## I'd like to invest in a rental property. Can I use my IRA to buy real estate?

IRA, profits will be taxed at your ordinary income tax rate, not the more favorable capital-gains rates. (If you own the property in a Roth. it isn't an issue because gains are tax-free.)

Finally, if you own the property in a traditional IRA, you'll encounter major hassles when the time

your property is in a Roth IRA because you don't have to take RMDs from a Roth.)

n better choice. There are other ways to invest in real estate in your IRA that won't jeopardize your account's tax-advantaged status. One good option is a real estate investment trust. REITs own property such as apartment buildings, offices, malls, warehouses and hotels. They're required to return at least 90% of taxable income to shareholders, so dividends are typically generous. REIT stocks yield 3.9%, on average, compared with 2.1% for the S&P 500. If you'd rather invest through a mutual fund, you have plenty of choices. Kiplinger's top picks include MANNING & NAPIER REAL ESTATES (SYMBOL **MNREX)** and **FIDELITY REALES-**TATE INVESTMENT (FRESX), with one-year returns of 20% and 21%, respectively. If you want to simply track the REIT market, SCHWABU.S. REIT ETF (SCHH), an exchangetraded fund with a one-year return of 18%, follows the Dow Jones U.S. Select REIT index (see "Invest in Real Estate? It's Easy," Sept.).

Because dividends are always taxed as ordinary income, IRAs provide a tax-efficient way to invest in REITs. In a raditional IRA, taxes on the dividends will be deferred until you take withdrawals. If your REITs are in a Roth, dividends-along with all other earning.-are tax-free. SAMOPARLOCK

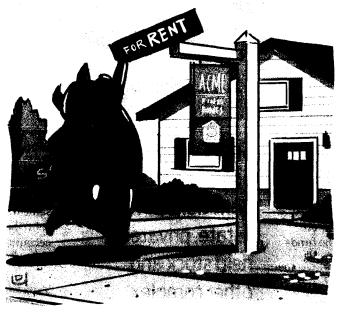
YOU CAN USE YOUR IRA TO BUY

a rental property, but the rules are complex. You'll also be prohibited from claiming of a lot of landlordfriendly tax breaks.

In order to invest money from a traditional or Roth IRA in rental property, you must first set up a selfdirected IRA. Some companies, such as Equity Trust and Entrust Group, specialize in self-directed IRAs that invest in real estate.

You'll need a significant amount of money in your IRA because you'll probably want to pay cash for your rental property. If you borrow to finance the property, you'll run into the unrelated business taxable income (UBTI) rule, which could require you to pay hefty taxes on your rental income and profits when you sell inside the IRA, says David Hultstrom, a certified financial planner (CFP) in Woodstock, Ga. That's right: Income inside the tax shelter would be taxed as it is earned and, because you'll also have to pay taxes you own the property in when you withdraw funds from your IRA, you'll be taxed twice.

In addition, you must pay



others to do work on the property, using funds from the IRA, even if you're capable of doing the work yourself. Run afoul of these rules and your IRA could be disqualified, triggering taxes and early-withdrawal penalties (if you're younger than-591/2) on the entire amount.

Landlords typically enjoy a host of tax write-offs for depreciation, property taxes and other expenses. When an IRA, however, you can't claim any of those tax breaks. Worse, if you own the property in a traditional

comes to take required minimum distributions. Once you turn 701/2, you must take annual withdrawals from all of your tax-deferred accounts, based on the year-end balance of vour IRAs. To determine the year-end value of a piece of real estate, you must obtain an appraisal, says David Mendels, a CFP in New York City. Appraisals are expensive-the average cost is about \$300-and subject to interpretation, which means a lowball number could be challenged by the IRS. (This doesn't apply if