# MLPs, UBTI, ETFs, and IRAs: What You Need to Know

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### Summary

- Unrelated Business Taxable Income (UBTI) is the income that can trigger Unrelated Business Income Tax (UBIT) for tax-exempt organizations and retirement accounts.
- Investors can own MLPs directly in tax-exempt accounts but may have to worry about UBIT if UBTI exceeds $1,000.
- Investors can own ETFs that predominately hold MLPs in tax-exempt accounts and not worry about UBTI triggering UBIT.

### What is UBTI and UBIT? Why does it matter for MLP investors and retirement accounts?

Financial advisors and MLP investors have likely seen UBTI or UBIT mentioned in their investment research but may not really understand what these acronyms mean. Unrelated Business Taxable Income (UBTI) is the income that can trigger Unrelated Business Income Tax (UBIT) for tax-exempt organizations and retirement accounts. In other words, UBTI is income that could be taxed for an otherwise tax-exempt entity. Employee benefit plans and Individual Retirement Arrangements (IRAs), including traditional, SEP, SIMPLE, Roth or Coverdell IRAs, are subject to the tax on unrelated business income.

Why does this matter for MLP investors? Practically all of the taxable income from publicly traded partnerships is considered UBTI. Because MLPs are pass-through entities, for tax purposes, it is as if the owner of MLP units is directly earning the income generated by the MLP. MLP businesses, like operating pipelines, are not related to the purpose of a retirement account that allows it to be tax exempt, and therefore, taxable income from an MLP is considered UBTI. There is nothing prohibiting investors from owning individual MLPs in tax-exempt accounts, but they could incur taxes if UBTI exceeds the $1,000 deduction amount. To be clear, taxable income is not the same as distributions or net income. MLP investors can find taxable income on their Schedule K-1s.

For investors that want MLP exposure in their retirement accounts but do not want to worry about UBTI, investment products can help. Exchange-traded funds (ETFs) that predominantly own MLPs can provide diversified exposure to MLPs and will not generate UBTI because they are structured as C-Corporations. A partnership can generate UBTI, but an ETF does not. To repeat, investors that own MLP ETFs in tax-exempt retirement accounts do NOT have to worry about UBTI triggering UBIT. For those whose eyes may be glazing over, the box below summarizes the discussion thus far.

- **Investors can own MLPs directly in tax-exempt accounts but may have to worry about UBIT if UBTI exceeds $1,000.**
- **Investors can own ETFs that predominately hold MLPs in tax-exempt accounts and not worry about UBTI triggering UBIT.**

## Not all that is permissible is beneficial.

While investors can own MLPs and MLP ETFs (for this discussion, MLP ETFs are those that mostly own MLPs and are structured as C-Corporations) in retirement accounts, it is arguably suboptimal. Remember, MLPs provide special tax advantages – most notably the potential for tax-deferred income. The distributions from MLP ETFs maintain the tax advantages of their underlying holdings, and typically, a significant portion of those distributions are tax-deferred. Using a tax-advantaged investment in a tax-exempt account is a bit like wearing both a belt and suspenders. Generally, investors only have so much money in tax-exempt accounts because of annual contribution limits. As such, it would be more optimal to own investments without tax advantages in accounts that are tax exempt. This is why MLP exchange-traded notes are better suited to ownership in tax-exempt accounts. Next week's note will expand on this and explain more about ETNs.

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## Related Alerian Research:

Decisions, Decisions: Demystifying MLP Investment Options
Energy Infrastructure Investing
MLP Taxation: The Benefits and What You Need to Know

## Additional Resources:

IRS Publication 598 – Tax on Unrelated Business Income of Exempt Organizations
Energy Infrastructure Council: MLPs and Retirement Accounts

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