REPORT OF THE FEDERAL AFFAIRS COMMITTEE

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REPORT OF THE FEDERAL AFFAIRS COMMITTEE

Over the past year the activities of the Federal Affairs Committee have been focused, as they were the year before, on preserving the tax status of publicly traded partnerships when and if Congress enacts tax reform legislation. While the continuing dysfunction of the 113th Congress makes comprehensive tax reform appear to be an unlikely event, both the House Ways and Means Committee and the Senate Finance Committee are moving forward with serious intent, and NAPTP is responding in kind.

Also of considerable interest and related to tax reform is the effort by several members of Congress and alternative energy proponents to enact legislation to broaden the scope of section 7704 to include renewable energy projects. NAPTP has continued to remain neutral with regard to this effort, leaving it to Congress aided by those with expertise in alternative energy financing to reach a decision on the appropriate policy.

The carried interest legislation, which was our main preoccupation in other years, is still alive and continues to be supported by the Administration and some tax writers, although there have been few developments over the past year. Since the current version is written more narrowly than earlier versions and no longer poses a concern to traditional MLPs, we have limited efforts on this issue to monitoring its status.

The Administration continues to call for elimination of various tax provisions benefiting oil, gas, and coal in its annual budget but does not call for repeal of section 7704. Some members of Congress, however, have suggested that all "tax expenditures," which the Joint Committee on Taxation defines to include MLPs, be removed from the tax code as part of the tax reform effort. Apart from this context, there is not a Congressional majority for the elimination of these energy tax provisions.

TAX REFORM

Issue Background

For a good part of the current administration, both Congressional and executive branch policy makers have been devoting substantial thought to reforming the federal tax code. The last time the tax code underwent a thorough revamping was in 1986, when Congress simplified it by eliminating a number of deductions and credits, reducing the number of tax brackets, and lowering rates. In the 25 years since then, the Code has once again become cluttered, complex, and

inefficient; and every year Congress enacts legislation that adds new special provisions and more complexity.

Why Tax Reform

Interest in tax reform has been renewed in recent years for a number of reasons. Concern over the size of the federal budget deficit has focused attention on the revenue lost to "tax expenditures." The term "tax expenditure" is used to denote a provision in the tax code that varies from the normal rules of income taxation in a manner that reduces revenue, and by doing so provides a subsidy to particular taxpayers that policymakers consider to be equivalent to a direct federal expenditure.

There is also a widespread belief that the corporate tax rate is too high, putting U.S. businesses at a disadvantage to their foreign competitors. One way to achieve a lower rate in a revenue neutral manner is to eliminate most or all of the current tax expenditures, allowing a lower rate to be applied to a broader base. While the end result would be a fairer (or value neutral) tax code, the process of getting there would create a number of winners and losers among different industries. Because tax reform could result in significant disruption to some critical sectors of the economy such as real estate, entities dependent upon charitable contributions, and of course the energy sector, it could prove to be politically difficult to achieve, especially if we continue to face a weak economy.

When comprehensive tax reform is discussed, the taxation of business entities is usually part of the discussion—in particular, which businesses, if any, should pay an entity level tax and which should be able to have pass-through tax status. The answer to this question will impact MLPs. Some tax policy experts suggest that entities over a certain size, or that are publicly traded, should not be allowed pass-through taxation. Others suggest that there only be one level of taxation, but at the entity level.

The issue has received particular attention in the current tax reform discussions because the trend over the past several years has been a diminution of corporate tax revenues and a rise in the number of pass-through entities. In addition, several experts have pointed out that because of the amount of business income earned by pass-through entities, corporate tax reform should be accompanied by a similar process on the individual side; otherwise pass-through entities like MLPs whose taxes are paid by individuals could lose the deductions that lower their taxable income without the compensating lower tax rate.

Tax Reform Proposals

There was a short-lived effort at rethinking the tax code during the George W. Bush administration. In November 2005 the President's Advisory Panel on Tax Reform, which had been appointed by the President to develop recommendations for making the tax code "simpler, fairer, and more conducive to economic growth," issued a report suggesting two possible alternative

plans. One was a Simplified Income Tax Plan under which all large entities—those with more than $10.5 million in receipts—would be taxed at the entity level, paying a 31.5% rate. The other, the "Growth and Investment Tax Plan" would impose a flat 30% cash flow tax on all businesses other than sole proprietorships.

