UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Lakehead Pipe Line Company,) Docket Nos. IS-92-27-000,
Limited Partnership) IS-93-4-000, and IS-93-33-0001

MOTION OF THE COALITION OF PUBLICLY TRADED PARTNERSHIPS FOR LEAVE TO FILE AMICUS CURIAE BRIEF

Pursuant to Rule 212 of the Commission's Rules of Practice and Procedure, the Coalition of Publicly Traded Partnerships ("the Coalition") hereby seeks leave to file the attached amicus curiae brief in support of the Petition for Rehearing of Lakehead Pipe Line Company, Limited Partnership ("Lakehead").

The Coalition is a trade association organized under section 501(c)(6) of the Internal Revenue Code to represent the business interests of publicly traded partnerships and those who work with them before Congress, the executive branch of the United States government, and federal regulatory agencies. The dues paying membership of the Coalition includes four oil and gas pipelines which are PTPs, including Lakehead.

The Coalition does not request intervenor status in the Lakehead case. Rather, it seeks to assist the Commission in its understanding of this matter of critical importance by offering the Coalition's perspective on the tax allowance issue. As the Washington representative of publicly traded partnerships since 1983, the Coalition has particular expertise in both the history of Congressional tax legislation regulating PTPs and the way that

these entities are taxed under the Internal Revenue Code. The Commission has allowed the filing of an amicus brief by an intervenor in similar circumstances. See, e.g., Virginia Electric Power Company (CCH) ¶61,093 (1984) (amicus brief in support of petition for rehearing); Kalaeloa Partners, L.P., 48 FERC (CCH) ¶ 61,173 (1989) (amicus brief found to assist the Commission in understanding issues).

WHEREFORE, for the foregoing reasons, the Coalition of Publicly Traded Partnerships respectfully requests leave to file the attached amicus curiae brief.

Respectfully submitted,

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AMICUS CURIAE BRIEF OF THE COALITION OF PUBLICLY TRADED PARTNERSHIPS IN SUPPORT OF THE REQUEST FOR REHEARING OF LAKEHEAD PIPE LINE COMPANY, LIMITED PARTNERSHIP

The Coalition of Publicly Traded Partnerships ("the Coalition") hereby submits its amicus curiae brief in support of the rehearing of Opinion No. 397, Lakehead Pipe Line Company, Limited Partnership, 71 FERC (CCH)¶ 61,338 (1995)("Opinion No. 397"), with respect to the Commission's denial of a full income tax allowance as part of cost-of-service calculations to Lakehead Pipe Line Company, Limited Partnership ("Lakehead"), for income attributable to individual limited partners, an issue which is of overriding importance to oil and gas pipelines that are organized as partnerships, including specifically publicly traded partnerships ("PTPs"), also known as "master limited partnerships" or MLPs.

The Coalition is a trade association organized under section 501(c)(6) of the Internal Revenue Code to represent the business interests of publicly traded partnerships and those who work with them before Congress, the executive branch of the United States government, and federal regulatory agencies. The dues paying

membership of the Coalition includes four oil and gas pipelines which are PTPs, as well as PTPs in a number of other industries.

I. THE COMMISSION'S OPINION WITH REGARD TO LAKEHEAD'S INCOME TAX ALLOWANCE CONTRAVENES CONGRESSIONAL POLICY WITH REGARD TO PIPELINES OPERATING AS PUBLICLY TRADED PARTNERSHIPS.

Publicly traded partnerships are limited partnerships, the ownership shares or "units" in which are traded on public securities exchanges. The first PTPs were formed in the early 1980s as a means of expanding the pool of capital available to the natural resource and real estate industries. In particular, the liquidity of PTPs and the ability of investors to purchase units in affordable amounts allowed these industries to reach the small, middle income investor who previously could not afford to invest in partnerships. Although businesses in other industries have utilized PTPs as well, these original industries remain the primary users of the PTP form of business.

Between 1983 and 1987 there was debate in Congress as to which, if any, PTPs should be allowed to retain their partnership tax status. Tax policy makers feared that businesses which had not traditionally used the partnership form and for which that form was not appropriate might decide to operate as PTPs solely to avoid the corporate level tax (this debate involved misconceptions about entity level vs. flow-through taxation that will be discussed in section II).

