

QUICK GUIDE TO UBTI & UDFI

IRAs are a great shelter for growing investments tax-deferred (in a Traditional IRA) or even tax-free (in a Roth IRA). However, there are instances in which the income produced by an IRA-owned investment can generate taxes. There are two types of investment income taxes to be aware of.



Unrelated **Business** Taxable Income (UBTI) occurs when a retirement account earns active business income, which is considered unrelated business income under federal tax law and is subject to its own tax.



Unrelated **Debt-Financed** Income (UDFI) occurs when a retirement account owns a real estate property that is debt-financed (with a non-recourse promissory note) and the property generates income.

TAXABLE EVENT TRIGGERS

If you earned income from selling goods or performing services with the intent to profit in an ongoing trade or business. Exclusions apply:

- Interest
- Dividends
- Royalties
- Capital Gains
- Rents (if not debt-financed)

See [IRS Publication 598](#) for additional details.

If your real estate investment was made by your IRA obtaining a non-recourse loan to purchase real estate. The average indebtedness is calculated for the year, and only that portion of the income is taxed as UDFI.

For example: If your average property indebtedness is 50% and your investment income is \$6,000, then the portion of the income that is considered UDFI is \$3,000. As the indebtedness goes down, so does the UDFI.

WHY WOULD IRA INVESTMENT INCOME BE TAXED?

When IRA assets are invested in certain types of income-generating investments, the IRA itself is required to pay tax each year on the investment income. This payment of tax does not create basis in the IRA. Instead, think of it more like the cost of doing business within a tax-exempt entity, such as an IRA or other qualified retirement account.

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If you owe UBTI and/or UDFI, the investment sponsor must report each investor's financial information on a Schedule K-1 (IRS Form 1065) and payment of UBTI or UDFI must come from the IRA. It is important that the K-1 properly reflect STRATA's tax identification number (TIN) of 26-2637994 rather than your social security number.

TAX REPORTING

The account owner is responsible for determining if the filing of IRS Form 990-T is necessary – which is why IRA account owners are advised to work with an experienced tax professional. As a custodian, STRATA does not file IRS Form 990-T, nor advise on or calculate UBTI or UDFI.



IRA ACCOUNTHOLDERS

- ✓ Consult with your [investment sponsor](#) to determine if a 990-T is necessary.
- ✓ Consult with your [tax professional](#) to obtain an employer identification number (EIN) for your IRA by filing IRS Form SS-4.
- ✓ Complete IRS Form 990-T* and submit electronically to the IRS.
- ✓ Provide a copy of completed Form 990-T and IRS Form 8879-EO to STRATA. Fill out and submit STRATA's [Expense Payment Authorization Form](#).



IRA CUSTODIANS

- Once all forms are received, the IRA custodian will process the disbursement as a wire transfer using tax code 990.
- The IRA custodian will submit Horizon Bank's Outgoing Domestic Wire Transfer Request in order to wire funds directly to the US Treasury.

**This form should NOT include STRATA's EIN (26-2637994), but instead an EIN for the IRA.*

WHEN IS IRS FORM 990-T DUE?



If Form 990-T is filed late or not filed, the IRS may assess penalties and interest. The minimum penalty for a return that is more than 60 days late is the smaller of the tax due or \$435. Allow plenty of time for the custodian to meet the IRS tax filing deadline for IRA custodians which typically aligns with federal income tax filing deadlines.

PRO TIP

If the amount of gross UBTI/UDFI is less than \$1,000, Form 990-T is not required to be filed. However, filing the form even if you have a loss allows it to carry forward to subsequent years. Any income or loss shown on the K-1 for an IRA-owned asset should not be included or reported on your personal tax return.

WHAT SETS STRATA APART

STRATA's commitment to our clients, solid industry expertise, robust regulatory controls, investment flexibility and customer-focused technology create a clear difference amongst IRA service providers.



EXPERTISE

A team with more than 350 years of self-directed IRA expertise.



EXPERIENCE

A broad range of asset experience with both traditional and alternative assets.



EASY-TO-USE TECHNOLOGY

Customer-focused technology that enables seamless account management.