As tax reform became a growing issue, President Obama asked members of the President's Economic Recovery Advisory Board ("PERAB," a group headed by Paul Volcker that was established at the beginning of 2009 to advise the President on policies to promote economic growth) to examine tax reform options. In August 2010, PERAB issued "The Report on Tax Reform Options: Simplification, Compliance, and Corporate Taxation." More a laundry list of options than a recommendation of any specific measures, the Report includes a section on "reviewing the boundary between corporate and non-corporate taxation." It discusses possible changes to that boundary, including taxation of some or all PTPs or extending corporate taxation to currently non-taxed entities based on other criteria such as size or income. The Report includes both the pros and cons of such a change.

Also in 2010, President Obama appointed a bipartisan commission to examine ways to reduce the deficit, the National Commission on Fiscal Responsibility and Reform. The Commission was organized into working groups, one of which was a Tax Reform Working Group. On December 1, 2010, the Commission issued its recommendations for achieving $4 trillion in deficit reduction through 2020. Among them was comprehensive tax reform which, on the business side, would be achieved by setting a single corporate rate between 23% and 29%, eliminating all tax expenditures for businesses, and establishing a territorial tax system. The Commission was silent on the taxation of pass-through entities and whether PTPs would be considered tax expenditures. The plan called for a "failsafe" mechanism which would begin to automatically reduce tax expenditures if Congress did not pass legislation meeting specific revenue targets by 2013.

The report did not achieve the required number of votes from Commission members to become an official recommendation of the Commission, but nevertheless garnered a good deal of attention. It continues to be mentioned as the sort of plan which needs to be adopted to deal with the current budget situation. Most recently, as discussed below, the leadership of the Senate Finance Committee has announced that they plan to undertake tax reform stripping all tax expenditures out of the tax code, as recommended by the Commission, and asking Senators to submit justifications for the expenditures they wish to retain.

Energy PTPs as Tax Expenditures

Adding to the concern over what tax reform means for MLPs has been the fact that since 2008, energy and natural resource publicly traded partnerships (PTPs) have been included as a tax expenditure in the list issued annually by Congress' Joint Committee on Taxation (JCT), as well as occasional JCT analyses of energy tax expenditures. As noted in the discussion above, when tax reform is under discussion, policymakers are usually talking about eliminating tax expenditures to

obtain lower rates. Tax expenditure status also makes MLPs of interest to those members, like Senator Bernie Sanders (I-VT) who wish to eliminate all tax expenditures benefiting oil and gas.

Last year's tax expenditure list, published in January 2012, estimated the total tax expenditure for energy and natural resource PTPs at $1.5 billion over five years, comprised of $1.2 billion for energy-related activities and $0.3 billion for exploration and mining. The number was actually significantly lower than the previous (December 2009) estimate of $2.8 billion.

The most recent estimate, released on February 1, 2013, is considerably higher. The estimate for PTPs with qualifying income from energy-related activities has gone from $1.2 billion over five years to $6.7 billion. The estimate for PTPs with qualifying income from natural resources and mining has gone from $0.3 billion over 5 years to $0.8 billion—for a total of $7.5 billion 2013-2017, vs. $1.5 billion in the 2012 estimate for 2011-2015, as shown below.

Joint Committee on Taxation
Tax Expenditure Estimates for Natural Resource PTPs
($billions)

Year(s)	PTPs engaged in certain energy related activities		PTPs engaged in exploration & mining of natural resources		All Natural Resource (Approximate Total[1])	
	Jan 2012 Rpt.	Feb 2013 Rpt.	Jan 2012 Rpt.	Feb 2013 Rpt.	Jan 2012 Rpt.	Feb 2013 Rpt.
2011	0.2	(2)	0.1	(2)	0.3	-
2012	0.2	1.2	0.1	0.1	0.3	1.3
2013	0.2	1.2	0.1	0.1	0.3	1.3
2014	0.3	1.2	0.1	0.1	0.4	1.3
2015	0.3	1.4	0.1	0.2	0.4	1.6
2016	(2)	1.4	(2)	0.2	-	1.6
2017	(2)	1.5	(2)	0.2	-	1.7
2011-2015	1.2	(2)	0.3	(2)	1.5	-
2012-2016	(2)	6.3	(2)	0.7	-	7.0
2013-2017	(2)	6.7	(2)	0.8	-	7.5

(1) The JCT provided numbers only to one decimal place. Therefore column totals, provided by the JCT, may vary from sum of yearly figures due to rounding, and row totals, which were not provided by the JCT, are approximate.

