STRATA
TRUST COMPANY

SELF-DIRECTED IRAs

The Tax-Smart Tool For Financial Advisors

Self-Directed IRAs

All eyes are on IRAs right now, for myriad reasons. IRAs have been used over the years to both supplement workplace savings plans and receive rollovers of retirement savings when workers change jobs or retire. But IRAs have quietly taken center stage on the retirement savings scene – not only because of the amount of wealth they now hold (almost twice that of 401(k) plan assets) but because of the range of tax advantages and investment options available with self-directed IRAs.

As more investors are looking to diversify from publicly traded mutual funds, a self-directed IRA is a multi-purpose, tax-smart tool financial advisors can use to help clients meet their investment objectives, accumulate tax-deferred retirement savings, generate tax-free retirement income, and pass assets directly to heirs.

IRAs have also caught the eye of government regulators. New rules are designed to ensure financial advisors are making investment and rollover recommendations in the best interests of the investor. Financial advisors should understand the market opportunities and regulatory framework for IRAs today and have a business model for including this tax-smart tool in their financial planning and investment strategies.

IRAs FOR INDIVIDUALS

IRAs are an undeniable force in the U.S. financial and retirement savings market.

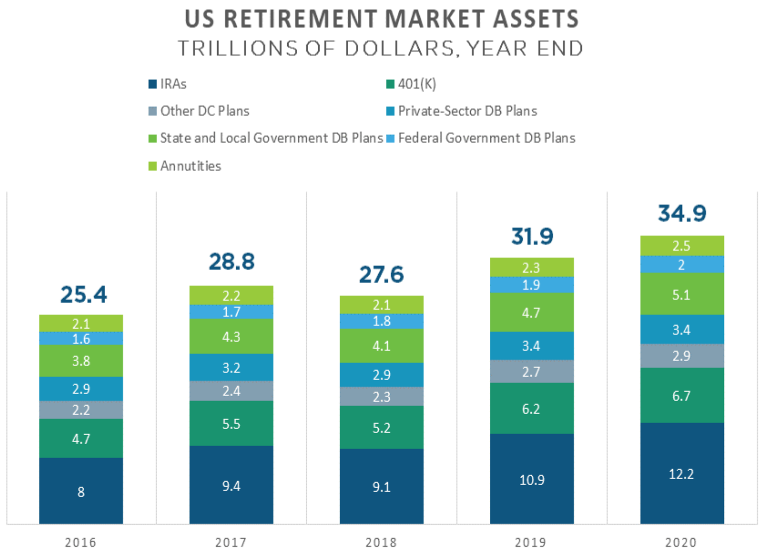
IRA MARKET SHARE

At the end of 2020, IRAs held more than $12 trillion dollars in retirement savings – accounting for 35% of all retirement assets.[1] In mid-2020, IRA assets made up 11% of all U.S. household financial assets.[2]

RETIREMENT PLAN ROLLOVERS

Rollovers from retirement plans to IRAs are driving the growth of IRA assets. When an individual changes jobs or retires, the tendency is to disengage from the former employer and pull retirement savings out of the former employer's plan. In 2020, an estimated $623 billion was rolled over to IRAs.[3] With the rate of baby boomers retiring and workers changing jobs, the volume of rollovers is expected to continue.

Because of the importance of retirement savings to U.S. workers' financial security, government agencies have increased regulatory requirements and enforcement efforts on IRA rollovers and the financial professionals who recommend them to their clients. FINRA, the SEC, and the Department of Labor (DOL) have made changes in recent years to address concerns that potential



Source: Investment Company Institute. The US Retirement Market, Fourth Quarter 2020."

conflicts of interest may result in investment and rollover recommendations that do not serve individuals' best interests.

Recently, the DOL issued a new Prohibited Transaction Exemption (PTE) 2020-02, *Improving Investment Advice for Workers and Retirees*, which allows financial advisors whose investment and rollover recommendations trigger fiduciary status to receive what would otherwise be prohibited compensation for that advice if they meet certain conditions. One of these conditions requires the financial advisor to document the reasons why the rollover recommendation is in the best interest of the investor.

