Self-Directed IRA or FreedomFirst 401(k)?

How to choose the best retirement plan to build a FORTUNE

Can you handle the truth?

Do you remember the first time you heard about self-directed IRAs? Chances are, the phrase, “too good to be true” was running through your head. Then, when you went to talk to professional advisors, they probably tried to talk you out of a self-directed IRA and keep you in mutual funds.

Yet if you set up a self-directed account and invested it, you’ve probably achieved some incredible results.

This report is going to have some great news for you and some not so great news. The great news is that you may qualify for a tax-exempt account even stronger than a Self-Directed IRA, a Freedom First 401k.

The bad news is that you’re going to read some information in the next few pages that is going to make you start questioning things again – the kind of information which you’ll probably think is “too good to be true”. We are going to show you the power and flexibility that Freedom first 401ks have over self-directed IRAs.

For example, features of a Freedom First 401k include:

- No need for a custodian
- Ability to borrow from your 401k
- Tax exemption for leveraged real estate profits
- Stronger asset protection
- Variety of investments
- Safety from prohibited transactions
- Flexible estate planning

No Need for a Custodian

Perhaps the biggest benefit that a Freedom First 401k has over a Self-Directed IRA is that a Freedom First 401k does not require a custodian.

The tax code requires that your Self-Directed IRA be administered by a custodian, meaning you have to play by the custodian's rules. So, let's assume you want to make an investment. That means you'll have to fill out the custodian's paperwork and ask them for permission to make the investment you think would be best for your IRA. And the investment is out of the ordinary? Then you can bet you're going to get a lot of grief from the custodian.

In a similar vein, if you need to make the investment quickly, good luck with that. Custodians are just like any other bureaucracy: they're going to take time, money and plenty of paperwork to approve your desired investment.

In comparison, with a Freedom First 401k, there's no requirement for a custodian. Instead, the Freedom First 401k is controlled by the trustee…you.

If you want to make an investment, the only permission you need is your own. You don't have to fill out a bunch of silly forms. You don't have to beg and plead for the investment to be made. You're in complete control of your investments. In terms of time, the only question you've got to answer is "how long does it take you to write a check?" Investing with a Freedom First 401k is as fast as you want it to be: Just pull up the checkbook and make the investment.

Next, there's the annual valuation issue. Every year, your IRA custodian is going to ask you for the value of your IRA's assets.

Go ahead and read the fine print of your IRA account application. You're going to find out that if your custodian doesn't agree with your valuation, they're allowed to hire someone to provide the custodian with a valuation. One more thing…you're the one who's going to pay for the valuation.

I had one client recently tell me they were paying their custodian thousands of dollars a year just for valuation work.

With the 401k, you provide your own valuation. That doesn't mean you have to pay thousands of dollars to hire a fancy appraiser. Instead, the IRS says that any reasonable method you use is acceptable.

The bottom line is you can move a lot faster and be a lot more efficient without being subject to the parameters of an IRA custodian.

Ability to Borrow from your 401k

What if you have a cash flow problem and you need to gain access to cash fast? With your 401k plan, you can borrow money when you need it. In comparison, if you try to borrow money from your IRA, you'll have to create a prohibited transaction, rendering your complete IRA distributed.

Let's examine the loan rules in depth.

Under the tax code, you're allowed to borrow out the lesser of 50% of your account balance in your 401k plan or $50,000. By the way, that means that if you have a piece of real estate worth $75,000, and $50,000 cash inside your Freedom First 401k plan, you can borrow up to $50,000. It is 50% of the value of the assets, not 50% of the value of the cash.

You'll have to pay back the loan within 5 years. Under one loophole, if you are using the loan to purchase a new primary residence, you can take up to 30 years to pay the loan back.

Typically, the IRS likes to see the interest rate on the loan as prime plus 2%. Some people complain about the rate being too high, but let's be realistic for a moment - how much are the interest rates on credit cards?

Another requirement for the loan is that the payments should be level amortized payments. That means equal payments throughout the time period of the loan. You can make the payments either monthly or quarterly. If you miss a loan payment you have up to 90 days to make it up after that time. If you still can't make the payment after a further 90 days, the IRS will consider the entire loan as distributed and you'll pay taxes on the full value of the loan.

Once you have the money in your hands, you're free to use it for anything you want. This is a great solution for people who want to jointly invest with their 401k plan. Typically you shouldn't partner with your 401k. The smarter route is to have the 401k owner borrow from the plan. They then fund the investment solely in their name. Now there is no concern about accidentally engaging in a prohibited transaction.

The great thing about this is that so long as you play by the rules, you can get cash out of your plan, totally tax free. If you tried this with your IRA, you'd end up with a tax disaster on your hands. Just another reason to use a Freedom First 401k instead of an IRA.

Tax Exemption for Leveraged Real Estate Profits

Chances are, if you're reading this, you're a real estate investor. So, let me ask this simple question, "Are you aware that your IRA has to pay taxes on the profits it makes on leveraged real estate?"

This typically comes as a surprise to a lot of people. They've all been told that their IRA is a tax-exempt entity and then they get a love letter in the mail from the IRS saying they owe taxes on certain transactions. These transactions are typically called "unrelated business income," These include the income from flipping real estate or from buying properties using leverage. The profits from both are subject to taxes with the tax rate being 37% as soon as you make over $14,000.

With a Freedom First 401k, you're allowed to make a profit on real estate, even leveraged real estate, and not pay a dime in taxes.

Using an IRA instead of a 401k is probably costing you a lot of money.

