

# What Is UBIT?

**Unrelated business income tax (UBIT) is a tax that your self-directed IRA may incur when:**

- ▶ **It earns unrelated debt-financed income (UDFI)** through profit from rental income or the sale of property that has outstanding debt.
- ▶ **It receives unrelated business taxable income (UBTI)** due to its ownership in a business that is not taxed as a C corporation.

Some investors hesitate to invest in assets that may incur UBIT because they see it as a penalty or an excessive tax. But it's just a cost of doing business related to certain investment structures.

## How UBIT Works

- ▶ UBIT from UBTI does NOT apply to investments into C corporations as C corporations pay tax at the corporate level and then pass dividends to shareholders.
- ▶ Interest, rent (from a property without debt), royalties, and dividends received from investments are not subject to UBIT.
- ▶ UBIT is not a personal tax; your IRA pays it. Your IRA has its own tax ID number and must file Form 990-T.
- ▶ UBIT tax rates follow trust tax rate schedules, not individual income tax rates. An exception may apply if your IRA sells property that has outstanding debt.
- ▶ When calculating potential UBIT, your IRA may be able to use deductions to reduce the tax.
- ▶ Fix-and-flip real estate income is generally considered business income (UBTI).

## 7 Ways to Reduce or Avoid UBIT

- ▶ Don't allow your IRA to use leverage to fund your real estate investment. UBIT only applies to the debt-leveraged percentage of net profit of an asset.
- ▶ Partner your IRA funds with cash or another investor instead of using leverage.
- ▶ Use a solo 401(k) as they generally do not have to pay UBIT from UDFI.
- ▶ Use "banked" losses from previous years to offset profits in the current year.
- ▶ Pay down debt leverage quickly with profits from other IRA investments.
- ▶ Pay off debt leverage a full twelve months prior to the sale of an IRA-owned property to avoid UBIT on sale profits.
- ▶ When investing in a business, choose a C corporation, which pays business tax before profits are disbursed to investors (including IRA investors), so no UBIT from UBTI occurs.

**For more information contact Advanta IRA today.**