This determination should involve an analysis of rollover options, including factors such as fees, investments, and services available with each option.

Financial advisors who understand these rules can use this rollover evaluation requirement to enhance their service offering.

INVESTMENT FREEDOM

Besides being a vessel for consolidating retirement savings and allowing tax-deferred investment growth, certain IRAs can offer investors the freedom to choose from an almost unlimited array of investment options.

These "self-directed IRAs" allow investors to diversify their holdings from investments tied to publicly traded markets and invest in private, non-exchange traded investments.

Financial advisors can help investors achieve a truly personalized investment portfolio with a self-directed IRA.

WHAT IS A SELF-DIRECTED IRA?

A self-directed IRA is an individual retirement account that empowers investors to take greater personal control of their financial future. Technically, it is an IRA, governed by the same tax laws as a "regular" IRA established at a bank or brokerage firm. And it can be established as either a Traditional IRA or Roth IRA (or even a SEP or SIMPLE IRA), with the same tax benefits associated with those types of IRAs.

WHO BENEFITS?

Investors who are looking for ways to diversify their portfolio or achieve specific investment objectives, while also growing their savings on a tax-advantaged basis, can benefit from a self-directed IRA.

CUSTODIAL REQUIREMENTS

The main difference from a regular IRA is that a self-directed IRA provides individuals more investment options and greater control of their retirement savings. This is possible because of the entity acting as custodian for a self-directed IRA. When banks, credit unions, brokerage firms, and other entities eligible to act as an IRA trustee or custodian offer IRAs, the investment options are typically limited to certificates of deposit and publicly traded mutual funds, stocks, and bonds. Only a custodian with the specialized policies, procedures, and expertise in holding specific types of assets can offer self-directed IRAs that permit alternative IRA investments, like real estate or private equity funds. Except for a few discreet items specifically prohibited by federal law (like collectibles and life insurance contracts), the investment possibilities within a self-directed IRA are limited only by the custodian's policies and terms.

INVESTOR KNOWLEDGE

The term "self-directed" is used to describe these IRAs because the IRA owner is responsible for directing the investments of the IRA (unless engaging with a discretionary investment fiduciary). This includes conducting the due diligence to determine risk/reward potential. A custodian specializes in processing, registering, and reporting investments along with administering the IRA. Self-directed IRA custodians do not determine the potential risks or merits of an investment or an investment issuer.

MORE CONTROL

Financial advisors understand the importance of true diversification, and they know their clients' investment objectives, risk tolerance, personal values, and special areas of expertise. With this knowledge, they can help their clients optimize their retirement savings portfolio and choose investment opportunities clients truly believe in and value by using self-directed IRAs.

BEYOND WALL STREET

Many investors are drawn to the types of investments possible in a self-directed IRA because these investments oftentimes can provide additional diversification opportunities beyond what is achievable through conventional investment alternatives. At the end of 2020, 45% of IRA assets and 59% of defined contribution plan assets were invested in publicly traded mutual funds.[1] In addition to the basic constraint of limiting one's investment options to just mutual funds, many IRA owners and plan participants are further limited in their investment options by providers or plan sponsors who only provide access to a narrow list of "preferred" providers.

As was demonstrated by the extreme market volatility that resulted from the COVID-19 pandemic in 2020 and the hedge fund fiascos of 2021, the stock market can readily fall prey to extreme economic forces, both natural and contrived. With the use of self-directed IRAs, investors can further diversify their investment portfolio, protect against market volatility, and seek greater returns – all on a tax-advantaged basis.

PERSONAL VALUE INVESTING

Savvy investors are turning to alternative investments not only to mitigate the typical investment risks inherent in stock market investing but also to leverage their retirement savings to achieve more meaningful, holistic investment objectives. In doing so, individuals with specialized knowledge can leverage their

unique expertise to make impactful, profitable investments in areas near and dear to them.

