

\_\_\_\_ NATIONAL ASSOCIATION OF \_\_\_\_  
PUBLICLY TRADED PARTNERSHIPS  
**2014 ANNUAL MEETING**

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REPORT OF THE  
FEDERAL AFFAIRS COMMITTEE

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**REPORT OF THE FEDERAL AFFAIRS COMMITTEE**

The Federal Affairs Committee continues to focus its energies on ensuring that the current tax treatment of publicly traded partnerships under section 7704 of the tax code remains intact when and if Congress undertakes tax reform or any other legislation affecting business taxation. It is highly unlikely that such legislation will receive serious consideration during the remainder of the 113th Congress, despite the best efforts of House Ways and Means Committee Chairman Camp. Discussion will continue in the next Congress, however, particularly in the Senate Finance Committee, where action on tax reform was halted by the departure of former Chairman Baucus. A Current Finance Committee Chairman Wyden is in the process of scheduling hearings on tax reform, and Ranking Member Hatch, who would chair the Committee if the Senate changes hands, is also thinking about his version of tax reform.

Some tax reform proposals would remove most or all “tax expenditures,” which the Joint Committee on Taxation defines to include MLPs, from the tax code in order to simplify it and allow lower rates. Most notably, this year Chairman Camp issued a comprehensive tax reform proposal that proposed to eliminate a broad range of tax expenditures, including many oil and gas provisions to achieve a 25% corporate rate. The proposal would preserve most natural resource MLPs but those in other industries would not fare as well. Judging from the reaction to the Camp proposal, however, Congress has little appetite for a wholesale elimination of tax expenditures.

The Federal Affairs Committee is also monitoring the MLP Parity Act, an 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. Although we continue to stay in touch with the Act’s proponents and have had a cordial conversation with the bill’s sponsor, NAPTP continues to remain neutral with regard to this legislation.

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. To our knowledge, there is not a Congressional majority for the elimination of these energy tax provisions and the Administration proposals are unlikely to be adopted any time in the near future.

Changes in the tax treatment of carried interest continue to be proposed in connection with tax reform—most recently and somewhat surprisingly by Chairman Camp-- and also as a revenue raiser. The most recent version of the legislation to treat carried interest as compensation, proposed every year as part of the Administration’s budget, is written more narrowly than earlier versions and no longer poses a concern to non-financial MLPs. However, Chairman Camp’s proposal to narrow section 7704 to natural resource MLPs would impact certain non-financial MLPs.

## 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 until recently, Congress has enacted legislation that adds new special provisions and more complexity.

### *Why Tax Reform*

The interest in tax reform has been sparked by this growing complexity, by concern over the budget deficit, and by a desire to design a more competitive corporate tax code. There is 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 would be to enact tax reform that would eliminate most or all of the current “tax expenditures,” allowing a lower rate to be applied to a broader base. 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 budget professionals consider to be equivalent to a direct federal expenditure.

While the end result of such reform would directionally reduce the corporate tax rate, 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 has proven to be politically difficult to achieve.

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.

### *Comprehensive 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 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 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 Commission was silent on the taxation of pass-through entities and whether PTPs would be considered tax expenditures.

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, Ways and Means Committee Chair Dave Camp (R-MI) issued in February a comprehensive tax reform plan that was the result of two years of hearings, research, and discussion by working groups. This will be discussed in greater detail later.

### *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.

The 2012 tax expenditure list 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 estimate, released on February 1, 2013 was 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 had 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.

<b>Joint Committee on Taxation</b> <b>Tax Expenditure Estimates for Natural Resource PTPs</b> <b>(\$billions)</b>						
Year(s)	PTPs engaged in certain energy related activities		PTPs engaged in exploration & mining of natural resources		All Natural Resource (Approximate Total <sup>1</sup> )	
	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 hired an economic consultant to provide background on this matter. The consultant believes 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. The consultant found that when this calculation was applied to actual distributions in 2010, the result was very close to the JCT number at that time. Thomas Barthold, the chief of staff of the JCT, 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.

As of the writing of this report, the JCT has not issued a 2014 tax expenditure report. During the time when it would have been producing the report, the JCT staff was fully occupied with revenue estimates for Chairman Camp's tax reform proposal. We do not know when the next report will be forthcoming. In the meantime, the economic consultant has been building and analyzing a database of MLP information that we hope to be able to use to moderate future JCT numbers.