(2) Not provided.

In order to gain a better understanding of how the JCT may calculate the tax expenditure impact for PTPs, the Association last year hired Quantria Strategies, an economic consulting firm led by two former JCT economists. Quantria's report theorized that the tax expenditure number is based on distributions and is calculated as the difference between the tax collected when a distribution to the investor is taxed at both the entity level and the investor level, and the tax collected when the distribution is taxed only at the investor level. Quantria found that when this calculation was applied to actual PTP distributions in 2010, the result was very close to the JCT number at that time.

Thomas Barthold, the chief of staff of the JCT, has told the press only that the growth in the tax expenditure number stems primarily from the fact that MLPs are generating more income than before. It is likely that the increase was based at least in part on the large number of MLP IPOs and acquisitions that drew substantial attention over the past year; however, this does not completely explain such a large increase.

It is important to remember, as the JCT itself states, that the *tax expenditure* estimate, an estimate of the amount of revenue that the government foregoes by allowing natural resource PTPs to be taxed as partnerships, is not the same as the *revenue estimate,* i.e., the estimate of the amount of revenue that would be raised by changing the taxation of PTPs. The revenue estimate would be affected by behavioral and timing issues (i.e., some taxable activity might not be undertaken if the law changed, and transition rules might be provided), and therefore would be less than the tax expenditure estimate. To our knowledge, the JCT has not estimated the revenue that would be gained by changing PTPs' taxation.

It is also worth noting that even at the higher level, the tax expenditure estimate associated with PTPs is dwarfed by the cost of such major tax expenditures as the mortgage interest deduction ($379 billion), nontaxed employer-provided health insurance ($760 billion), and income deferral for controlled foreign corporations ($266 billion), to name a few.

Developments and NAPTP Action over the Past Year

Over the past year NAPTP and its Washington representatives have continued their efforts to educate members and staff of the tax writing committees and potential allies on other committees about what MLPs are, what they do for the country as a whole and members' states in particular, and why it would be a mistake to change their tax status. These efforts picked up somewhat at the beginning of 2013 with the arrival of new committee members and staff as the 113th Congress got underway.

These efforts have produced some success in recent months, as we have developed a solid core of allies on the House Ways and Means Committee and believe we have made a good case for MLPs to Chairman Dave Camp and the Committee as a whole. These include in particular Rep. Kevin Brady (R-TX), who made sure during the tax reform subgroup process discussed below that MLPs were considered for their contribution to energy security and not simply as another pass-through entity. Other friends on Ways and Means include Reps. Charles Bustany (R-LA), Kenny Marchant (R-TX), Tom Reed (R-NY), Patrick Tiberi (R-OH), Lynn Jenkins (R-KS). NAPTP members with operations in their states are encouraged to thank them for their efforts and let them know about your presence.

On the Finance Committee side, we hope that Senator Cornyn (R-TX) will count MLPs as among the constituent interests he will look out for as part of tax reform. Senators Roberts (R-KS), Enzi (R-WY), and Grassley (R-IA) are also expected to be supportive. Senator Inhofe (R-OK), although not on the Finance Committee, is a strong supporter of MLPs. It is also expected that the

supporters of the MLP Parity Act (see below) will strongly oppose any effort to eliminate MLPs as part of tax reform.

Our Washington efforts are overseen by the Board of Directors and the Federal Affairs Committee and carried out by a Washington lobbying firm representing NAPTP itself as well as government relations personnel and outside lobbyists of a number of individual companies. Any member MLP with a presence in Washington is encouraged to participate in these efforts.

This spring we took the additional step of hiring a D.C.-based public affairs firm, Story Partners, to assist us in our efforts. Story Partners is helping NAPTP deal with the growing media attention to MLPs as energy companies, as investments, and as an issue in tax reform. Amos Snead of Story Partners will serve as NAPTP's media spokesperson, fielding all media inquiries, and Story Partners is working on placement of pro-MLP articles in appropriate publications.

In addition, Story Partners is helping us refine our advocacy material to be sure that we tell our story and make the points in our favor as effectively as possible. We plan to send NAPTP members talking points and other material to help deal with any inquiries they may receive about tax reform.