For example, an investor with specialized knowledge about the real estate market in a particular geographic area might use his or her expertise to invest in a small condominium development that is not on the radar of the big investment firms. Likewise, an investor who is passionate about the "eat local" trend may identify a local investment opportunity focused on connecting the dots between area farmers and area restaurants. Self-directed IRA owners could use their savings to invest in start-up companies, for angel investing, or to help a local company raise capital for expansion in order to create jobs.

What's more, self-directed IRAs can be used to incorporate socially responsible and "green" investment factors in more personal and customized ways than with mutual funds.

TAX ADVANTAGES

Tax-smart investing is always important, but it is likely to take on even greater significance for high-net-worth clients in the coming years as tax rates are projected to increase to address the rising national debt. The tax benefits associated with Traditional and Roth IRAs make the self-directed IRA a tax-smart investment tool:

- Tax-deferred investment growth in IRAs
- Tax deduction for Traditional IRA contributions
- Tax-free distributions from Roth IRAs
- Option to convert pre-tax retirement savings to after-tax assets in a Roth IRA
- Option to recharacterize the tax status of current-year IRA contributions
- Ability to transfer ownership of IRAs directly to beneficiaries outside of probate

One of the primary benefits of investing in an IRA is the deferral of taxes on investment gains while the investment is held in an IRA. And if assets are held in a Roth IRA, the tax liability on investment growth can be eliminated. When considering alternative investments for a self-directed IRA, investors should consider whether an investment is expected to have frequent short-term gains that might otherwise be taxable or long-term capital gains, and then assess the potential tax consequences for holding that investment in a tax-deferred IRA or a taxable account.

COMMON ALTERNATIVE INVESTMENTS OPTIONS

Private equity – private start-up company stock, bank capital raise, acquisition of an entity, hedge fund investments, oil & gas, or energy ventures

Private debt – mortgage notes & trust deeds, promissory notes, timber deeds, private corporate debentures

Real estate – Residential property, commercial property, REO properties, apartment buildings & condominiums, raw land, improved land

Crowdfunding – access to many different asset types. Funds typically require a small amount of capital from a large number of investors

Precious metals – gold, silver, platinum & palladium bullions or coins

Public investments – publicly registered limited partnerships, limited liability companies, REITs

IS A SELF DIRECTED IRA RIGHT FOR YOUR CLIENTS?

Although anyone can own a self-directed IRA, the best fit may be for investors who are able to

- Understand the rewards related to nontraditional investments, and
- Weigh the risks against the value of the potential for higher returns.

CHARACTERISTICS

Personal characteristics of investors who are looking for the opportunity for more control and investment freedom with their retirement savings might include

- ☑ Extensive investment experience or business savvy,
- ☑ Expertise in a particular field (e.g., real estate),
- ☑ Skills to conduct research or investigate opportunities,
- ☑ Visionaries capable of appreciating long-term outcomes/benefits,
- ☑ Passion for a specific initiative (e.g., environmental or socially responsible investing), or
- ☑ Creative thinkers.

Investors should be able to conduct the due diligence necessary to evaluate the merits of an investment and investment providers or work with financial, tax, or legal professionals who can assist with this analysis.

Tenured investors are typically more likely to have accumulated significant retirement assets to invest. But self-directed IRAs are not just for retirees with large account balances. In fact, younger individuals have more time to benefit from long-term growth potential, and withdrawal activity is lower among younger investors.

Regardless of age, many investors' portfolios are at risk due to lack of diversity. Those with a workplace retirement plan or who work with a brokerage firm likely only have exposure to publicly traded stocks, ETFs, and bonds. These investors may want to consider further diversifying their retirement portfolios with a self-directed IRA. If an investor does not yet have a sizeable account balance to invest or is not yet able to roll over money from an employer plan, they may be able to pool their self-directed IRA assets with other investors to access the alternative investment they want.

Many investors just need to be educated about the possibilities available within a self-directed IRA to begin thinking about investing beyond Wall Street.

