



MySolo401kFinancial

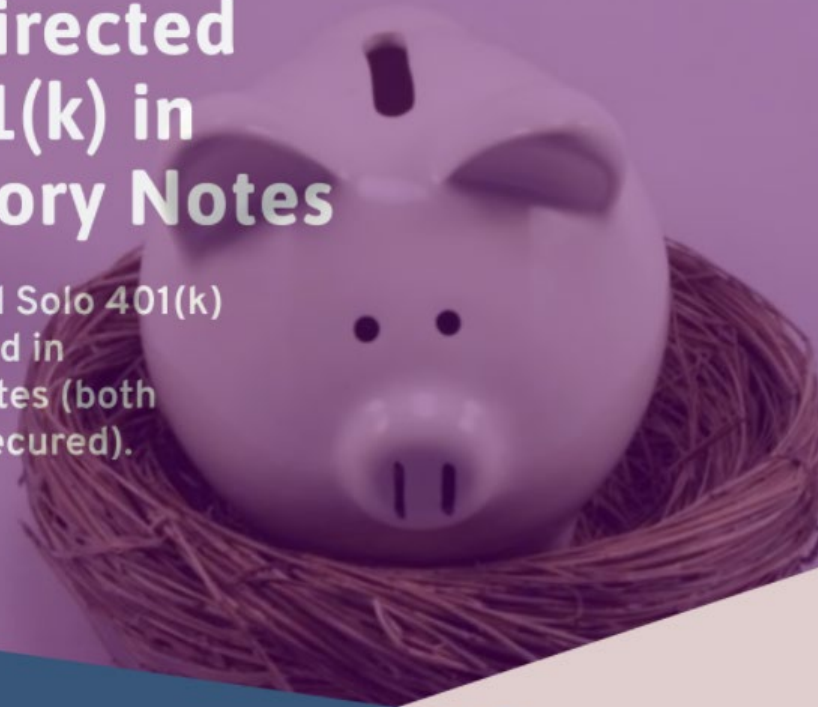
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<https://www.mysolo401k.net/>

1-800-489-7571

Investing a Self Directed Solo 401(k) in Promissory Notes

A Self-Directed Solo 401(k)
may be invested in
Promissory Notes (both
secured & unsecured).



Key Rules

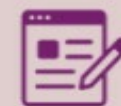
Key rules to understand before investing
a solo 401(k) plan in Promissory Notes



- Can't lend to a disqualified party such as: the solo 401(k) owner, their spouse, kids, parents, or business owned or managed by any of the aforementioned disqualified parties.



- The purpose of investing a solo 401k in Notes is to grow the retirement account.
- Charge an interest rate that benefits the plan and that does not violate your state's Usury laws.
- To help determine the interest rate to charge, look at the borrowers credit history.



- A solo 401(k) Note investment may be structured as secured or unsecured.
- Unsecured Notes generally demand a higher interest rate since the Note is not backed by an asset.
- Secured Notes are generally secured by real estate but can also be secured by equipment or stock, for example.



**Below are the steps for
investing a Solo 401(k)
Plan in Promissory Notes.**



Open a Solo 401k Plan

- Make sure to open a solo 401(k) with a provider such as My Solo 401k Financial whose Plan allows for investing in alternative investments including Promissory Notes.



Secured or Unsecured

- Determine if the Note will be secured by collateral such as real estate or equipment.
- If Unsecured, your solo 401(k)'s only option in trying to enforce payments is to take legal action against the borrower.



Compose Promissory Note

- The Note instrument contains the investment terms--such as the following: the borrower, the lender, loan amount, interest rate, maturity date and guidelines for dealing with possible loan default.
- Here is how to list the solo 401k as the lender/beneficiary on the Note document:

Jane Do, Trustee of ABC Solo 401k Trust



Draft an Amortization Schedule

The amortization schedule is used to track the note/loan payments which flow back to the solo 401k bank or brokerage account.



Process/Fund the Investment

- When funding the Note investment, the funds will flow from the solo 401k bank/brokerage account directly to the borrower.
- The Note funding can be processed by wire or by check.



Going Forward

Note payments must be deposited directly into the solo 401(k) plan bank/brokerage by check or electronically.



