Abstract: Traditional and Roth IRAs can be relatively “safe” retirement-saving vehicles, depending on what they’re invested in. But one drawback is that they limit the account owner’s investment choices. A self-directed IRA provides more flexibility in investment choices but comes with greater risk as well. This article explains how self-directed IRAs work, what makes them appealing, and the rules investors must understand before moving forward.

Taking control with self-directed IRAs

You have until April 15, 2026, the tax filing deadline, to make 2025 contributions to an IRA. If you’re seeking more than the traditional mix of stocks, bonds and mutual funds, a self-directed IRA offers greater autonomy and diversification. But it also introduces added complexity.

Put investment decisions in your hands

A self-directed IRA is simply an IRA that provides greater control over investment decisions. Traditional and Roth IRAs typically offer a selection of stocks, bonds and mutual funds. Self-directed IRAs (available at certain financial institutions) offer greater diversification and potentially higher returns by permitting you to select virtually any type of investment, including real estate, closely held stock, precious metals and commodities (such as lumber, oil and gas).

A self-directed IRA can be a traditional or Roth IRA, a Simplified Employee Pension (SEP), or a Savings Incentive Match Plan for Employees (SIMPLE). But be aware that additional rules and different deadlines apply to SEP and SIMPLE IRAs.

Steer clear of tax mistakes

To avoid pitfalls that can lead to unwanted tax consequences, exercise caution with self-directed IRAs. The most dangerous traps are the prohibited transaction rules. They’re designed to limit dealings between an IRA and “disqualified persons,” including account holders, certain members of their families, businesses controlled by account holders or their families, and certain IRA advisors or service providers.

Among other things, disqualified persons can’t sell property or lend money to the IRA, buy property from the IRA, provide goods or services to the IRA, guarantee a loan to the IRA, pledge IRA assets as security for a loan, receive compensation from the IRA, or personally use IRA assets. This makes it nearly impossible for an IRA owner to actively manage a business or real estate held in a self-directed IRA.

The penalty for engaging in a prohibited transaction is severe: The IRA is disqualified, and its assets are deemed to have been distributed on the first day of the year in which the transaction took place, subject to income taxes and potentially penalties.

Is it the right fit?

A self-directed IRA can be a powerful tool if you’re looking to diversify beyond traditional markets. But it’s not a strategy to adopt lightly. Knowing the rules, risks and responsibilities is crucial before moving retirement assets into alternative investments. Have questions? Contact us.