NATIONAL ASSOCIATION OF
PUBLICLY TRADED PARTNERSHIPS

2014 ANNUAL MEETING

REPORT OF THE STATE AFFAIRS COMMITTEE

The Association has continued its efforts to address tax issues impacting the members of the Association of the course of the last year. The Association has actively worked to influence or monitor tax issues impacting its membership in 10 states. The following overview and state by state report provides information on each of the state efforts as well as the overall health of state economies.

State tax collections have remained relatively stable in the last year with the average growth in revenue of just 2 percent. States benefitting from increased oil and gas have seen significantly higher rates of growth, ranging from 3.1 percent in Texas to 7.1 percent in North Dakota. States in the northeast continue to carry significantly higher debt, while overall, few states face continuing budget shortfalls as a result of the economic downturn in 2008.

The primary issue the Association has focused on over the last year is that of lower-tier withholding. Despite nearly all states recognizing some type of exemption for publicly traded partnerships (PTPs) from composite returns and withholding provisions, states have been actively auditing the lower-tier partnerships. In total, at least five states have issued notices of enforcement and directed the lower tiers of PTPs to collect and remit tax. These states are: Montana, Alabama, Georgia, New Jersey, and Indiana. Other issues include seeking exemptions from existing composite returns and withholding provisions--on both income and royalties, per partner filing fees and overall tax reform.

One of the greatest issues faced by the Association is that of the change of staff in Departments of Revenue throughout the country. Many personnel the Association has worked with over the last decade have now retired or moved on. This has left a gap in historical knowledge, and in a few cases, slowed the process of issue resolution for the Association or its members directly.

Highlights of the past year's activities can be found below. The Association will continue to actively monitor tax developments at the state level and work to address those that impact the membership. Information will be provided to the membership as developments occur in addition to creating specific committees to address and guide more formal legislative and regulatory activities going forward.

Alabama

The State of Alabama is one of the more recent states to formally adopt an exemption for publicly traded partnerships from existing composite return and withholding requirements. Since that time, the Department has conducted at least two audits of publicly traded

partnerships and sought composite returns and withholding from lower-tier operating partnerships. The first case occurred in 2011 and the most recent occurred this spring.

In 2011 the Association worked on this with the Department and successfully secured an informal agreement that the lower tiers of PTPs would not be required to file a composite return and withhold. However, it appears now that this finding will be awarded on a case-by-case basis instead of a blanket ruling applying to all PTPs. As a result of the recent audit finding, the Association has again reached out to the Department with the hope of securing the same determination. The Department is requesting the PTP submit a formal request for relief. Once the information is received, the Department will either make a determination based on the information provided or seek additional information. The Association will be working with the member involved to resolve the issue in a manner that is satisfactory. If that cannot occur for whatever reason, we will be recommending a more formal course of action.

California

For the past several years, unitholders of certain Association members have been the recipients of tax liability notices issued by the California Franchise Tax Board (CAFTB). The notices indicate that the unitholder is subject to the minimum franchise tax payment, and in many cases, significantly more than that due to their receipt through ownership of an LLC interest of income related to California activities. The Association has worked diligently to resolve these issues in a favorable manner. On the last year, more than a half-dozen such notices have been brought to our attention. And, all have been successfully resolved, with one even resulting in a significant refund to the unitholder.

There are two other current developments worth noting in California. The CAFTB has recently issued updated drafts of two rulemakings pertaining to partnerships, specifically the apportionment and allocation of partnership income and the sales factor on the sale of items other than tangible personal property, which includes a provision relating to market securities. The Board held the third public meeting on both issues July 8th. The initial meetings on the proposals were held in 2008 and 2011.

The proposed drafts can be reviewed at the following links.

Apportionment and allocation of partnership income:

https://www.ftb.ca.gov/law/regs/25137/07082014_Proposed_Language.pdf

Sales factor for sales of items other than tangible personal property:

https://www.ftb.ca.gov/law/regs/25136/07082014_Proposed_Language.pdf

Georgia

Georgia was one of the first states to adopt language that exempts publicly traded partnerships from the State's composite return and withholding requirements. Since that time, there has been little reason to engage, or even monitor the activities of the Department of

Revenue for actions that may impact the members of the Association. However, a PTP was pursued for a composite return and withholding on a lower-tier partnership in the spring of this year.

The Association was able to work through the Chamber of Commerce to contact the Department to provide information regarding the issue. The Department has since been in contact with the PTP and has dropped the potential notice of enforcement. The Association will continue to monitor the actions of the Department and determine whether a more permanent solution must be secured or whether the Department will continue to extend the current exemption to the lower-tiers through an informal basis.