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 natural resource 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.

### **Status at July 2013 Annual Meeting**

At the time of the 2013 Annual Meeting both Ways and Means Committee Chairman Camp and Finance Committee Chairman Baucus were proceeding through a process that they hoped would lead to a tax reform bill. Both had hopes of leaving a reformed tax code as their legacies, as Chairman Camp will reach his term limit as Chairman after this session, and Chairman Baucus was planning to retire at the end of his term.

On the House side, Chairman Camp had completed the process of examining different aspects of the tax code through eleven subgroups, with MLPs falling under the Energy Subgroup headed by Rep. Kevin Brady (R-TX, an MLP supporter, and co-chaired by Rep. Mike Campbell, a cosponsor of the MLP Parity Act. Several NAPTP members had been invited to address the Subgroup, either in Washington or in Houston, and had received a cordial reception. In addition, NAPTP had submitted a written statement to the Subgroup. In May 2013 the JCT released 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. The comments received advocated either the current tax treatment or enactment of the MLP Parity Act.

In addition to forming the subgroups, Chairman Camp had released three discussion drafts of specific tax reform issues and potential reforms. The third of these dealt with small business and pass-through entities. It did not mention or address MLPs other than in the outline of current law,

but rather presented two options for improving the tax system for pass-through entities, in particular partnerships and subchapter S corporations. The first would keep 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.” The proposal contained provisions tightening the rules in such areas as basis adjustments, precontribution gain, and partnership audits.

The second option proposed a sweeping revision of subchapter K and subchapter S in which 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. The second option was not well received and its provisions are unlikely to be adopted.

On the Senate side, Finance Committee Chairman Baucus had similarly divided tax reform into several key issues and undertaken to educate Committee members on each. The Committee did not form subgroups to examine these issues, but rather had staff prepare option papers on each issue, followed by briefings for all committee members. This process took place between March and June 2013. During this time MLP Parity Act supporters had been working on gathering support for and re-introducing their legislation; as a result extending the scope of MLPs was part of the Finance Committee discussion of energy tax issues and pass-through entities.

An options paper on “Infrastructure, Energy, and Natural Resources” released on April 25, 2013 briefly discussed a reform option of equalizing the 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.

Another options paper released June 6, 2013 focused on “Types of Income and Business Entities.” In an options section titled, “Redraw line between passthroughs and C corporations” the paper mentioned taxation of large or publicly traded pass-through entities as options that have been discussed, along with various other proposals; however the discussion was even-handed and did not advocate any of the proposals it discussed.

On June 27, 2013 Finance Committee Chairman Baucus and Ranking Member 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 would 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 were 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, 2013.

Finally, in a show of bipartisanship and an effort to gain public support for tax reform, Senator Baucus and Representative Camp undertook a “Simpler Taxes for America Tour” in which they traveled to sites around the country, focusing on particular aspects of the tax code at each site to hear people’s views. At the time of the last Annual Meeting, they had made their first visit, to the Minneapolis-St. Paul area, where they visited 3M Corporate Headquarters and a family-owned bakery. We believed at that time that a stop in Houston to discuss energy tax policy was a possibility; however, this did not occur.

## **Developments and NAPTP Action During the Past Year**

### *Events During the Remainder of 2013*

Our first task following last year’s Annual Meeting was to ensure that Senators Baucus and Hatch received 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 in ensuring energy independence, and should not have their tax treatment changed. Representatives of NAPTP and its members asked Senators who were known to be supportive to include this message in their letters. In addition, knowing that many Senators had a mixed reaction to the Baucus-Hatch request, and in many cases were reluctant to send their thoughts in writing, NAPTP sent a letter to all Senators asking them, in whatever way they decided to respond to the request, to consider asking that the tax treatment of MLPs be retained intact.

While Senators Baucus and Hatch promised to keep the letters confidential, some Senators made their submissions public. Letters from Senators Inhofe (R-OK), Landrieu (D-LA), and Pryor (D-AR) contained an attachment that included a discussion of the importance of maintaining current MLP tax treatment to encourage investment in domestic energy infrastructure. Letters from Senators Bob Casey (D-PA) and Chris Coons (D-DE) advocated extending MLPs to renewable energy sources.