Developments During the Remainder of 2012

During the latter part of 2012, Congress continued to hold hearings and otherwise examine the issue of tax reform, but although there was occasional talk of an effort to force action on tax reform before the end of the year, it was fairly universally acknowledged that tax reform was on hold until after the election and the start of the new Congress. It was hoped that the election would result in a more unified government that would be capable of undertaking major initiatives without gridlocking.

On August 1, 2012, the Senate Finance Committee held a hearing on taxpayers' choice of business entity. As usual, the JCT issued a report discussing the issues associated with choice of business entity in advance of the hearing. Similar to a report issued earlier in the year for the Ways and Means Committee, the report presented data on the numbers and sizes of various business entities, outlined current and past entity classification law, and delved into policy analysis regarding the choice of a corporate or pass-through entity The report discussed PTPs and the issue of whether partnerships should be publicly traded without paying corporate tax, giving the arguments for both and against. It also examined the possibility of a unified pass-through regime.

At the hearing, there were no calls for imposing corporate tax on PTPs or pass-through entities in general by either the witnesses or the Senators attending the hearing. In fact, there was general agreement that one level of taxation for all business income would be best, and that a 25% corporate rate should not be achieved "on the backs of the non-corporate sector." Everyone agreed as well that corporate and individual tax reform need to be done together.

Chairman Max Baucus (D-MT) noted in his opening statement the increasing extent to which businesses are avoiding both public trading and the corporate form, saying 95 percent of all U.S. businesses are structured as pass-throughs. He attributed this to the growing number of private equity firms and other sources of capital for businesses not wishing to go public, and the tax advantages of operating in pass-through form. He stated “While a valuable tool for small businesses, we should examine if the use of pass-throughs have [sic] disrupted the level playing field for larger non-public companies and their public competitors. Ideally, our tax code should cause as few distortions in business as possible. Businesses should plan and organize based on growth and job creation – not the tax code.”

Ranking member Orrin Hatch (R-UT) strongly advocated moving to one level of taxation and said of the Administration’s “framework” for tax reform (which suggested considering taxation of large pass-throughs), “Like all bad ideas, this one should be rejected.” Senators Ben Cardin (D-MD) and Robert Menendez (D-NJ) expressed strong support for leaving pass-through entities as they are.

NAPTP submitted a statement for the hearing record recommending that "Congress continue to preserve the ability of business enterprises to choose the structure that is the most efficient and effective for their particular business activities, whether it be a pass-through structure or a C-corporation, in any future tax legislation," and asking that "publicly traded entities that are currently able to choose pass-through taxation be allowed to continue doing so." The statement noted the contributions that MLPs are making to domestic energy independence, as well as their benefit to investors seeking income, and urged that their tax treatment not be changed.

For the remainder of the year, attention in Washington was focused on the November election, which retained the current balance of power in the White House and Congress, and the looming “fiscal cliff” when the Bush-era tax cuts would expire and “sequestration”--automatic budget cuts--would take effect. The issue was ultimately resolved when Congress passed and the President signed a bill preserving the Bush era rates for taxpayers with income less than $400,000 (single) or $450,000 (joint return) and postponed sequestration for two months.

Tax Reform in 2013

This year both Ways and Means Committee Chairman Camp and Finance Committee Chairman Baucus are moving forward with a process that they hope will lead to a tax reform bill. Chairman Camp will reach his term limit as Chairman after this session, and Chairman Baucus has announced that he will retire at the end of the session. This makes achieving tax reform in this session of Congress of paramount importance to both Chairmen.

House Ways and Means Committee

On the House side, Chairman Camp began the process by moving on two tracks. The first involves the release of discussion drafts of specific tax reform issues and potential reforms. This

began in 2011 with a discussion draft centered on international taxation. The second, which came out this year on January 24, dealt with financial products.

The third dealt with small business and pass-through entities and was released on March 12 after a weather-related delay. On the day the release was originally scheduled, March 6, there was another flare-up of the rumor mill, as people were hearing that the paper contained a proposal affecting MLPs, or specifically one that would increase taxation on unitholders. Fortunately, we were able to obtain a denial from a reliable source and put the rumor to rest.

When it did come out, the discussion draft did not mention or address MLPs other than in the outline of current law. Rather, it presented two options for improving the tax system for pass-through entities, in particular partnerships and subchapter S corporations. Option 1 leaves the current system in place but "establishes additional limits on the use of partnerships as tax avoidance structures without interfering with the legitimate business operations of partnerships, clarifies confusing areas of partnership law, and corrects a technical flaw with partnership rules to align them with S corporation rules."