CONSIDERATIONS

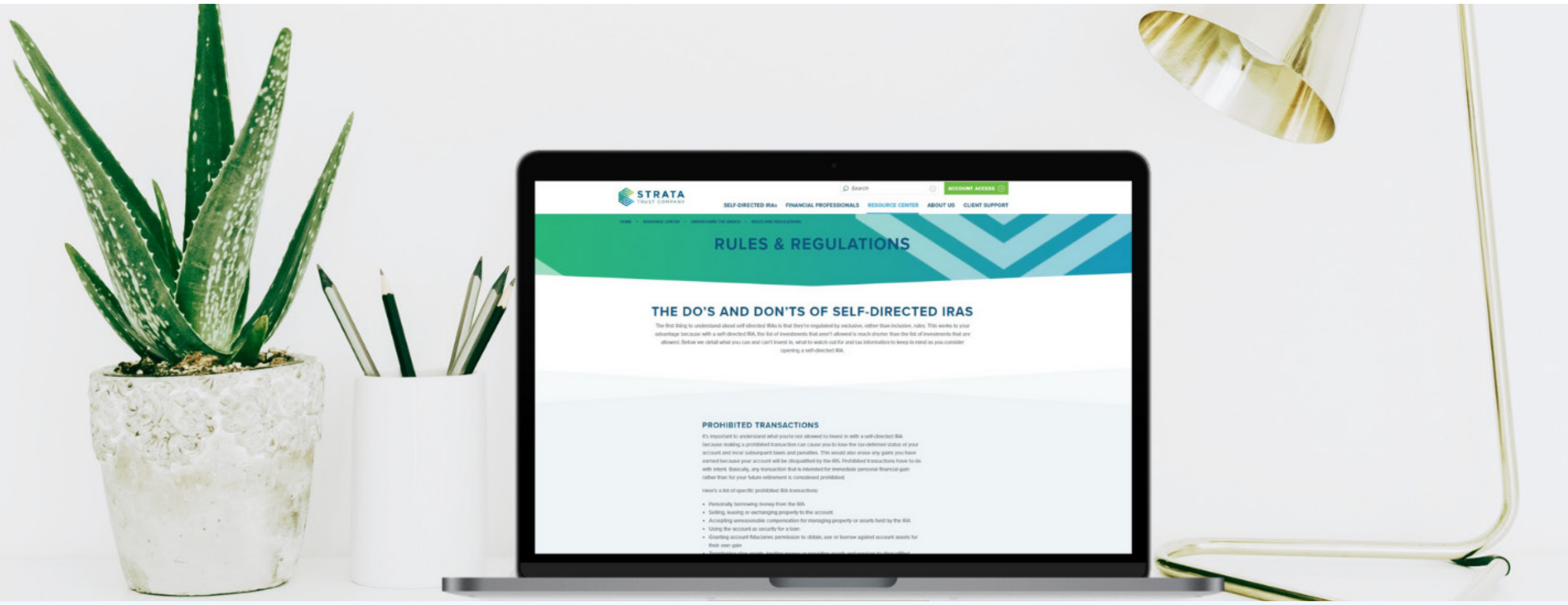
With the ability to tailor IRA investments to an investor's personal interests comes the potential to violate the *prohibited transaction rules. These rules are designed to ensure that IRA owners (and certain others associated with them) are not receiving an additional, personal benefit from the investment in the IRA. To avoid the tax consequences of a disqualified IRA, financial advisors and investors must understand the prohibited transaction rules and avoid investment scenarios that could be perceived by the IRS as improper. For example, an IRA owner, their family members, and fiduciaries to the IRA cannot

- Sell property to the IRA or purchase assets directly from the IRA,
- Borrow money from or lend money to the IRA,
- Provide materials or services to the IRA investment, or
- Otherwise use or benefit personally from the IRA investment.

Other considerations when exploring alternative investments for a self-directed IRA include the requirement (and cost) to obtain a valuation of the asset each year and the need to maintain liquidity in the IRA to cover taxes, insurance, maintenance, or other expenses associated with the investment, as well as to pay out required minimum distributions if the Traditional IRA owner is age 72 or older.

Additionally, under certain circumstances, an IRA may have to pay taxes if investments within the IRA generate Unrelated Business Taxable Income (UBTI) or Unrelated Debt-Financed Income (UDFI).