Shortly afterwards, on July 31, 2013, the Finance Subcommittee on Energy, Natural Resources and Infrastructure held a hearing titled “Powering Our Future: Principles for Energy Tax Reform.” NAPTP submitted a written statement which discussed the importance of MLPs in raising capital for needed energy infrastructure and urging that that publicly traded entities that are currently able to choose pass-through taxation be allowed to continue doing so. At the hearing, Senators Chris Coons (D-DE) and Jerry Moran (R-KS) testified in favor of the MLP Parity Act, as did Professor Dan Reicher of Stanford University Law School. The use of MLPs for alternative energy was also mentioned by Phyllis Cuttino, Director, Clean Energy at The Pew Charitable Trusts, and Will Coleman, a partner at OnRamp Capital.

As Congress left town for its August recess, both Baucus and Camp were optimistic about advancing a tax reform proposal and spoke of marking up tax reform bills after the August recess. Representative Camp in particular indicated that his staff was beginning to draft a bill, and that he would begin markup after September 30, the deadline for Congress to pass a continuing appropriations resolution. Senator Baucus spoke of circulating a discussion draft in the same time frame; however, there were factors working against both of them that delayed action during the fall.

One was the difficulty of reaching consensus in their respective committees. Representative Camp, who was aiming for a bill getting corporate and individual tax rates down to 25%, had to negotiate extensively with his committee members over the tax breaks that would need to be eliminated to do so. On the Senate side, where bipartisan consensus is important, Ranking Member Hatch was not comfortable with all aspects of tax reform under Baucus' direction and wanted to take more time and have more member-only meetings before putting out a proposal.

Another factor delaying action was the revenue question, which has been a major roadblock to reform in the Senate. Republicans in both the House and the Senate have been adamant that tax reform should not raise revenue; the Senate Democratic leadership has been equally adamant that it should. This increased the difficulty for Senator Baucus of developing a proposal with which Senator Hatch would agree.

Perhaps the most serious development, particularly for Representative Camp, was the government shutdown in October. Congress failed to agree to a continuing resolution by the end of September, primarily due to disagreement between House Republicans and the President over issues such as funding the Affordable Care Act, and as a result, most federal government functions ceased and non-essential federal employees, including many Congressional employees, were furloughed until October 17, the day after an agreement was finally reached. This delayed Congressional activity in a number of areas, including work on tax reform; exacerbated the partisan animus that already existed; and diminished whatever appetite the House leadership had had for tax reform. It became clear that Representative Camp's proposal would not be forthcoming until 2014.

On November 19, 20, and 21 Senator Baucus released three discussion drafts, two of which contained items of interest to MLPs, and stated his intention to issue drafts in additional areas and to release a tax reform proposal in 2014. The Tax Administration Reform draft proposed to push the due date for partnership tax returns back to March 15, while the Cost Recovery and Accounting draft proposed significant changes in accelerated depreciation, moving it closer to economic depreciation and adopting a pooled asset system for depreciation of personal property. This draft also proposed a change in recovery of intangible drilling costs ("IDCs") and depletion costs, with IDCs required to be written off over five years and all taxpayers eligible for cost but not percentage depletion (the third draft dealt with international tax reform).

On December 18, Senator Baucus issued an energy tax reform discussion draft. Despite rampant speculation, the draft did not contain any provisions on MLPs; it dealt primarily with

revising clean energy incentives and eliminated two oil production incentives, the enhanced oil recovery credit and the credit for production from marginal wells. However, additional discussion drafts were still in the wings, and there was the possibility of a draft on business entities that could address MLPs. We heard from some sources that Baucus had resisted his staff's suggestion that the released discussion drafts include MLPs.

Shortly after the release of the energy discussion draft, word leaked out that Senator Baucus might be appointed Ambassador to China; and on December 26, the White House confirmed this with an announcement. He was officially nominated on January 7 and confirmed on February 6. Senator Baucus resigned from Congress on the same day, passing the Finance Committee chairmanship to Ron Wyden (D-OR) and cutting short his tax reform efforts.