The debate was resolved by the enactment of the Omnibus Reconciliation Act of 1987, P.L. 100-203. Section 10211 of that legislation, which created section 7704 of the Internal Revenue Code of 1986, set forth Congress' policy with regard to publicly traded partnerships. That policy was that all PTPs deriving at least 90 percent of their gross income from certain sources would be taxed as partnerships, rather than corporations. Among the specified sources is "income and gains derived from the exploration, development, mining or production, processing, refining, transportation *(including pipelines transporting gas, oil, or products thereof)*, or the marketing of any mineral or natural resource...". I.R.C. §7704(d)(E)(emphasis added).

Thus, Congress, when presented with the opportunity to deny to oil and gas pipelines the benefits of operating in publicly traded partnership form, declined to do so and in fact gave its specific approval to the operation of oil and gas pipelines as PTPs. It effectively recognized that the pipeline industry had legitimate business reasons for choosing to raise capital in this manner and should not be penalized for doing so.

If pipelines operating as PTPs, whose earnings are in fact taxed, are not allowed to utilize the same tax allowance as other pipelines in their rate setting, they will be severely penalized. By denying to Lakehead solely on the basis of its partnership structure a tax allowance which is fully available to other

pipelines, the Commission is thus directly contravening the policy of Congress as set forth in P.L. 100-203.

II. THE FACT THAT LAKEHEAD DOES NOT PAY AN ENTITY LEVEL INCOME TAX SHOULD NOT PRECLUDE IT FROM BEING ENTITLED TO A TAX ALLOWANCE ON INCOME ATTRIBUTABLE TO PARTNERS WHICH ARE INDIVIDUALS.

The Commission has ruled that because Lakehead does not pay an entity level tax, it is not entitled to a tax allowance, except to the extent of its income attributable to partners which are corporations. This ruling demonstrates a lack of understanding of the concept of a passthrough business entity, and of the way that the taxation of business entities actually works.

A. TAX IS IN FACT PAID BY BUSINESSES OPERATING AS PARTNERSHIPS

The relevant question in deciding whether a business entity is entitled to a tax allowance should be, does it in fact pay tax? Under subchapter K of the Internal Revenue Code and the corresponding state statutes, the business entity known as a partnership is an aggregate of its partners. Collectively they receive any income, experience any loss, and, most importantly for the purpose of this issue, pay any federal or state tax due on the resulting net income. The fact that the entity paying the tax is an aggregate of partners rather than an artificial person known as a corporation does not make it any less true that tax has been paid.

In fact, the absence of an entity level tax does not necessarily mean that income is not taxed twice. It is important to understand the difference between a partner's distributive share of partnership income and a cash distribution from a partnership to a partner. Many people make the mistake of analogizing one or both of these to a dividend on corporate stock, when in truth, they are very different things.

A partner's distributive share of income is his portion of the income earned by the partnership that year, allocated to him as part of the collective business entity. This is an allocation on paper, not an actual receipt of cash. He pays tax on this income, representing his share of the tax owed by the collective business entity. This tax is analogous to the tax paid by a corporation on its income, not to the tax paid by a corporate shareholder on his dividend.

Nor is a cash distribution the same as a corporate dividend; rather, it is a return on the partner's capital. As such, it is not taxed at the time it is distributed, but rather subtracted from the partner's basis in his partnership interest. The partner's share of the partnership's taxable income increases his basis, but in many PTPs the reduction due to the distribution exceeds the increase due to the taxable income allocation.

Only when the basis reaches zero (and all the partner's capital has been recouped) will cash distributions be taxed on a

current basis. However, to the extent that total distributions exceed total taxable income allocated, thus reducing the basis, at the time the partner disposes of his interest the taxable gain--i.e., the difference between the sales price and the basis--will be increased. Thus, the cash distributions, too, may ultimately taxed, albeit at a later time and at capital gains rates.

B. THE FACT THAT THE LAW IMPOSES TAX ON BOTH A BUSINESS ENTITY AND ITS INVESTORS DOES NOT NECESSARILY MEAN THAT SIGNIFICANTLY OR ANY MORE TAX IS PAID OVERALL ON THAT BUSINESS' EARNINGS THAN ON THE EARNINGS OF A PASSTHROUGH ENTITY.

The notion many people have of the difference in overall tax paid by a business subject to corporate tax compared with a passthrough entity, as typified by the example on page 36 of the Commission's opinion, is in truth highly simplistic. In fact, it is not necessarily true that significantly, or even any more tax will be collected on the earnings of a corporation than on those of a partnership.