**Find out more about prohibited transactions @ StrataTrust.com*



WHAT TO LOOK FOR IN AN IRA CUSTODIAN

As with conventional IRAs, every self-directed IRA must have an institutional custodian (or trustee). The custodian plays a crucial role by maintaining control of its customer's uninvested cash and holding title to all self-directed IRA investments for the benefit of its customers. While not all self-directed IRA providers are regulated by a state or federal banking authority, many IRA owners prefer to work directly with an IRA custodian that is subject to regulatory oversight, taking comfort in the fact that a state or federal regulatory agency is helping to look out for their best interests.

REGLATORY CONTROLS

Unlike custodial providers, non-custodial IRA administrators are not directly regulated by state or federal banking authorities. Consequently, these entities typically do not have onsite safety and soundness examinations conducted for their operations. In addition, non-custodial administrators do not have the authority to hold customer funds in pooled accounts or hold title to customer assets in their name. Because they do not have the same legal authority and accountability as a regulated custodian, non-custodial administrators that wish to offer self-directed IRAs must contract with a custodian to provide several services, oftentimes blurring to which entity is responsible for what.

After a well-publicized failure of an IRA administrator based in Utah in 2014, some states are beginning to tighten state laws to prevent the inherent risks with the non-custodial administrator business model. This is contributing to additional trends being seen within the IRA service provider industry. Recently there has been an influx of IRA administrators obtaining charters to become custodians in states where they do not operate. One might assume this is to possibly avoid strict regulatory controls and oversight although this might not always be the case. With data breaches becoming a regular occurrence, it's important to understand how your potential IRA service provider operates and why.

Financial advisors can help their clients ask the following types of questions to ensure an IRA custodian is regulated by a state or federal authority and has policies and procedures to meet the state and federal rules and regulations.

Is the custodian ...

- ☑ Approved by the IRS?
- ☑ Allowed to custody assets?
- ☑ Allowed to hold custodial (uninvested) cash?
- ☑ Subject to federal or state bank regulator oversight?
- ☑ Chartered in the state they operate in? If not, why?

Does the custodian …

- ☑ Maintain a comprehensive insurance package?
- ☑ Conduct internal and/or external audits?
- ☑ Comply with IRS and DOL statutory requirements?
- ☑ Comply with federal BSA/AML, CIP and Patriot Act rules and requirements?
- ☑ Maintain information security policies to protect its customers?
- ☑ Maintain disaster recovery/emergency preparedness plan to ensure business continuity?
- ☑ Conduct annual employee training on Bank Secrecy Act/Anti Money Laundering, Customer Identification Program, Information Security, and Disaster Recovery?

EXTENSIVE EXPERIENCE AND A SERVICE-ORIENTED CULTURE

Besides regulatory requirements, the important differentiators for IRA custodians are experience and service. An experienced custodian specializes in handling alternative assets and has the expertise to handle your asset custody, titling, and transfer needs. When helping clients choose a self-directed IRA custodian, financial advisors will want to find one with the experience to custody a broad range of investments and fulfill the IRS requirements for IRAs, as well as one with the culture and values that ensure their clients will receive outstanding customer service.

Characteristics of a service-oriented custodian:

- Breadth of investments under custody
- Reputation for stability and integrity
- Commitment to service and innovation
- Teamwork to provide solutions for financial professionals and other service providers
- Investment in customer-focused technology and online resources

STRATA values form the bedrock of how we conduct our business:

Service First and Client-Centric – We provide service above and beyond by anticipating your needs proactively.

Stability - We are dedicated to continually working to strengthen our relationships, products, services, and community.

Integrity – We are grounded in trust and provide honesty, respect, and transparency.

Innovation – We deliver customer-focused technology that makes IRA transaction processes superior to our competitors and easier for you.

Teamwork - We believe in collaborating to leverage our shared knowledge and skill sets to bring greater value to our clients.

HOW TO GET STARTED WITH STRATA TRUST COMPANY

With growing concerns about the stock market's vulnerability to economic pressures and fraud, more investors are seeking increased personal control over their retirement savings portfolio. Financial advisors can help their clients achieve increased diversification and peace of mind by taking advantage of a self-directed IRA with STRATA.