### ***2014 to Date***

#### *House Ways and Means Committee*

The most important tax reform development of 2014 came on February 26, when Ways and Means Chairman Camp released a comprehensive tax reform proposal. The proposal sets a top rate of 25% for both individuals and corporations. High-income individuals would have a 35% effective rate, however, as the proposal imposes a 10% surtax and phases out the benefit of the 10% bracket as incomes rise. There would not be a special capital gains rate but rather an above the line deduction of 40% of capital gains. On the business side, the plan achieves the 25% rate by eliminating tax provisions important to a broad range of industries, including many benefiting the energy and financial industries.

With regard to MLPs, the Camp proposal would keep the natural resources section of section 7704 almost intact, allowing the majority of MLPs to continue as before. This is one of the very few oil and gas tax expenditures that would not be cut back under the plan, and we can thank several MLP advocates on the Committee for accomplishing that.

The proposal would, however, remove fertilizer and timber income from the qualifying list, and also reverse the 2008 addition to the list of income from transportation and storage of certain renewable fuels. In addition, income and gain from natural resource activities would be the *only* type of income qualifying an MLP for partnership treatment for section 7704. Under the Camp proposal, income from the sale or rental of real estate, interest and dividends, and income from commodities would no longer be qualifying income.

Association members with substantial income from fertilizer operations would thus be adversely affected under the proposal, as would MLPs with current or planned operations involving timber or wood products. Even MLPs engaged in qualifying natural resources activities could be affected by the Camp proposal, as the common practice of placing assets generating non-qualifying income into corporate subsidiaries would be limited by the elimination of dividends as

qualifying income. There are also MLPs in the Association who receive some of their income from real estate assets.

In addition to the practical effects on current MLPs, the proposal represents the first retrenchment of section 7704 since it was enacted in 1987. The precedent of carving chunks out of section 7704, however little it may appear to affect most MLPs now, is not one we want to be set.

The Camp proposal would also eliminate accelerated depreciation deductions, requiring depreciation to more closely match an asset's actual economic life, which could result in a higher level of taxable income for MLP unitholders. It would treat carried interest as compensation taxed at ordinary income rates, repeal percentage depletion (but not IDCs), and repeal the passive activity exception for working interests in oil and gas property. It makes technical changes in partnership taxation, most of which were included in the first reform option in his earlier discussion draft on small business and pass-through entities "as a means of establishing additional limits on the use of partnerships as tax avoidance structures."

Despite the enormous amount of effort devoted to putting it together, the chances of the Camp proposal moving any further are remote at best. By the time it emerged, the House leadership had other priorities and no enthusiasm at all for tax reform. The proposal received widespread criticism from the industries and interest groups whose tax benefits would be affected, and the combination of leadership disinterest and stakeholder hostility towards the plan has doomed it for this Congress. Chairman Camp has refocused his effort on the "extenders" — expiring tax provisions — and an effort to make the worthwhile provisions permanent while discarding the rest.

With Chairman Camp retiring at the end of this Congress, it will be up to the next Chairman to decide where the Ways and Means Committee goes next on tax reform. Currently two Committee members are seeking the spot: Paul Ryan (R-WI), current Budget Committee Chair and 2012 Vice Presidential candidate, and Kevin Brady, who has been a strong supporter for MLPs on the Committee. Representative Brady has seniority and his ascension would put a friend of MLPs in the Chairman's seat; however, Paul Ryan is extremely popular among Republicans and has a national reputation. Assuming the Republicans maintain their majority in the House, the new Chairman is expected to be appointed by the House leadership in January.

#### *Senate Finance Committee*

Finance Committee activity on tax reform has been in limbo since the departure of Senator Baucus; however, current chairman Wyden is a longtime advocate of tax reform who has previously introduced comprehensive tax reform bills with Republican cosponsors. Similar to the Camp proposal, the Wyden tax reform legislation proposed to lower tax rates while eliminating a number of corporate benefits, including many used by the oil and gas industry. With regard to MLPs, he has been quoted as saying that he favors a "level playing field approach" as embodied in the MLP Parity Act. While he is expected to continue the process started by Senator Baucus with

additional hearings and discussion drafts, there is little time left in the 113th Congress for him to address comprehensive tax reform.

The direction of tax reform next year will be significantly affected by the outcome of the midterm elections. There is a good chance that the Republicans will gain control of the Senate; if this happens the chairmanship of Finance will go to Senator Hatch, who is anxious to put his own stamp on tax reform. Hatch's staff is preparing for a potential tax reform effort and is aware of the issues associated with MLPs and the MLP Parity Act.

