Potential Hidden Tax Burden for MLP Holders

A recent WSJ.com **article** by **Laura Saunders** contains a cautionary tale for investors holding master limited partnerships in their IRAs. Many are receiving surprise tax bills for units of master limited partnerships they hold.

The article highlights the fact that IRAs and Roth IRAs, while offering tax-free investment growth, do carry some hidden tax traps. When investors use IRA funds to invest in partnerships, as opposed to stocks, bonds and funds, they owe tax on certain annual income from the partnership exceeding $1,000 because of an antiabuse provision. This levy is known as Unrelated Business Income Tax, or UBIT, and its top rate of 39.6% can take effect at about $12,000 of taxable income.
However, when this tax is due, the IRA custodian or trustee, not the individual investor, is responsible for obtaining a special tax ID number and then filing and signing an IRS Form 990-T reporting the income. The IRA owner is typically responsible for paying the tax. If the custodian or trustee doesn't file the necessary tax forms in a timely manner or fails to secure an extension, the individual investors may also be hit with additional late-filing penalties and interest.

As a result, according to the article, many advisors warn investors against putting publicly traded partnerships into IRAs.

To learn more about Master Limited Partnerships, check out these informative AAII articles:

- Making Sense of Master Limited Partnership Tax Rules
- Master Limited Partnerships
- Master Limited Partnerships: Income From a Unique Structure and Industry