Knowing the investment options possible in a self-directed IRA can give you an edge when it comes to raising capital and inspiring your clients to invest.

See our website for Financial Professionals to find out how to expand your client's investment portfolio by providing direct access to alternative investments in as little as three steps:

STEP 1 – Open an IRA (online or with a paper application)

STEP 2 – Fund the account (by transfer, rollover, or contribution)

STEP 3 – Direct the investment (find checklists and forms for purchasing, transferring, or rolling over different asset types)

Footnotes
[1] Investment Company Institute, 2021 Fact Book, A Review of Trends and Activities in the Investment Company Industry, https://www.ici.org/system/files/2021-05/2021_factbook.pdf
[2] Investment Company Institute, ICI Research Perspective, Vol. 27, No. 1, "The Role of IRAs in US useholds' Saving for Retirement, 2020, January 2021," www.ici.org
[3] LIMRA, Press Release, "Secure Retirement Institute Predicts Increase in Money Moving from DC Plans to IRAs," June 22, 2021, https://www.limra.com/en/newsroom/industry-trends/2021/secure-retirement-institute-predicts-increase-in-money-moving-from-dc-plans-to-iras/

APPENDIX: CHARACTERISTICS OF TRADITIONAL AND ROTH IRAs

Traditional and Roth IRAs have unique tax benefits. Investors may be a candidate for one or both types of IRAs, depending on their level of income, tax status, other tax-qualified savings, and current and future financial objectives.