Option 2 proposes a sweeping revision of subchapter K and subchapter S. All pass-through rules would be combined in one new Subchapter K and would apply to all pass-throughs, defined as partnerships and "pass-through corporations." All non-traded corporations could opt for pass-through treatment. While the first option has been fairly well received, the second option, which would significantly change some aspects of partnership and subchapter S taxation, has not.

By the time this discussion draft came out, the Committee was already proceeding along the more important track, the tax reform subgroups. Chairman Camp divided the committee members into eleven subgroups, each led by one Republican and one Democrat and focused on a particular area of taxation. The subgroups were to "review current law in their designated issue areas and then identify, research and compile feedback related to the topic of the working group. The working groups will be responsible for compiling feedback on their designated topic from: (1) stakeholders, (2) academics and think tanks, (3) practitioners, (4) the general public and (5) colleagues in the House of Representatives" (Ways and Means Committee website).

MLPs could have fallen under the Small Business/ Passthroughs subgroup led by Reps. Vern Buchanan and Allyson Schwartz, but Rep. Brady claimed MLPs for his own Energy Subgroup, which was co-chaired by Rep. Mike Campbell, a cosponsor of the MLP Parity Act. Several NAPTP members were invited to address the subgroup, either in Washington or in Houston, and received a cordial reception. Statements were coordinated with NAPTP's material so that speakers delivered a consistent message. All stakeholders were invited to submit written comments to the subgroups as well. NAPTP submitted a statement very similar to our August statement to the Finance Committee.

After the subgroups had concluded their meetings and all written statements had been submitted, the JCT collected the commentary and on May 6 week issued a report titled, "Report to

The House Committee on Ways And Means on Present Law and Suggestions for Reform Submitted to The Tax Reform Working Groups." The report contained a discussion of the tax treatment of PTPs as well as brief mentions of PTPs with regard to other areas of the tax code. It made no recommendations but rather was a fairly neutral discussion of current tax law, including the law with regard to PTPs and pass-through entities in general; a summary of various tax reform proposals; and a summary of comments submitted to the Ways and Means working groups, including those regarding PTPs. To the extent that the comments addressed PTPs, it appears that virtually all favored either retaining current law or expanding eligibility to renewable fuels. It is expected that the report will be used as a reference point as the Committee formulates a tax reform proposal.

Senate Finance Committee

The Finance Committee has also undertaken an education of its members on various aspects of tax reform and has divided tax reform into several key issues. It has not formed subgroups to examine these issues, however; but rather has had staff prepare "option papers" on each issue which are followed by briefings for all committee members. This process began in March and continued through June. During this time MLP Parity Act supporters were working on gathering support for and re-introducing their legislation; as a result extending the scope of MLPs has been part of the Finance Committee discussion of energy tax issues and pass-through entities.

On April 25 an option paper on "Infrastructure, Energy, and Natural Resources" briefly discussed a reform option of equalizing tax treatment of MLPs in the energy sector, and mentioned both alternatives for doing this—i.e., allowing MLPs to be used for all forms of energy, as proposed by Senator Coons, or eliminating pass-through treatment for all energy MLPs, as proposed by Senator Sanders. This was briefly touched on during the briefing for members and received no commentary.

On June 6 another option paper was released, this one focused on "Types of Income and Business Entities." In an options section titled, "Redraw line between passthroughs and C corporations" the paper mentions taxation of large or publicly traded pass-through entities as options that have been discussed, along with various other proposals; however the discussion is even-handed and does not advocate any of the proposals it discusses.

On June 27 Finance Committee Chairman Baucus and ranking Republican Hatch somewhat unexpectedly issued a Dear Colleague letter outlining their plan for approaching tax reform and asking their fellow Senators for input. The letter stated that they will start with a blank slate, with all tax expenditures, as defined by the JCT, taken out of the Code: "We plan to operate from an assumption that all special provisions are out unless there is clear evidence that they: (1) help grow the economy, (2) make the tax code fairer, or (3) effectively promote other important policy objectives." Senators are asked to "formally submit legislative language or detailed proposals for what tax expenditures meet these tests and should be included in a reformed tax code, as well as

other provisions that should be added, repealed or reformed as part of tax reform" and to do so by July 26.

