STRATEGIC LEGACY INVESTMENT GROUP, INC.

NON-RECOURSE LOANS

WHAT IS A NON-RECOURSE LOAN?

The difference between recourse and non-recourse loans is that in a non-recourse loan, if the borrower defaults (i.e., the IRA), the lender/issuer can seize only the collateral, which is usually the property purchased through the IRA. The underwriter of the non-recourse loan only uses the IRA's ability to repay the loan back. Since the IRA holder cannot extend their personal credit worthiness to the IRA, the IRA investment must have enough income to warrant the lender to fund the non-recourse loan. Most lenders will only fund multi-family dwellings to mitigate risk. To lessen the risk of repayment, non-recourse lenders typically requires for the IRA to put a larger down payment, at a minimum, of at least 50% of the value of the property.

Many investors choose to take advantage of a non-recourse loan as an alternative to all-cash purchases using a self-directed IRA. Since an IRA holder cannot extend credit to an IRA to purchase an investment, a non-recourse loan is required for all real estate purchases that use leverage within a self-directed IRA.

HOW DOES A NON-RECOURSE LOAN WORK IN AN IRA?

A non-recourse loan is a loan in which you, as the IRA holder, are not personally liable for repaying the loan. You, the IRA holder, cannot personally guarantee the loan. This is viewed as extending credit. Once you locate a lender/bank, the lender will lend to your IRA, not to you as an individual. The lender will have no recourse against you or the other balance of your IRA funds in the event of a default. As a strategy, most IRA holders establish a separate IRA to only hold an investment that is associated with a non-recourse loan to avoid issues. The lender will only be able to recover the property and your equity. Again, in a non-recourse loan, you may not use your personal credit to facilitate the loan.

UNRELATED DEBT FINANCED INCOME (UDFI) FOR YOUR REAL ESTATE IRA

Unrelated Debt Financed Income (UDFI) is covered in IRC 514. If you are using your IRA and a non-recourse loan to purchase a property, the debt financing transaction will subject the IRA to UDFI. The income earned by the investment that is associated with the percentage of the asset that is unpaid or still subject to the loan agreement will be taxable. The tax associated with this income is called UDFI. The IRA must file a tax return using an IRS Form 990-T to report the taxable income. This requires that the IRA obtain its own EIN to complete the return. The tax liability for the income is determined using the trust tax rates since an IRA is a trust. The marginal rates that apply to trusts are much higher than personal tax rates.

If your IRA does owe UDFI, it is best to consult a tax professional to prepare IRS Form 990-T. Once completed, you can submit the Form 990-T to Entrust with your authorization to file and pay the UDFI tax. To find out more about UDFI, please see IRS publication 598 or speak with your tax advisor.

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