Leveraged Comparison

If your IRA went out and bought a property valued at $100,000 and it borrowed $80,000 to buy the property, it would effectively make 80% of the profits subject to taxes. So, if your IRA sold that property 2 years later and made $50,000, 80% of that $50,000 (or $40,000) is going to be subject to taxes. On the other hand, if your 401k did the exact same deal, nothing would be subject to taxes.

Stronger Asset Protection

So, let’s assume that you've learned a lot about self-directed retirement plans, and you actually took action and have built up quite the large nest egg. Now you’re probably confronting another big concern: What about lawsuits? Can a judgment creditor come in and wipe out your entire retirement savings?

If you're using a self-directed IRA, there's probably a pretty good chance that they can.

I have been hired by bankruptcy trustees in Arizona to review people's IRAs and see if they had violated any of the various rules that apply to Self-Directed IRAs. If they have violated the rules, the bankruptcy trustee could take the retirement plan away. Invariably, every IRA account that I reviewed had some violations, with many of those same violations being sufficiently serious for the bankruptcy trustee to take away their IRA.

Alternatively, I was asked to review the 401K plan of somebody who filed for bankruptcy. Even though I would have been paid a heck of a lot more money if I could have found a flaw with the 401K, I couldn't. In fact, in one bankruptcy case, even though they found some flaws with a 401k plan they allowed the its owner to amend their plan so that it was still valid, and the bankruptcy trustee couldn't take it away.

Taking this a little bit further, the bankruptcy code itself has placed a limit of just over a million dollars for IRAs. With the 401k plan, there is no limitation. So, it could potentially be $250 million and it would still be protected. Thus, 401k plans give much stronger asset protection than IRAs do.

Variety of Investments

In theory, you’re reading this Special Report because you wanted to invest in real estate and implement real estate financing within your retirement plan. But can you make other kinds of investments inside your self-directed retirement plan?

In theory, yes. However, if you are using a Self-Directed IRA, there are still going to be some limitations on what you can invest in.

Want to invest in gold bullion and bury it in your backyard for safety? That will be considered a distribution.

Want to purchase some classic sports car you are sure is going to skyrocket in value? Once again, that would be considered a distribution from your IRA.

Want to use your Self-Directed IRA money to purchase a life insurance policy on yourself? Bad news… once again, that's considered a taxable event.

How about jointly investing your Self-Directed IRA with your spouse's Self-Directed IRA - can you do that? This is the classic gray area. And like what we talked about in the prohibited transaction area, if it falls into gray area territory and the IRA decides it's not allowed, your entire IRA account is on the line. On this basis, my suggestion is that you avoid it altogether.

Now, let's look at those investments from a 401k point of view. A 401K doesn't have the same investment limitations.

Want to jointly invest with your spouse's retirement plan assets? Great. Pooling retirement money is ultimately what 401ks are designed to do.

Want to purchase a '57 Chevy with your 401k assets? That's allowed as well.

Want to buy life insurance inside your 401k? Well, I think you already know I'm going to say that it's allowed.

Once again, Self-Directed IRAs are pretty incredible and 401Ks are even more incredible.

Safety from Prohibited Transactions

Prohibited transactions. The phrase is enough to make most IRA owners lose sleep. The reason is that the tax code says if you engage in a prohibited transaction with your IRA, your IRA is considered fully distributed and fully subject to taxes.

That means that if you had built up your IRA to be worth $300,000 and made a tiny misstep that led to a prohibited transaction, the $300,000 would automatically be subject to a tax liability. Not only that, but since the IRA is considered fully distributed, the judgment creditor may even take away the IRA altogether: the IRA would no longer has any asset protection.

In comparison, the tax code says that if your 401k engages in a prohibited transaction, there is a penalty of 15% of the dollar amount involved: No full distribution, just a penalty. By the way, the IRS definition of the dollar amount involved is typically the amount of interest on a loan or the amount of rent on a property. So, for example, if the IRS said you loaned your 401k $200,000 and it was a prohibited transaction, your 401k would not be fully distributed. Instead, you would pay a 15% penalty on the interest of that loan. So, let's assume the interest rate was 10%; you'd owe a penalty of 15%* $20,000 (10% of $200,000) which would be equal to $3,000. That is a heck of a lot cheaper than having to pay taxes on the full $300,000.

Another saving grace is that under certain conditions, the IRS will give you 14 days to fix the prohibited transaction before they hit you with a penalty.

If you want to sleep better at night, you really should use a 401k instead of an IRA as it is a much more forgiving vehicle.

Flexible Estate Planning

The final aspect of using a Freedom First 401k plan instead of a Self-Directed IRA surrounds estate planning.

As we discussed with the prohibited transaction rules, 401k are a much safer vehicle to use for complicated transactions. Once again, one misstep with an IRA and your entire retirement account could be blown up and subject to taxes.

However, with a 401k plan, there are a number of special exclusions written into the tax code that allowed the 401k to engage in some pretty crazy transactions. Want to distribute an annuity from your 401k plan without paying a single dime in taxes? No problem: there's a special exclusion within the tax code for that. Is your 401k low on cash and you want to loan it some money without charging interest? Great, there's a special exclusion written side the tax code for that as well.

The special exclusions really shine when it comes time to do estate planning. Want to leave the assets to the kids but have a trusted friend be the trustee of your plan so they can't just take it all and spend it? You can do that.

Want to limit the dollar amount the kids can take out every year to protect them from themselves? You can do that as well.

Once again, using a Freedom First 401K instead of an IRA is going to give you and your family a lot more flexibility to both accumulate your assets as well as protect them for generations to come.