To highlight the tradeoffs involved, the letter cites a JCT estimate that every $2 trillion of individual tax expenditures added back in will increase tax rates, depending on the bracket, between 1.3 and 2.2 percentage points. Every $200 billion in corporate tax expenditures will, according to the JCT, raise the highest corporate rate by 1.5 percentage points.

Finally, in a show of bipartisanship and an effort to gain public support for tax reform, Senator Baucus and Representative Camp are undertaking a "Simpler Taxes for America Tour" in which they will travel to sites around the country, focusing on particular aspects of the tax code at each site to hear people's views. Their first visit was to the Minneapolis-St. Paul area, where they visited 3M Corporate Headquarters and a family-owned bakery. As of the writing of this report a visit to Philadelphia has been announced, and several other cities are under consideration. We believe that a stop in Houston to discuss energy tax policy is a possibility.

Despite these efforts and the two Chairmen's attempt at bipartisanship, most Washington observers believe the chances that tax reform will be enacted in this Congress to be slim. Congress is still deeply divided; Senate Democrats and Republicans are already drawing lines around the issue of whether tax reform will raise revenue or be revenue neutral. Tax reform cannot be done without real bipartisanship and a willingness to compromise. The tax reform effort is also hindered by the absence of strong leadership from the White House and a presence of a number of other issues on Congress' plate, including the IRS investigation, the immigration bill, appropriations bills, and as we get later into the year, the debt ceiling.

Action Planned in the Coming Months

The immediate task for the remainder of July will be to ensure that Senators Baucus and Hatch receive the message from their fellow Senators that MLPs represent a part of the tax code that has worked well, add economic value far beyond their estimated cost in tax revenue, play an important role in the development of our new energy resources, and should not have their tax treatment changed.

Over the next few weeks, we will also collect information from Association members on their economic presence in each state and in the nation as a whole in order to enhance Senators' and Representatives' awareness of how MLPs impact their states and districts. We hope to be able to begin using this information in September, when Congress returns from its August recess.

Beyond that we will continue our education efforts and closely monitor the development of tax reform legislation in the House and Senate, and be prepared to take action if there are adverse developments. While we believe that it is unlikely that this Congress will reach agreement on a major tax reform bill or decide to tax MLPs as part of such a bill, we will take nothing for granted as Congressional discussions continue. Moreover, we will continue to make submissions to

committees, etc. when appropriate to establish the benefits of MLPs for any future consideration of tax reform.

MLP Parity Act

Background

Section 7704(d) currently includes in qualifying income only activities with respect to oil and natural gas and their products, coal, and other minerals. Renewable energy sources such as solar and wind are specifically excluded. From time to time groups representing the renewable energy or electric transmission industries have proposed extending section 7704(d) to include them. When asked about such proposals, NAPTP has traditionally taken a neutral position on the grounds that these proposals are not of interest to our current membership. Since none of these proposals gained any traction, this noncommittal stance was readily accepted.

Last year a serious effort to expand section 7704 to include renewable energy sources was launched and is being taken quite seriously in the Senate. On June 7, 2012 Senator Chris Coons (D-DE), along with Senator Jerry Moran (R-KS) and five other cosponsors introduced "The Master Limited Partnership Parity Act," S. 3275, which proposed to amend section 7704(d)(1)(E) to include the generation, storage, or transmission of electrical energy or the generation of thermal energy using wind, closed and open loop biomass, geothermal, solar, municipal solid waste, hydropower, marine and hydrokinetic, fuel cells, and combined heat and power. It also included alternative transportation fuels such as cellulosic, biodiesel, and algae-based fuels (transportation and storage of biofuels has been included in section 7704 since 2008). Later in the year, a House counterpart was introduced by Rep. Ted Poe (R-TX) and cosponsored by Rep. Mike Thompson (D-CA), a member of the House Ways and Means Committee. Rep. Poe was the co-chair, along with Kevin Brady, of the tax reform working group on energy in this year's Congress.

The legislation received widespread attention in the energy and financial press and was endorsed by a number of alternative energy groups, including the American Wind Energy Association, Third Way, Solar Industries Association, Biomass Power Association, Biotechnology Industry Association, Ocean Renewable Energy Association, American Council on Renewable Energy, Natural Resources Defense Council, Advanced Biofuels Association, Offshore Wind Development Coalition, Advanced Ethanol Council, and Environmental Entrepreneurs.