Illinois

Members of the legislature have introduced legislation that would recognize the gain or loss of a partnership unit if sold or otherwise disposed of. This proposal, HB 3422, is similar to others the Association have seen or worked to address in recent history. Under the proposal, a partner when determining its net Illinois income would be required to include the total gain or loss multiplied by the apportionment factor of the partnership determined under Section 304 of the Illinois Code for the taxable year of the partnership in which the sale, exchange, abandonment, liquidation or other disposition occurs.

At this time, the bill has been slowly working through the legislative process. It is unclear whether it will be adopted as it is still pending in the Senate, with no action occurring in the House to date. The Association will continue to monitor the legislation and coordinate with other Associations as necessary and will update the membership as soon as we have more information.

Indiana

The State of Indiana is one of four states that have existing statutes that require composite returns and withholding on nonresident partners and have not granted formal or informal exemptions to publicly traded partnerships. This spring two PTPs received formal notices of enforcement action due to the lack of filing historical withholding and composite returns. It was the first time the Indiana Department of Revenue has taken such an action.

The Association met with the Department in late March to seek a more formal, long-term solution that would secure a permanent exemption for PTPs from the requirements as well as secure an exemption for lower-tier partners. The Department has since indicated they are supportive of making a change to accommodate PTPs in addition to dropping the pending enforcement actions pertaining to the two PTPs. The Department also acknowledged that they were very appreciative of our reaching out to them about the issue. Recent changes in high-level personnel at the Department have somewhat slowed the effort, but the Department has reiterated its willingness to secure a long-term solution that is favorable to the Association's membership. We expect a formal rulemaking or legislation will be put forward late this year to address the situation. We will continue to provide information as developments occur.

Louisiana

The State of Louisiana was the first state in which the Association actively pursued an exemption for publicly traded partnerships. Under the current law, a PTP must apply to the Department every three years for the exemption. Over the last several years, a number of issues have arisen relating to the exemption. Initially a number of PTPs were denied the exemption status. While this issue was resolved through discussions with the Department and a legislative directive, another issue has been brought forward by a member PTP concerning a recent rulemaking by the Department.

In January 2014 the Department adopted revised rules pertaining to the existing composite return and withholding rules. The action was taken after legislative changes to the statute that did not impact PTPs. The rulemaking appeared to impact the existing provision that permits PTPs to secure an exemption from the requirements. Under the rule, Section 1401(D) states: "All partnerships engaging in activities in this state that have nonresident partners that are not corporations, partnerships or tax-exempt trusts shall make composite payments on behalf of all of their nonresident partners, other than corporate partners and partners, who are themselves partnerships, who do not file an agreement to file an individual return and pay Louisiana Income tax." The words "all partnerships" imply that PTPs will be required to comply with the composite return and withholding provisions going forward. At the same time, there is a provision at the very end of the rule that seems to offer some relief in that it states: "Nothing in this regulation shall restrict the secretary's authority to otherwise provide for efficient administration of the composite return and composite payment requirements of R.S. 47:201.1." The complete and final rulemaking can be viewed at: www.rev.state.la.us/forms/lawspolicies/1401RUL027.pdf

Meetings have recently been held with the Secretary to determine if there is a path the Department can support going forward. The Department has provided verbal indications that they did not intend to impact the current waiver process through the rulemaking and that they are open to working with the Association to secure a more permanent solution to resolve the issue formally. The Association hopes that legislation, or a similar solution, can be secured that will align with the MTC language as well as exempt lower-tier partnerships from the composite return and withholding requirements. This would help alleviate the requirement that a waiver be secured every three years.

Montana

The dialog with the Montana Department of Revenue has continued. The Department put a great deal of pressure on members of the Association to secure waivers through an informal process by April 1st of this year. The need for this was spurred by a PTP that secured an agreement independently, and without working with members of the Association, in an attempt to resolve an outstanding tax issue. Under their agreement, they offered to turn over partnership agreements as well as structure documents in exchange for the development of the waiver process. That PTP is leaving the state, and will only have to file these documents once.

The Department used the initial agreement to leverage against the others. In the end, at least four members sought informal waiver providing an exemption from filing certain information with the Department each year. Three PTPs filed for, and were granted, waivers by the Department by providing the requested information. The remaining PTP was denied initially due to lack of proper documentation. The application has been resubmitted and it now pending.

