

Who Says You Can't Trade Your IRA on Margin?

Conventional wisdom has convinced many traders that they can't trade their individual retirement account on margin or sell stock short. Fortunately, you're about to join the exclusive ranks of traders who refuse to be governed by such poppycock as conventional wisdom.

Brokerage houses that would rather not allow you to leverage your IRA account or pursue downside earnings have perpetuated the myth that IRAs are somehow off-limits for traders. Nothing could be further from the truth; in fact, the IRS is cool with the idea of margin trading and short selling your IRA, provided you stay within its tax rules.

The Economic Growth and Tax Relief Reconciliation Act of 2001 loosened considerably the rules regarding IRAs. In addition to margin trading and short sales, you can also invest your IRA in a wide variety of non-traditional investments, including real estate, deeds of trust, certain business entities and coins, as we will see shortly.

But exceptions do apply. A Traders Accounting professional can advise you on the most tax-effective ways to get your IRA out of the slow lane.

IRA Margin Trading

The IRS has specific guidelines for trading your IRA on margin called the debt financed income rules that essentially ensure the government gets a cut of the profit. Still, by IRS standards the split is a generous one: you only pay tax at the corporate tax rate on the profits you make on the borrowed money alone.

Here's how it works: Say you use your \$80,000 IRA to purchase a position for \$100,000. When your IRA exits the position with a profit of \$50,000, 20% of your profit, or \$10,000, would be subject to tax because you borrowed 20% of the IRA amount (\$20,000) to make the margin trade.

IRA Short Sales

Hard though it may be to believe, the IRS doesn't view borrowing stock against your IRA and selling it within your margin account as incurring debt (IRC Revised Rules 95-8). That means you get to keep every penny you earn on a short sale, tax-free within your IRA, without facing the debt financed income rules.

Here's a likely scenario: You think XYZ stock is overpriced at \$100 a share, so you instruct your broker to sell short \$100,000 worth for your IRA account; essentially your IRA borrows 1,000 shares of stock from your broker and sells those shares. When your prediction comes true and ABC stock drops to \$80 a share, you buy your 1,000 shares back for \$80,000, turn them over to your broker to close out your position, and walk away with a \$20,000 profit.

Granted, you will be liable for taxes when you ultimately take distributions from your IRA, unless you used a Roth IRA. The upside is, you could increase your IRA investing account by 40% or more in the process. Trade within a Roth IRA and you could well take your distributions tax-free.

Non-Traditional Investments

Although the vast majority of America's IRAs are invested in conventional assets such as stocks and mutual funds, the IRS allows other non-traditional investments as well, including:

- Real estate: single- and multi-unit homes, commercial and land, leveraged or unleveraged
- Private stock
- Promissory notes, mortgages and deeds of trust
- Tax liens
- Limited partnerships, Limited Liability Companies (LLCs) and Private Placement Limited Partnerships
- Certain coins and bullion, including gold, silver and platinum.

By contrast, the IRS disallows IRA investing in such things as artwork, rugs, antiques, metals and gems (with some exceptions), stamps, coins, alcoholic beverages and life insurance.

Key to tapping into these opportunities is to locate an independent self-directed IRA custodian. Unlike many brokerage firms that claim to offer this service, a true self-directed IRA custodian does not sell investment products on which it earns a commission. These offer the widest range of IRA investment options.

Once you fill out the new account paperwork and authorization forms, your IRA custodian will open your account by either transferring money from an existing IRA into a similar IRA or rolling over funds from an employer's plan into the new IRA. Transfers are tax-free and not reported; rollovers are tax-free as long as the entire amount is deposited into the new IRA within 60 days.

To authorize your custodian to make purchases on behalf of your IRA, simply fill out an Investment Authorization form. Although procedures vary, you will typically be asked to complete the purchase by check or wire from your account, and you may have to provide a deed to ensure that vesting is properly handled.

What's the best way to set your IRA account into investing mode? Simple - contact your trading accountant professionals at Traders Accounting. Why leave your IRA money stuck in the slow lane? At Traders Accounting, we can help you turn your sleepy retirement account into a vigorous, tax-advantaged investment.