### **NAPTP Action for the Next Year**

For the immediate future we will continue our education efforts and closely monitor the sentiments regarding MLPs and tax reform in both the House Ways Means and Senate Finance Committees. If there are hearings or other opportunities to make our case regarding the benefits of MLPs, we will take advantage of them.

In addition, we will continue to gather as much information as we can about the impact MLPs are having in each state. NAPTP members can assist in this effort by providing information on the states in which they have operations, assets in these states, capital expenditures for energy infrastructure, employment, and other information showing the economic benefits provided by MLPs. The states of greatest importance are those represented by the leadership and members of the tax writing committees and House and Senate leadership.

After the midterm elections, when we know who will control the Senate and chair the tax writing committees, the Federal Affairs Committee will develop a plan of action for the 114th Congress, including educating new members, making our case with the committee chairs, reinforcing current allies, and cultivating new ones.

## **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.

For the past two years a serious effort to expand section 7704 to include renewable energy sources has been underway. 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 was reintroduced in both houses by the same sponsors in 2013. The Senate bill, S. 795, is again cosponsored by Senator Jerry Moran, along with Lisa Murkowski (R-AK), Mary Landrieu (D-LA), Susan Collins (R-ME), and Debbie Stabenow (D-MI), a Finance Committee member. The House bill, H. R.1696, currently has 43 cosponsors, including Ways and Means Committee members Thompson, Earl Blumenauer (D-OR), and Allyson Schwartz (D-PA). This version is broader than the one introduced in 2012, adding to the sources of income listed in the earlier bill the production, storage, or transportation of 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 and reportedly have support elsewhere in the Administration, although there have been no public statements to that effect. The proposal has not been included in the Administration's budget for any year since it was introduced.

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](http://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. 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 discussion includes expanding them as much as 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.

On November 13, the MLP Parity Act finally received a revenue estimate from the JCT. The revenue loss is estimated at \$307 million over five years, \$1.3 billion over ten. This does not include the changes in the passive loss and at-risk rules that would be necessary to make the bill's provisions fully useful in raising capital from MLP investors.

### **NAPTP Position and Activity**

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 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.

While not taking a position on the MLP Parity Act, NAPTP and its lobbyists have stayed in touch with its advocates, and on two occasions have had the opportunity to speak directly to Senator Coons. The first occurred in October 2013 when he spoke (via video feed, as the government shutdown prevented him from traveling) to an MLP conference in Houston which Mary Lyman was attending. He spoke at length about the purpose of the legislation and his desire to ensure that all sectors of the energy market are seen as important and treated fairly and equally, rather than having one party denouncing traditional fuels and the other denouncing alternative fuels. He stated that he wants MLPs, which have proven to be highly successful at raising capital, to be available to all forms of energy. He mentioned the hazard to MLPs posed by tax reform and said that he is working to make sure that they are kept intact.

Mary thanked him for the work he has done to highlight MLPs and their value in raising capital. He stated that he looked forward to working with her to preserve *current* MLPs in tax reform.

On May 8, representatives of NAPTP and four MLPs met with Senator Coons in his office for the purpose of getting to know each other and opening a dialogue. It was a cordial meeting, and Senator Coons reaffirmed his commitment to maintaining the current tax treatment of all MLPs as well as to expanding section 7704 to include alternative energy. He continued to be optimistic

about the prospect of advancing his bill in 2014; however, as with other legislation without wide bipartisan consent, it does not appear likely that this will happen.

## GAO REPORT ON LARGE PARTNERSHIP COMPLIANCE

On April 17, Senators Ron Wyden, Carl Levin (D-MI), and John McCain (R-AZ), released a preliminary report on tax compliance by large partnerships, prepared at their request by the General Accounting Office (GAO). The GAO is the audit, evaluation, and investigative arm of Congress. The report states that:

- Between 2002 and 2011 the number of large partnerships, defined by the GAO as those with 100 or more direct partners and \$100 million or more in assets, increased more than 200 percent, from 720 to 2,226. In 2011 these partnerships accounted for \$2.3 trillion in assets and \$68.9 billion in total net income.
- Fewer than one percent of large partnership tax returns were audited by the IRS.

