a step back and talk to a qualified professional that knows the nuances of these rules, because there are multiple layers and tiers. You first have to hit the controlled group rules which is based on ownership, and then Congress realized, okay, people were circumventing this and they decided they were going to implement the affiliated services group rules, which is based on ownership, but if there's related businesses, they're servicing each other, generating revenue from the same sources, then Congress says, "That's all one company. That's not two companies. That's all one company."

So, that's a great question. That's something people have to be aware of. Another thing that people have to be aware of is you've got to have a trade or business. So we call it an owners only trade or business, and a trade or business, we see misconceptions about what qualifies and what trade or business is and isn't. One of the things that I love hearing from people, I love hearing, it makes me chuckle when somebody says, "I've got an LLC so I qualify." An LLC is not a trade or business. So it's about whether or not you've got business activity independent of whether or not you have an LLC. Having an LLC is meaningless from the IRS' perspective.

Sometimes I get vice versa, somebody may say, "I've got a business. I'm doing consulting on the side. From my side consulting I'm generating $150,000 of income, but I don't have an LLC, so I don't know if I can have a solo 401k." You can have a solo 401k without an LLC. It's about the business activity, and not everything that you may think of as a business is a business. So a common mistake that we hear is people thinking that they have rental income, and having that qualify them for a solo 401k. A rental income, you don't pay self employment tax on that, it's not a trade or business for purposes of sponsoring a 401k plan.

David Phelps: Got it. Got it. So, I think, since the bulk of our listeners are, like I am, have businesses where we have employees so we don't qualify for the solo 401k, then is our best opportunity in the checkbook IRA arena, then? Be it Roth, traditional, whatever? To have more of the expediency, the ability to move faster, and also not have the fees necessarily associated with the transactions going through a custodian. Would that be where the checkbook would help us the most?

Bernard Reisz: Yes. Absolutely. The checkbook would help you to get into the deals and keep the fees down. It can be just a pure upside. But of course when you can have that checkbook control there is less of a barrier between yourself and the money. You want to think before you write that check to make sure you're not breaking any of the rules, and I'd love to share the basics of those rules for anybody listening now, because no discussion of checkbook, or self-directed IRAs and 401ks is completed without addressing those.

David Phelps: I think that'd be good, because I think that's the scary thing. None of us, I think, intend to go out and break rules, right? But sometimes it's the convenience of having, in this case, a checkbook. Well, let's face it. I will raise my hands high and say, you know, I have had different entities, have different entities, and sometimes we don't like to tell our CPA about ... You know what I'm saying? We'll move some money around. He goes, "What were you thinking?" You know? "Was that a loan? Was that a capital contribution?" "Well, I don't know. I just needed some money." Right?

Well, okay, you can probably work that out in the books, but now we're talking about a whole different construct that Congress has given us, for building wealth in a self-directed account. Now, that's a big no-no there. I've got a checkbook here, I've got checkbook control, and heck, you know, I've got the gardener out here at my house, it's got some money in it, well, hey, it's just $500, come on? What's ... Okay. Take it from there and then give us some of the rules, because compliance is very important here.

Bernard Reisz: Yes. And for those that ... It's also good to understand that the custodian is a bit of a barrier. It's harder to make those inadvertent errors. But frankly, well, we've seen things go on throughout this space as a CPA, so people come to us not necessarily just to set these up but to consult after the fact. And a custodian is a barrier, but custodians do not provide legal advice, and it's a mistake to think because the custodian signed off on it that means it's okay. You really need to familiarize yourself with the rules and work with a competent advisor that knows the ins and outs of these rules.

So, what are these rules? These rules are not about restricting the assets that you can buy, but they're about making sure that you invest for the long-term. That's conceptual underpinning for these rules. Congress wants to make sure that you don't derive a benefit today from this money, because if you can somehow derive a current benefit, that's going to conflict with Congress' intent for this which is that you should take actions today to maximize the future value of these accounts. It's about keeping you from self-dealing today. And there are certain rules there that Congress have said, "This is what we determine is always going to be a prohibited transaction."