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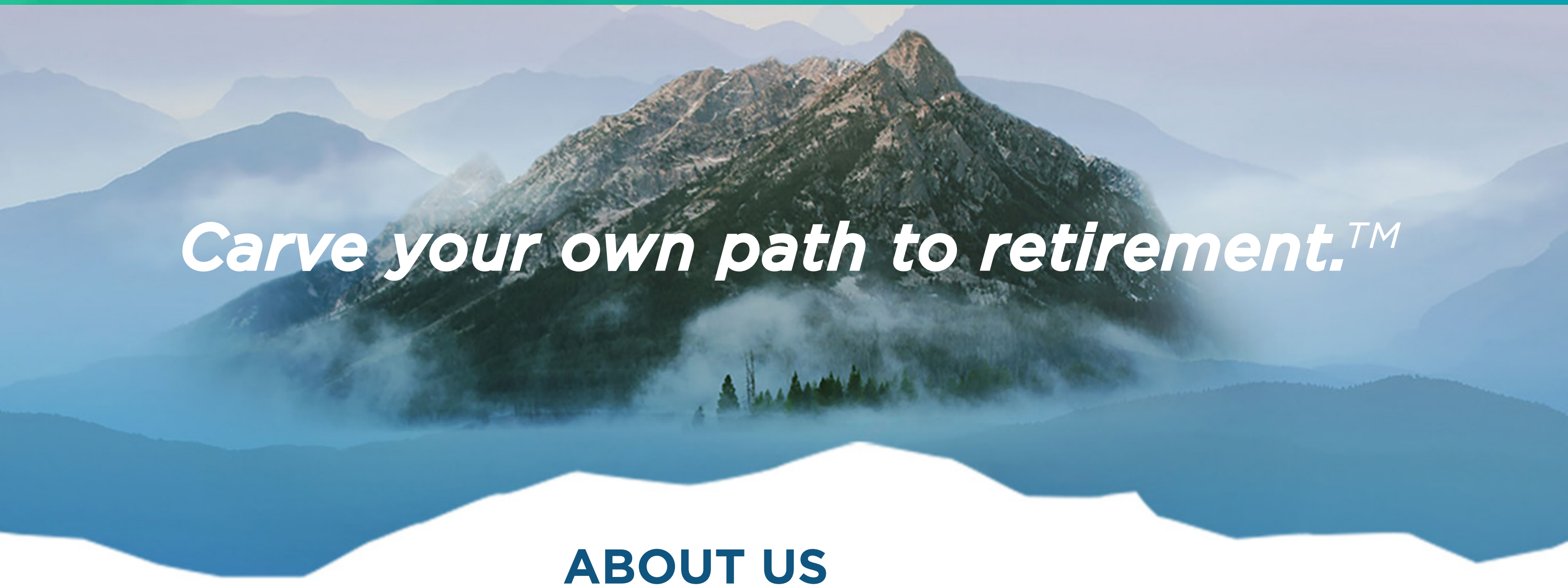
	TRADITIONAL IRA	ROTH IRA
ELIGIBILITY TO CONTRIBUTE	Earned income for the year of contribution	Earned income for the year of contribution under $208,000 for married individuals, $140,00 for single individuals
CONTRIBUTION LIMIT	$6,000 for 2021 + $1,000 catch-up contribution if age 50 or older Must be aggregated with Roth IRA contributions	$6,000 for 2021 + $1,000 catch-up contribution if age 50 or older Must be aggregated with Traditional IRA contributions
TAX TREATMENT OF ANNUAL CONTRIBUTIONS	Deductible unless participating in a workplace plan, then must have income within limits to take deduction: • Active participant & married: $125,000 • Married to an active participant: $208,000 • Single, active participant: $76,000	Never deductible
ROLLOVER ELIGIBILITY	May accept rollovers of pre-tax and non-Roth after-tax assets from Traditional, SEP, & SIMPLE IRAs, 401(k) plans, 403(b) plans, governmental 457(b) plans & Federal Thrift Savings plans	May accept rollover of Roth assets from Roth IRAs & designated Roth accounts in 401(k) plans, 403(b) plans; may accept taxable conversions of pre-tax assets from Traditional, SEP, SIMPLE IRAs, 401(k) plans, 403(b) plans, governmental 457 (b) plans & Federal Thrift Savings plans
TAX TREATMENT OF INVESTMENT EARNINGS	Tax-deferred until withdrawn (NOTE: UBTI/UDFI may trigger current-year taxation)	Tax-deferred, possibly tax-free (NOTE: UBTI/UDFI may trigger current-year taxation)
TAX TREATMENT OF WITHDRAWALS	Taxable, except for nondeductible contributions & after-tax rollovers from retirement plans; taxable portion subject to additional 10% early distribution tax	Contributions distributed tax-free at any time; earnings distributed tax-free in a "qualified" distribution • Have had a Roth IRA for at least five years, & • Age 59½ or older, disabled, first-time homebuyer distribution, or a beneficiary distribution 10% early distribution tax applies only to taxable earnings (nonqualified distributions)
DISTRIBUTION TIMING	Withdrawals permitted anytime; RMD rules apply beginning at age 72	Withdrawals permitted anytime; RMD rules apply only after IRA owner's death
CANDIDATES	• Eligible for tax deduction • Tax deduction would lower income tax liability • Believe they will be in lower tax bracket in retirement • Not eligible to contribute to Roth IRA • Want to consolidate pre-tax retirement savings & continue deferring taxation	• Income within limits to contribute • Believe they will be in higher tax bracket in retirement • Want tax-free income in retirement • May need access to tax & penalty-free assets before retirement • Have significant time to accumulate tax-free investment earnings • Want to pass tax-free retirement assets to heirs



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ABOUT US

STRATA Trust Company is a premier national custodian for alternative assets and non-exchange traded investments in self-directed IRAs. STRATA has been helping investors use their retirement account funds to invest since 2008.

With offices in Waco and Austin, Texas, our team's vast experience in handling the details and complexities that alternative investment transactions require is unrivaled. Our seasoned team's experience in the custody of alternative assets spans over 350 years. With a well-established reputation for honesty and integrity, STRATA is committed to delivering responsive, flexible and innovative solutions.

At STRATA, we work to ensure that the highest standards for safety and soundness are met. As a subsidiary of Horizon Bank, SSB, STRATA is a Texas-chartered trust company regulated by the Texas Department of Banking, which has long set the benchmark among state banking regulators. Strict controls are in place to ensure the safety of uninvested cash, and independent auditors are retained to conduct regular audits of our operations.

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