



NATIONAL ASSOCIATION OF PUBLICLY TRADED PARTNERSHIPS



MLPs and Retirement Accounts

Investors often ask if they can invest in MLPs through their retirement accounts--IRAs, 401(k)s, and similar plans which are allowed to earn tax-deferred income under the Internal Revenue Code. The regular cash distributions offered by MLPs make them an appealing possibility for investors wishing to build up retirement funds.

The answer is **yes, IRAs, 401(k)s, and other qualified retirement accounts are allowed to invest in MLPs** the same as any other traded security. There is nothing in the federal tax code or pension laws that says they cannot. Before you add MLPs to your retirement account, however, there are some special considerations that you need to weigh carefully.

First, remember that one reason many people buy MLPs is for the tax advantages -- the tax-deferred distribution and the ability to shelter taxable income passed through from the MLP with depreciation and other deductions. In a retirement account, however, the income is already tax-deferred, so the tax benefits of an MLP are, in a sense, "wasted."

More importantly, contrary as it may seem, **holding MLPs in a retirement account can result in the account owing tax.**

Unrelated Business Income Tax

There is a concept in the tax code (I.R.C. §§511-514) called "**unrelated business income tax**" (UBIT). Under the UBIT rules, tax-exempt institutions and retirement accounts must pay tax on income from a business that is not related to their exempt purpose (a university operating a business that had nothing to do with education would be an example).

Because of the pass-through nature of an MLP--or any partnership (no tax paid by the partnership, all tax items flow through to the limited partners/shareholders, who pay tax on their share), the shareholders are treated by the tax code as if they are directly earning the MLP's income. Thus, as a shareholder in the MLP, the IRA, 401(k), or other account is considered to be "earning" its share of the MLP's business income.

The tax is owed on the retirement account's share of the MLP's taxable business income, minus its share of depreciation and other deductions related to the business, as reported on the K-1, (**not** on the quarterly distributions). There is a deduction that covers the first \$1,000 of unrelated business income from all sources; after that, the retirement account will owe tax.

It is important to remember that **you are not** the one who will owe any unrelated business income tax on MLP units held in your retirement account. **The tax is owed by the IRA, 401(k), or other account itself.** It is the responsibility of the custodian of the account to file a tax return (form 990, the return for tax-exempt organizations) and pay any tax owed out of the account's funds.

You should also note that the tax applies only to the income allocated to the retirement account each year while it holds the MLP units. It does not affect the treatment of capital gain realized when the units are sold. This would remain exempt from taxation.

Should I Hold MLPs in my Retirement Account?

Investment advisors who follow MLPs differ on whether it is a good idea to include them in a retirement account. Some analysts feel it's inappropriate to put an MLP in an IRA or 401(k). They argue that because the tax benefits are such an important feature of MLPs, this investment should be in a taxable account where the benefits can be realized. They also feel that placing MLP investments in an account where they are subject to UBIT unnecessarily diminishes the return and creates additional complexity.

Others feel differently, arguing that because the taxable income is so heavily sheltered by deductions like depreciation, taxable income for many retirement accounts is unlikely to exceed the \$1,000 UBIT deduction. They also feel that the income aspect of the MLP is the most important benefit, and that even if the retirement account does have to pay tax, the cash distributions will still provide a highly desirable return on an after-tax basis.

This is a decision that investors need to make for themselves after weighing their priorities, consulting their investment advisors, and running the numbers on the MLPs that interest them.

Additional Resources

[IRS Publication 598](#), Tax on Unrelated Business Income of Exempt Organizations (partnerships are discussed on page 13).

[Internal Revenue Code §§511-514](#), Unrelated Business Income Tax (rule for partnerships is in section 512(c)).