The bill was not expected to and did not advance in 2012; however, it has been reintroduced in both houses by the same sponsors. The Senate bill, S. 795, is again cosponsored by Senators Jerry Moran, along with Lisa Murkowski (R-AK), and Debbie Stabenow (D-MI), a Finance Committee member. The House bill, H. R.1696, has 18 cosponsors, including Ways and Means Committee members Thompson, Earl Blumenauer (D-OR), and Allyson Schwartz (D-PA). The 2013 version is broader than last year's, adding the production, storage, or transportation renewable of chemicals; audit and installation of energy efficient building property; gasification with sequestration of carbon

dioxide; and generation and storage of electricity from a facility that captures and sequesters carbon dioxide.

The legislation's advocates have mounted a significant lobbying effort in both Congress and the Executive Branch since the original bill was introduced. They garnered the support of former Energy Secretary Chu before his departure last year and reportedly have support elsewhere in the Administration, although there have been no public statements to that effect.

The bill's advocates have also formed an advocacy organization called the Financing American Investment in Renewables (FAIR) Coalition whose purpose is "advocating for a level playing field through the use of Master Limited Partnerships (MLP) treatment for renewable energy sources under U.S. tax law." (Quote from FAIR Coalition website, www.faircoalition.org) The Coalition is coordinated by the law firm Covington & Burling and includes a number of renewable energy companies. The "level playing field" argument is a common theme of the effort, with proponents asserting that it does not make sense for the fossil fuel industry to be able to use MLPs while other forms of energy cannot.

The advocates' efforts have succeeded in making this proposal a prominent part of the tax reform discussion, particularly in the Senate. As noted, the Coons bill has featured in the discussion of MLPs in the Finance Committee's tax reform option papers and to the extent MLPs are being thought about in tax reform, the focus appears to be more on expanding them than eliminating them. The bill has generated less interest in the House, where there is a great deal of skepticism among the Republican majority about measures subsidizing alternative energy, but Rep. Thompson made sure that it was part of the tax reform energy subgroup's discussions.

NAPTP Position

As directed by the Board of Directors, with input from the Federal Affairs Committee, the official position of NAPTP is a positive but neutral stance towards the MLP Parity Act. The recognition by the bill's proponents of MLPs' value in raising capital for energy projects is a positive development and helps us make our case, and Parity Act supporters may prove to be valuable allies if tax reform threatens MLPs' tax status. However, there are a number of uncertainties associated with the use of the MLP structure in these different industries that are best answered by the proponents, and NAPTP's limited resources need to be focused on advocating for existing MLPs. The Federal Affairs Committee will continue monitoring the political and legislative environment relating to tax reform, MLPs, and this proposal, and welcomes input from NAPTP members on this issue.

CARRIED INTEREST

Background

The carried interest provisions, first introduced in 2007, are aimed at managers of private equity firms and hedge funds organized as partnerships who receive a share of profits, known as a carried interest, as part of their management arrangement. Of particular concern to lawmakers are those individuals who pay tax on that income at capital gains rates because the partnership's income is in that form. These arrangements, which first came to widespread attention when the Blackstone and Fortress private equity firms went public as PTPs, were criticized by tax policy makers as converting income that is really compensation for services into lower-taxed capital gains income. It was argued that this was unfair, as others who are compensated for services must pay ordinary income tax and employment tax on their earnings. There were also policy makers who felt that the PTP structure should not be available to this type of business.

The legislation has been through a number of iterations, but the important feature in all of the versions is that any person who receives a share of partnership profits in return for providing investment management services to the partnership is deemed to have an "investment services partnership interest" (ISPI). Regardless of the character of the income at the partnership level, income from an ISPI will be treated as compensation for services, subject to payroll tax and taxed at ordinary income rates, to the extent it is not matched by a "qualified capital interest" (i.e., a partnership interest obtained from the partnership in exchange for money or property). In addition, disposition of an ISPI will result in ordinary income rather than capital gain.

The Obama administration supports changing the tax treatment of carried interest and has included it in its budget each year since the President took office. There is no evidence that the administration's interest in the issue goes beyond the investment managers who have always been the targets. There has also been considerable support for the proposal among House Democrats, less so among Senate Democrats, and none at all among Congressional Republicans.

The earliest versions of carried interest legislation swept very broadly, with overly inclusive language whose effect would have gone beyond the targeted investment managers to sweep in traditional MLPs—particularly those which were general partners of other MLPs—and even public unitholders. NAPTP engaged in extended discussions with the members and staff of the tax writing committees as well as the Treasury Department, and subsequent versions of the legislation over the course of several Congresses were progressively more targeted and less likely to harm traditional MLPs.