If you yourself use the money in the account for personal needs, or somehow money from the account makes it over to your personal account, that's a prohibited transaction. Congress said, "You know what? It's not just yourself. There are certain people who are really close to you, you probably care a lot about them, and if faced with those choices, your future self, or giving them some sort of current benefit, you may prioritize giving your mother or father, or your kids, current benefit." Congress felt that extended to the spouses of your kids. Oddly enough not to your in-laws. They didn't think that issue existed there.

It's a couple of people, yourself and certain extensions of yourself, that should not be transacting with the plan. And that's it in a nutshell. There are a couple of gotchas, and we want people to know these rules before they get started, because when we set people up, we tell them the rules upfront. Not we set you up and then you find out the rules, either because you break them or because we told you afterwards. We want to make sure you can meet your objectives with the plan before you start.

So, if somebody says, "You know what? I want to buy a house. There's a great house down the block. I've been renting. I've got a couple hundred thousand dollars in my IRA. I figured self-direct, I'll buy the house, I'll move in." Well, sorry, that's not going to work. But you'd be amazed. We get those calls. Beyond that, the key thing is, when you get a loan it's got to be a non-recourse loan. That's the key thing that real estate investors have to be aware of.

We've got folks that we work with that provide these non-recourse loans, but what is a non-recourse loan and why would you have to work with a non-recourse lender? So, real estate provides this great thing called leverage. Some people call it OPM. Other people's money. You can build your portfolio with other people's money because you've got an asset that they're comfortable using to secure their loan. Well, you can do that in your IRA 401k as well. So, if you've got a few hundred thousand, or a few million dollars, more likely, in your retirement account, of course you can go out and buy a property. You can buy multi-family. You can do an all-cash deal. But you can also buy a much larger deal by borrowing money, like everybody does, to buy real estate, and you can leverage up between 50% to, theoretically, I mean there's no limit, but in practice you can leverage up between 50% to 80%. Your IRA can do that as well.

However, you cannot personally guarantee the loan. So, when your IRA or 401k borrow money from the bank or from a private lender to buy more real estate than they otherwise could, you cannot personally guarantee that. Because that's an extension of credit. That's using your credit to support the IRA, and that's a no-no. That's one of those transactions that Congress says you and your IRA can't be involved in that together. So, when your IRA borrows money, you're looking to do it without your personal guarantee.

David Phelps: And there are lenders that specialize in this kind of lending. Non-recourse versus if you went to your local community bank or Chase, Wells Fargo, or Bank of America, they're going to make you sign personally, and that would indeed be a prohibited transaction, if it involved your IRA. Obtaining the loan you would be helping your IRA, so therefore prohibit it.

Bernard Reisz: That's exactly it. But people have to know that it can be done and know the limitations. So, don't be concerned. There are lenders that will work with you and are happy to work with you and specialize in this space.

David Phelps: So, Bernard, we talked about it can be relatively easy for someone to break the rules, and run into a prohibited transaction. I mean, easy example would be that you want your IRA to invest in a property, whether it's all cash or maybe leveraged. But first thing we know we have to do is we have to enter into a contract with the seller. So, there we are, out there, and we find a deal, right? Seller makes the deal, it's a deal we want. IRA's going to be perfect for that. And we sign the contract and provide some earnest money. Whoops. Right there we've violated the rules, have we not?

Bernard Reisz: You have, and you've broken the rules, because the deal's in your own name. Right?

David Phelps: Oh, okay. Yeah.

Bernard Reisz: At that point-

David Phelps: At that point? Oh. Okay. Yeah. It's the follow-through where we break down, right? So, that's just one quick example. That's where a checkbook control would mitigate that, because now we can make deals on the fly, which is typically where you find your best deals. You don't go to somebody and make a really good deal and say, "Well, I'll follow up in a week or so when I get the paperwork done for my IRA." You might lose a deal, but here's where I want to go. So let's say we have, unfortunately, now that we know the rules, we've actually done a prohibited transaction in our IRA. What do you do?

Bernard Reisz: Okay. Sometimes the first thing you want to look back at is, really, sometimes things that on the face of it seem prohibited, there are certain kind of ticket out. There are ways to mitigate that, based on knowing the tax code, intimately knowing that, okay, this may not really be a prohibited transaction, and we can move on.

