

Beyond Allocation: The Importance of Asset Location in Private Markets

Investors appropriately devote considerable attention to asset allocation, or how capital is divided among equities, fixed income, real estate, and other asset classes. Less attention is often paid to asset location, the decision of which account should hold each investment. Yet for taxable investors, location can meaningfully affect how much of an investment's return is ultimately retained.

Vanguard draws an important distinction between the two concepts: asset allocation determines the risks an investor takes in pursuit of return, while asset location determines how efficiently those returns are preserved after taxes. In certain circumstances, Vanguard estimates that thoughtful asset location can add as much as approximately 30 basis points annually in after-tax return. The potential benefit is greatest for investors with meaningful balances in both taxable and tax-advantaged accounts, a diversified asset mix, and a sufficient time horizon for the benefit to compound.

The traditional examples are relatively intuitive. Taxable bonds generally produce interest taxed at ordinary income rates, making them natural candidates for tax-deferred accounts. Equities, by contrast, may benefit from qualified-dividend and long-term capital-gains rates, while appreciation can generally remain untaxed until the investment is sold. For that reason, equities are often comparatively efficient holdings in taxable accounts.

The same principle becomes more consequential, and more nuanced, when private market investments enter a portfolio.

Why private markets require greater attention to location

Private credit, private real estate, private equity, and private infrastructure can generate fundamentally different types of taxable income. They may also be offered through very different legal structures. Some vehicles issue Form 1099, while traditional partnerships typically issue Schedule K-1s. The same broad investment strategy can therefore have materially different tax consequences depending on the vehicle selected.

As PwC and other private market tax practitioners have emphasized, evaluating a private investment requires consideration not only of expected return, but also of the character and timing of income, partnership structure, leverage, state-source income, potential unrelated business taxable income, and reporting complexity.

For this reason, there is no universal rule that a given private asset class always belongs in an IRA or always belongs in a taxable account. The tax characteristics of the investment vehicle should be considered alongside the economics of the investment itself.

Private Credit

Private credit is perhaps the clearest private market example of where asset location can have a material influence. A meaningful portion of private credit returns is generally generated through contractual interest income rather than long-term capital appreciation. KKR describes direct lending as an income-oriented strategy centered on contractual cash flows, often through floating-rate loans.

In a taxable account, this interest can create substantial recurring tax drag because it is generally taxed as ordinary income. Therefore, private credit may be particularly attractive in an IRA or other tax-advantaged account, where that income can compound without creating a current personal tax liability.

Structure remains critical. A 1099-reporting private credit vehicle can have a materially different tax profile from a partnership issuing a K-1. EY has highlighted that certain registered alternative-investment structures may also reduce complications associated with partnership investments, including potential unrelated business taxable income (UBTI) and multistate tax filings.

Private Real Estate and Private REITs

Private real estate presents a more nuanced trade-off. Private REITs can distribute significant current income, much of which does not receive the same preferential tax treatment as qualified corporate dividends. That can make a private REIT an attractive candidate for a tax-deferred account by reducing the annual tax drag associated with its distributions.

A private real estate partnership, however, requires a different analysis. Direct and partnership real estate investments may generate depreciation, losses, and other tax attributes that can be valuable to a taxable investor. Housing such an investment in an IRA could eliminate the personal benefit of some of those deductions.

Leverage adds another consideration. Leveraged partnerships can, under certain circumstances, create unrelated business taxable income or unrelated debt-financed income for retirement accounts. Accordingly, it is important to distinguish between a private REIT with relatively straightforward distributions and a leveraged real estate partnership with more complex pass-through tax characteristics.

Private Equity

For private equity, the optimal location is less obvious. A significant portion of private equity's return is typically expected to come through appreciation in portfolio companies and eventual realization events. When those gains receive long-term capital-gains treatment, a taxable account already provides a relatively favorable tax environment.

Partnership structures may also pass gains, losses, deductions, and other tax attributes directly to investors.

At the same time, private equity's potential for significant long-term appreciation can make it attractive in a Roth account, where qualified future growth can potentially escape taxation entirely. The trade-off is therefore meaningful: a taxable account may preserve favorable capital-gain treatment and useful pass-through attributes, while a Roth can shelter potentially substantial future appreciation.

Private Infrastructure

Private infrastructure reinforces an important principle: asset location should be driven by how an investment produces its return, not simply by its asset-class label.

Some infrastructure strategies resemble private equity and derive much of their return from long-term capital appreciation. Others own mature utilities, transportation assets, energy infrastructure, or contracted assets that generate substantial current cash flow. The former may have a tax profile closer to private equity, while the latter may resemble income-oriented real estate or private credit. Partnership structure and leverage can also introduce UBTI or debt-financed-income considerations for retirement accounts.

Asset Location as Part of the Investment Decision

The central lesson is not that every private investment has a predetermined "correct" account. Rather, asset location should be incorporated into the underwriting process before a private investment is made.

Asset allocation should always remain the starting point and key driver. Tax considerations should not cause an investor to sacrifice appropriate diversification, liquidity, or portfolio risk management. But once an appropriate allocation has been established, asset location becomes an important additional lever for improving after-tax outcomes.

That consideration is particularly important in private markets. These investments are often illiquid and held for many years, meaning an account-location decision made at the outset may remain in place for nearly a decade or longer. Evaluating the investment and the account together can help ensure that an attractive pre-tax opportunity remains attractive after taxes.