Finally in September 2011 the President released the legislative language of his proposed American Jobs Act. The legislation included carried interest as a revenue raiser, the first time such language had been drafted by Treasury staff rather than Congressional staff. The Treasury

language was written in a way that much more clearly targeted the investment partnerships that were supposed to have been the target of the legislation from the beginning. While previous approaches began by defining "ISPI" very broadly, raising the possibility of sweeping far beyond the investment community, and then at our urging added various exceptions to the general rule to make it more narrow, this approach began with a narrower, more targeted definition that required investment management to be the primary business of the partnership in question. In the opinion of our tax lawyers, this new language did not have any of the hidden traps for non-investment MLPs that we had to root out in the earlier versions.

Current Status

Subsequent Congressional versions of the provision introduced by its primary advocate, Ways and Means Committee Ranking Member Sander Levin (D-MI), have retained the Treasury Department's approach. As a result, the carried interest issue, while still affecting some PTPs, has receded in importance on the Association's agenda.

Carried interest continues to be put forward when the administration or Congressional Democrats are looking for revenue raisers, and it may be raised in tax reform discussions, although it has never had Republican support. We will continue to keep an eye on any developments on carried interest and make sure that it remains narrowly targeted if it is advanced again.

REVENUE PROPOSALS IN PRESIDENT'S BUDGET

Every year at the beginning of February, the President issues the administration's proposed federal budget for the next fiscal year. The budget contains both spending and revenue proposals, and at about the same time, the Treasury Department issues a "Green Book" providing detail on the revenue proposals in the budget.

The Administration's budget for FY 2014 was released on April 10, 2013, along with the Green Book. The budget proposed $3.8 trillion in spending for the next fiscal year, which begins October 1, 2014, and $3.0 trillion in revenue, and according to budget documents included deficit reduction measures totaling $1.8 trillion over ten years. As has been the case with all of President Obama's budgets, there were no provisions that would change the partnership tax treatment of MLPs, but the carried interest proposal was included, as were the usual assortment of proposals to eliminate a number of "tax expenditures" for oil, gas, and coal.

Also as in the FY 2013 budget, there were some technical partnership provisions which could affect MLPs along with other partnerships. There is one positive proposal which would no doubt be welcomed by MLPs: to eliminate technical terminations of partnerships under section 708(b)(1)(B), which the Green Book termed "a trap for the unwary taxpayer or … an affirmative planning tool for the savvy taxpayer." Other partnership proposals include:

- Taxing gain from sale of a partnership interest by foreign partner on look-through basis.
- Expanding the definition of substantial built-in loss for purposes of partnership loss transfers.
- Extending partnership basis limitation rules to nondeductible expenditures.

The pages from the Green Book describing the carried interest and other partnership proposals are included in the supplemental materials for this report.

CONCLUSION

This past year the prospect of tax reform has underlain virtually all the Association's federal affairs activity, as it did last year. NAPTP and its Washington representatives have been working hard to educate members of Congress and build a network of supporters on Capitol Hill; to marshal the best facts, data, and arguments in favor of the continuation of MLPs' tax status; and to be aware and involved at every step of the tax reform process. With the addition of Story Partners to our team, we expect our messaging to become more sophisticated and to reach a wider audience.

We have been successful in gathering a strong core of supporters in the House Ways and Means Committee and have a number of friends in the Senate as well, potentially including MLP Parity Act supporters who want MLPs to continue intact so that they can begin using the structure. Our message to Congress regarding the success of Section 7704 continues to resonate with both Republicans and Democrats. Both parties want to enhance our domestic energy security and recognize that energy infrastructure is capital intensive and essential if our nation is to take advantage of the resources that have become available to be less dependent upon fuel produced outside the U.S. We are optimistic that key policymakers will reflect upon this fact if and when the tax code is amended.

Although we believe that the odds are against the 113th Congress producing a tax reform bill, we will continue to stay close to the tax reform proceedings and continue our education efforts. As always, we welcome NAPTP members' ideas and participation. In particular, we encourage all member MLPs to help us make our case by providing us with information on their contribution to the economy of the states in which they operate and nationwide, and to let their Representatives and Senators in these states know how important it is that tax reform not alter the taxation of MLPs. We have a great story, and we need to tell it with us much solid information as we can.