IRAs are subject to the unrelated business income tax

Affected taxpayers must file Form 990–T annually by April 15

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April 2023

Key takeaways

- IRAs are subject to the unrelated business income tax.
- IRAs with more than $1,000 of gross unrelated business taxable income are required to file Form 990–T.
- IRAs must file or extend Form 990–Ts by April 15.

Individual Retirement Accounts (IRAs) described in section 408 are subject to the unrelated business income tax (UBIT) to the extent their gross unrelated business taxable income (UBTI) exceeds $1,000. IRA fiduciaries generally have the responsibility of filing Form 990–T, *Exempt Organization Business Income Tax Return*, but the tax liability belongs to the IRA.

What is UBIT?

UBIT is a tax imposed on the unrelated business income of exempt organizations, including IRAs. For IRAs and other trusts subject to UBIT, the trust tax rates apply (reaching 37% at $14,451 of income in 2023).

What is unrelated business income?

For IRAs, any income that is not excluded investment income generally will be unrelated business income. Typically, IRAs earn taxable income through investments in partnerships or LLCs with operating businesses (e.g., private equity funds, hedge funds, venture capital, publicly traded partnerships, and other alternative investment structures).

What is excluded investment income?

There are five common types of income that are statutorily excluded from unrelated business income:

1. Interest
2. Dividends
3. Royalties (note that the provision of services in conjunction with the royalties generally taints all of the income)
4. Rents from real property (note that the provision of services in conjunction with the rental activity generally taints all of the income)
5. Capital gains

However, if borrowed funds are used by the IRA or the investment vehicle to generate any of the income, it generally will be taxable to the IRA.

What is unrelated debt-financed income (UDFI)?

If the IRA, directly or through a partnership or LLC investment, utilizes debt (whether recourse or nonrecourse) to acquire or improve an income-producing asset, the IRA's share of the income from that asset will be unrelated business income to the extent of the borrowing if not already considered UBTI. For example, if a real estate partnership borrows $400,000 to acquire a building for $1 million, 40% of the IRA's allocable rental income from that building generally will be subject to UBIT.

How to identify unrelated business income?

Partnerships are required to provide sufficient information such that partners subject to UBIT are able to compute their tax liability. Specifically, Form 1065, Schedule K-1 contains a code "V" in Box 20 for partnerships to report this information. In addition, for 2022 Schedules K-1 furnished to IRAs, partnerships should also include code "AH" and provide the IRA's EIN when there is UBTI.

How and when to report and pay the tax?

IRAs generally must file Form 990-T if they have gross UBTI in excess of $1,000. The return generally must be filed by April 15, unless extended to Oct. 15 by filing a Form 8868 on or before the original due date.

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