But in the event there is a bona fide prohibited transaction, the repercussions to an IRA are distribution of the IRA. The IRA is treated as distributed as of the beginning of that tax year. For a QRP, that is not the outcome. So, for a QRP, prohibited transactions are really ... You want to rectify them and fix them. The tax that you have, you have the opportunity to undo it. The tax will maybe be 15% of the amount involved, but it remains a solo 401k. The IRA, prohibited transactions, true, bona fide prohibited transactions, can be devastating.

David Phelps: And where that actually happens is under audit, right? I mean, everything's okay until you're audited. The day you get audited. So, there's something there. Would it be a good idea to maybe ... Of course, you can't take distributions out till 59 and a half, so is it worth it to kill an IRA? I guess it just all depends, right? It depends on how much is in there, what the size of it is. You might just want to consult somebody like yourself and decide, a little bit, what's the prudent thing to do here? Nothing? Hope for the best? Distribute it after 59 and a half? Right? Whatever. But just something to be aware of.

Bernard Reisz: It's to be aware of it, and the first place to start is with a professional that knows the rules. Ironically the first thing you should not do is probably call your custodian, frantically saying, "I just engaged a prohibited transaction." That's probably not the smartest move.

David Phelps: Or call the IRS hotline and ask them.

Bernard Reisz: Exactly.

David Phelps: With your tax identification number, right? Probably not the way to roll. Okay. All right. Any other frameworks or caveats or opportunities with the limited time we have today of talking about self-direction, checkbook control opportunities? Anything else you want to add to the conversation, Bernard?

Bernard Reisz: Absolutely. I think it's important, just like in any area of finance, and investments, it's about working with the right people. Be it custodian, be it independent providers such as my company, you want to be working with somebody that knows what they're doing and has substance behind them, but is not strictly trying to sell you something. And the amount of podcasts that a person's been on is not attestation for their expertise or their commitment to you. So, you want to can-

David Phelps: Except this podcast. This podcast. If I had to choose one podcast. But, yes, go ahead.

Bernard Reisz: So, it's really about knowing due diligence, due diligence, due diligence, and I think that's the recurring thing in everything that I'd say about anything you do in your financial life. It's about thinking it through and recognizing that there are ... To paraphrase the NRA, and not to politicize this, there's nothing that's, in terms of tools, very few things, perhaps the exception of variable universal life insurance, that have no time or place. Everything can be a great tool if wielded in the correct circumstances by the correct people. So it's not guns that hurt people, it can be people that hurt people. So you just want to make sure that you're working with the right people.

David Phelps: Couldn't say it any better. So, therefore, next week we'll do a whole segment on variable universal life insurance. No, we won't. No we will not. We don't need to do that. All right. This has been really, really fun. I'm really glad we got to do these two segments. Again, Bernard Reisz, R-E-I-S-Z, ResureFinancial.com, R-E-S-U-R-E Financial.com, 401kCheckbook.com and AgentFinancial.com. Definitely a guy that can be in your corner when you're trying to navigate the opportunities out there, but also make sure you're compliant, and also you're setting up the right frameworks, the right constructs.

You just need someone who has that expertise, who can tell you, "Well, if I just set up an LLC then I'm good to go," well, not necessarily. You've got to have a trade or business. I mean, the things you brought out, just little pieces that we could miss, and the whole things goes awry because we just missed one piece of it. Somebody like yourself can really be a help, and saying there's things out there, and the opportunities that they provide for us, which is the whole intent.

Bernard Reisz: Yes. And something that I would add, if I may, sometimes people may hear a CPA credentials and may thinking, you know, "If I work with this guy it's going to cost me an arm and a leg." Ironically our pricing, to get these structures set up, is very, very competitive, and on the back end we see folks that are charging two, three, four times our fees and not providing the support that their clients deserve and need.

David Phelps: Very good. Very good. All right. Bernard Reisz, thank you so much, sir. It's been a real pleasure.

Bernard Reisz: Dave, been great. I love this. Looking forward to doing it again one day.

David Phelps: We'll do it. Definitely, sir. Next time the tax code changes, all right? All right. All right. Take care.

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