Note Investment Terminology



Mortgage

- A legal document that pledges property to a lender as security for payment of a note investment/loan. Some states use a Deed of Trust instead.



Deed of Trust

- A legal document that pledges property to secure the repayment of a note investment/loan. Some states refer to it as a Mortgage instead.



Note

- An unrecorded legal document that obligates the borrower to repay a debt at a stated interest rate during a specified period of time.



Secured Note

- A loan that is backed by collateral, such as real estate.



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Secured Note

- A loan that is backed by collateral, such as real estate.



Collateral

- Property pledged as security for a note. If the note is not repaid, the borrower risks losing the property.



Balloon Payment

- A final note payment that is greater than the installment payments that preceded it, and pays the note in full.

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FAQs – Investing in Promissory Notes

QUESTION:

Can my solo 401k write a note to my LLC?

ANSWER:

No as that would result in a prohibited transaction . The rules do not allow for promissory notes to your own business.

QUESTION:

Is it okay to write an interest only + balloon loan to myself to be used for down payment on investment real estate as I can get better financing personally than my Solo 401k?

ANSWER:

No as the rules do not allow for that, but you could take a solo 401k participant loan and we prepare those loan documents as specific forms apply.

FAQs – Investing in Promissory Notes

QUESTION

If I create a solo 401K plan and it invests in a promissory note that pays interest and I get a 1099-INT, does the 401K plan need to pay taxes on that interest? Let's say I invest \$100K in a note that pays 10% interest and I get a 1099-INT for \$10K. Let's say the tax liability for that is \$4K. Then does the 401K plan need to pay \$4K in taxes?

ANSWER:

Because a solo 401(k) is a tax-sheltered vehicle, note payments continue to grow on a tax-deferred basis and taxes are paid once solo 401k distribution commence, generally at retirement age or age 72. Please also note that unrelated Business Income Tax does not apply to interest earned on a promissory note investment.

FAQs – Investing in Promissory Notes

QUESTION:

If I lend funds from the account as a hard money loan, and I also charge points, are the points also considered a “gain” for purposes of the Solo 401K?

ANSWER:

Yes and this would grow on a tax-deferred basis in the Solo 401k.

QUESTION:

Can my Solo 401k buy an existing promissory note?

ANSWER:

Yes provided that the Solo 401k purchases the note from an unrelated person and the borrower is also an unrelated person. The note will need to be assigned to the Solo 401k and possibly recorded with the county.

FAQs – Investing in Promissory Notes

QUESTION:

I have invested my Solo 401k in a Promissory Note secured by real estate (i.e. a home mortgage) and the borrower is deducting the interest paid to the solo 401k (as the lender) from their personal tax return. Does my Solo 401k need to issue a Form 1098 "Mortgage Interest Statement" reflecting the interest paid?

ANSWER:

From a 401k reporting perspective, a Form 1098 is not required as it only pertains to lending money as part of a "trade or business" which does not apply to a retirement trust such as a 401k as the 401k is a passive investor. However, you are not prohibited from issuing a Form 1098 to the borrower if they are requesting such documentation to file with their personal tax return.

FAQs – Investing in Promissory Notes

QUESTION:

Can my Solo 401k invest in a promissory note secured by foreign real estate?

ANSWER:

Yes provided that the borrower is an unrelated person. Please note that it would be best to work with a local legal advisor to determine the cost and process to foreclose on the property.

QUESTION:

Can my Solo 401k invest in a promissory note that holds junior/second lien?

ANSWER:

Yes provided that the borrower is an unrelated person.

FAQs – Investing in Promissory Notes

QUESTION:

Are promissory note investments subject to Unrelated Business Income Tax?

ANSWER:

No - Unrelated Business Income Tax does not apply to interest earned on a promissory note investment. Please note that a convertible note that converts to equity could subject the income attributable to such investment to UBIT.

QUESTION:

Can I rollover a promissory note from self-directed IRA to my Solo 401k?

ANSWER:

Yes provided that the IRA is not a Roth IRA. The borrower will need to be informed that the note has been assigned to your Solo 401k and payments made to the Solo 401k going forward. The IRA custodian will need to report the rollover on a 1099-R.



Learn More!

Contact Us:

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- ❖ (800) 489-7571