In releasing the report, the Senator Levin stated, “Auditing less than 1% of large partnership tax returns means the IRS is failing to audit the big money...It means over 99% of the hedge funds, private equity funds, master limited partnerships, and publicly traded partnerships in this country, some of which earn tens of billions each year, are audit-free. It is obvious something is wrong with the IRS audit program for large partnerships. We literally cannot afford to allow these entities to go unaudited.”

Despite Senator Levin’s mention of MLPs as part of the problem, MLPs in fact account for a small percentage of large partnerships. The GAO report shows that 81% of large partnerships are in the financial and insurance sectors; 7% are in real estate rental and leasing; and 3% are in professional, scientific, and technical services. All other sectors, including the industries in which the vast majority of MLPs operate, comprise only 8% of the total. Only 229 of the 2,226 large partnerships in 2011 had more than 1,000 partners; MLPs would be a subset of that group.

The *Wall Street Journal* ran two stories on the report, one directly reporting on its release and another asserting that the GAO report means that private-equity firms, hedge funds and MLPs are too complicated to be audited and are an investment that allows for the avoidance of IRS scrutiny. The second article quoted various sources as saying that the large partnerships are never challenged by the IRS; that these partnerships “know there’s almost no chance the IRS is looking over their shoulder” and it “affects their risk analysis”; and that investors can be assured that “[T]he agents may want to look at your entertainment or medical expenses, but they probably won’t question MLP income.”

The author of the second article contacted NAPTP for comment, which was handled through our public affairs firm, Story Partners. The story did include NAPTP’s comment that MLPs “make



every effort to be fully compliant and strongly encourage investors to do the same. The most significant lesson from the GAO report is that there should be closer examination of IRS funding."

A second GAO report issued in May estimated that roughly \$91 billion per year of partnership and S corporation income was misreported by individuals for 2006 through 2009. It suggested several steps the IRS might take to increase compliance and recommended that Congress consider requiring more partnerships and corporations to e-file their tax returns.

While the GAO reports may lead to additional compliance legislation or increased activity by the IRS, the main concern is that the reports as interpreted by the press and some Members of Congress could perpetuate the notion that MLPs are tax avoidance mechanisms and that MLPs and their investors are not complying with the tax laws, and could encourage those who advocate imposing corporate tax on large or traded partnerships. It is important to convey the message that, to the contrary, MLPs do in fact get audited and devote enormous resources to compliance with the requirements of the tax code. Over the next several months we will monitor Congress for any adverse sentiments based on the GAO reports and provide corrective information where necessary,

## **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 2015 was released on March 4, 2014, along with the Green Book. The budget proposed \$3.9 trillion in spending for the next fiscal year, which begins October 1, 2014, and \$3.3 trillion in revenue. 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 previous budgets, 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 as an affirmative planning tool for the savvy taxpayer." (This was also included in the Camp tax reform proposal.) Other partnership items in the budget 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; and
- 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

As we move towards the waning days of the 113th Congress, tax reform continues to be the principal issue facing MLPs on Capitol Hill. It has become increasingly clear that this will not be the year for definitive action on this issue; however, the desire to reform the tax system is still very much alive in the tax writing committees, and we expect to see this focus continue next year

The outcome of Chairman Camp's effort to craft a tax reform proposal was not ideal, but it confirmed that we have a strong core of supporters on the House Ways and Means Committee. In the coming year we will continue working to maintain and expand that network of support. MLPs have a number of friends in the Senate as well, both those committed to traditional energy sources and MLP Parity Act supporters who want MLPs to continue intact so that they can begin using the structure. We will work to solidify our Senate support and to identify Senators who will serve as MLPs' champion when and if the Senate takes up tax reform.

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 United States. We are optimistic that key policymakers will reflect upon this fact if and when the tax code is amended.

With the assistance of our public affairs firm, Story Partners, we will also continue working to convey accurate information about MLPs and their economic importance both to federal policy makers and to the media. Story Partners has already assisted us in refreshing our legislative handouts and in countering negative articles and misimpressions of MLPs that follow developments such as the GAO Report.

We welcome NAPTP members' ideas and participation. In particular, as noted earlier, 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. The more solid information we have to back our message, the stronger it will be.