OAK STREET ASSETS

UDFI & IRA INVESTING IN REAL ESTATE

What to Expect When Using a Self-Directed IRA in Leveraged Real Estate Syndications

Most IRA investors pay little to no tax during the hold period — and only a small amount at sale.

WHY TAXES CAN APPLY INSIDE AN IRA

IRAs offer powerful tax advantages — deferred growth (Traditional) or tax-free growth (Roth). But when investments use **leverage (debt)**, a portion of income becomes taxable.

This is called **Unrelated Debt-Financed Income (UDFI)** — and it only applies to the *debt-financed portion* of returns, not all income.

UDFI does not mean all returns are taxed — only the leveraged portion is exposed.

THE OFFSET ADVANTAGE

Real estate's most powerful tax tool — **cost segregation + bonus depreciation** — creates large paper losses that directly offset UDFI income.

In value-add multifamily:

- 60–90% of investment basis in Year 1 paper losses
- Losses offset UDFI during the hold period
- Carry forward to offset gains at sale

➡ Result: Most taxable UDFI exposure is neutralized by depreciation.

HOW LEVERAGE AFFECTS INCOME



~70% of income = potentially taxable (UDFI) — largely offset by depreciation

~30% tax-sheltered

WHAT HAPPENS OVER TIME

Y1

YEAR 1

Large paper depreciation loss (60–90% of basis). UDFI exists — fully offset.

✓ **Tax Owed: $0**

2–4

YEARS 2–4 HOLD

Cash distributions received. UDFI offset by depreciation carryforward losses.

✓ **Typically No Tax**

Y5

YEAR 5 — SALE

Gain + depreciation recapture trigger UDFI. Prior losses offset the majority.

⚠ **Small Tax Due**

$100,000 IRA INVESTMENT EXAMPLE

Assumptions: 5-year hold · 2.0x equity multiple · 70% leverage · ~70–90% Year 1 bonus depreciation

CATEGORY	AMOUNT
Initial IRA Investment	$100,000
Total Return (2.0x EM)	$200,000
Total Profit	$100,000
Estimated UDFI Tax	$2,000 – $6,000
Effective Tax Rate on Profit	**~2–6%**

-0.3%
to -1.0%

TAKE-HOME IMPACT

UDFI typically reduces IRR by just ~0.3% to 1.0% — a modest trade-off for tax-advantaged real estate investing.

KEY TAKEAWAYS

- ✓ UDFI is real — but typically modest in impact
- ✓ Depreciation neutralizes most taxable exposure
- ✓ Taxes are deferred until sale
- ✓ At exit, usually just 2–6% of total profit

WHAT AFFECTS YOUR EXPOSURE

↑ Higher leverage = more UDFI exposure
↓ Less depreciation = higher tax impact
⍰ Longer hold = smaller depreciation shield

Form 990-T: If UDFI exceeds $1,000/year, the IRA files this form. Tax is paid from IRA funds — not personal income.

Leveraged real estate remains a strong option for IRA investors — with tax impact typically limited relative to overall returns.

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