In the first place, as the Commission recognizes, many partnerships have corporate partners. To the extent that these partners pay corporate tax on their distributive share of income from the partnership, and then pass some of that income through to their shareholders in the form of taxable dividends, the partnership income is subject to double taxation. In some cases

where partners have corporate parents, a consolidated return is filed. The partnership income is consolidated with the income (or loss) from the parent and its other subsidiaries and tax is paid on the resulting net income.

Second, not all corporate earnings are subject to double taxation. Corporate earnings are not double taxed to the extent that they are retained or reinvested by the corporation rather than distributed as dividends to the shareholders. Many corporations pay only minimal dividends.

The Commission does not examine the tax actually paid by pipelines which are corporations in granting them a tax allowance; corporate pipelines are granted an allowance regardless of whether the various factors discussed above apply. There is no reason to apply a different rule to noncorporate entities.

Also, it should not be forgotten that tax-exempt shareholders such as pension funds and universities own a significant portion of the stock of many corporations. To the extent that corporations are owned by such shareholders, tax is paid at only one level, the entity level.[1] There is very little investment in PTPs by tax-exempt entities, on the other hand, because their distributive share of PTP income is subject to taxation under the unrelated business income tax rules of the Internal Revenue Code.

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[1]In the case of pension funds the earnings will eventually be taxed when distributed to beneficiaries, but under time-value-of money concepts, the value of the tax is significantly reduced.

A final reality that should be factored into the equation is that the highest federal corporate tax rate is 35%, while the highest tax rate for the individuals who collectively pay the tax on partnership earnings is 39.6%.

In sum, the difference between the overall tax paid by a PTP or other partnership, and that paid by any of its corporate competitors, is neither fixed nor predictable, but rather will vary according to the mix of investors in any given tax year, as well as corporate decisions with regard to borrowing, retention of earnings, and capital investment. It is quite possible for the difference to be very small or nonexistent. Such a varying and unpredictable difference is not an appropriate basis upon which to deny a tax allowance to Lakehead or any other PTP.

III. THE SOLUTION OFFERED BY THE COMMISSION IS IMPRACTICAL FOR PUBLICLY TRADED PARTNERSHIPS

The Commission's ruling offers a limited solution to the realities discussed above by allowing Lakehead a tax allowance with respect to income attributable to corporate partners. Aside from the fact that this solution ignores the other factors affecting the relative tax burden of PTPs and corporations, the solution is one that will be very difficult for PTPs to administer.

The income attributable to a corporate general partner can be known with certainty because the partnership knows who the general partner is and what share of income is allocated to that partner

under the partnership agreement. However, a PTP may also have any number of corporate limited partners, and knowing who they are and how much income is going to them on an ongoing basis is complex and difficult.

Tax items attributed to limited partners are attributed not on a per-partner but a per-unit basis. Moreover, because a PTP is publicly traded, ownership interests shift on a daily basis. It is impossible to know at any given time which of the tens of thousands of investors holding an interest on the PTP on any given day is a corporation.

A snapshot of the ownership of a PTP is taken only once a year, when it files its tax returns. In order to file these returns, the PTP must first receive a report (required by federal law under I.R.C. §6031(c)) from the various brokers who hold a large number of PTP units in "street name." It is only after a PTP has received the yearly report from the broker, combined it with its own information, and run everything through its computer system, that it has a reasonably accurate picture of who owned what percent of ownership interests over the past year.

This issue has come up in the Coalition's dealings with state legislatures and state agencies proposing to require partnerships to withhold tax from their quarterly distributions for nonresident partners. The same problem exists: the PTP has no way of knowing on a quarterly basis who those partners are. When the problem has

been explained to the state entity in question, PTPs are often exempted from the withholding proposal. States which have done this include California (through a ruling of the California Franchise Tax Board), New York and Georgia (PTPs were exempted from proposed legislation).

IV. CONCLUSION

Denying Lakehead a full tax allowance to Lakehead in its cost-of-service calculations directly contravenes Congressional policy allowing oil and gas pipelines to engage in capital formation through the partnership structure, fails to recognize that tax is being paid even though the entity paying it is an aggregate entity rather than a statutory "person," and does not accord with the realities of the relative tax burdens on earnings of partnerships and corporations. Moreover, compliance with the rule suggested by the Commission, to allow the allowance for tax on income attributable to corporate partners only, will be very difficult for Lakehead or any other PTP to administer.

For all these reasons the Coalition urges the Commission to reverse its decision and allow a full income tax allowance to Lakehead, as well as to any other PTP for which this issue comes before the Commission.