It is unclear what the next steps are, whether the Department is satisfied, and especially whether there will be any issues for the remaining 14 PTPs operating in the state. We will continue working with the Department to determine next steps. We do anticipate some level of legislation and regulatory activity will be necessary next year to codify the informal waiver process.

New Jersey

New Jersey was one of the first states in which the Association sought to address the treatment of nonresident unitholders. The effort, which was triggered by a substantial state deficit in 2003, resulted in the exemption from filing composite returns and withholding on behalf of nonresident unitholders. At the same time, and due to circumstances beyond the Association's control, a new per partner fee was also adopted that created a $250,000 tax liability for PTPs operating in the state. Since that time, the Association has monitored the state, but has not engaged in activities in the state as no issues of concern were raised by members.

The current environment and several factors that changed in early 2014 have warranted careful engagement by the Association in an attempt to determine the impact of recent court decisions, possible and known legislation, and audit findings impacting at least one member company. In many respects, these issues all relate to the per partner fee now in place. Further, the projected $800 million deficit resulted in detrimental legislation being passed in late June that will further restrict the ability of partners domiciled outside the state of New Jersey to seek refunds for taxes paid to the state.

The initial reason for the Association more actively monitoring New Jersey state tax activities were audit findings that impacted at least one Association member. In that case, the member received a notice of tax liability due as the result of a lower-tier operating partnership. While the issue appears to be resolved (the member is waiting for written confirmation) two other related, but independent issues could significantly impact PTPs operating in New Jersey, especially if the Department continues to seek composite returns and withholding from lower-tiered partnership and an entity's ability to seek refunds on behalf of operating entitled with New Jersey income is limited.

These issues are primarily being driven by the court case *BIS LP, Inc. vs. Director* (New Jersey) Department of Revenue. As a matter of background, BIS is a wholly owned subsidiary of a holding company, BISYS, Inc., with which it is engaged in a limited partnership, BISYS Information Solutions L.P. BIS is the limited partner with a 99% interest and BISYS the general partner with a 1% interest. According to Court documents, "The partnership agreement provided that the general partner had 'the sole and exclusive right to manage the business and

affairs' of the limited partnership except for limited decisions specifically reserved for the limited partner." Further, BIS had no place of business, property, employees, agents or representatives in the State of New Jersey. BIS sought the refund for taxes and penalties paid after a ruling by the Director that denied them status as an investment company. After numerous decisions at the Tax Court and Appellate Court levels, BIS' position was confirmed and a refund ordered in April of this year.

Parallels can be drawn between the BIS case and that of publicly traded partnerships. Many argue that implications of the decision can be applied to the applicability of the per partner filing fee, and specifically, the tax is unconstitutional as it taxes out-of-state businesses with no nexus to the State of New Jersey. As a result, several publicly traded partnerships have filed requests for refunds for the $250,000 annual payment from the Department. To our knowledge, several of those refunds have been denied at the time of this report.

The Department has acknowledged they will not seek an appeal of the outcome of the decision but will instead seek legislation to address the situation. One of the top goals of State leaders has been to prevent "windfall returns" to out-of-state businesses that do not pay taxes. The end result was a provision included in the final budget package in the last week of June that limits the ability of nonresident owners of pass-through-entities to seek refunds. Assembly Bill 3486 states that "only a nonresident partner who files a New Jersey tax return and reports income that is subject to tax in this State may apply the tax paid by the partnership an credited to the nonresident partner's partnership account against the partner's tax liability; and provided further that a partnership that pays tax pursuant to this section shall not be entitled to claim a refund of payments credited to any of its nonresident partners." The complete text of the legislation can be viewed at: http://www.njleg.state.nj.us/2014/Bills/AL14/13_.PDF.

The questions that now remain are:

- Will the Department take action to further address the outcome of the BIS case, and if so, what; will it do? and
- Will the Department continue to pursue the lower-tier partnerships of publicly traded partnerships?

If the answer to either of these questions is yes, the Association will likely need to take more proactive steps to address the impacts to its members. We have begun to work with several associations, specifically COST, API and the Chamber, to begin navigating the state and the best way to approach the Department. A call will be held in the next several weeks to further evaluate the impact of these issues on the membership and to determine next steps.

North Dakota

The North Dakota legislature passed a royalty withholding provision during the 2013 session. House Bill 1198 requires entities to withhold North Dakota income tax from North Dakota oil or gas royalty payments made to nonresident individuals and non-North Dakota domiciled business entities. The legislation exempted PTPs from the requirements; however,

under the legislation the lower-tier partnerships are still subject to the requirements, which poses difficulty for those with royalty interests. The Association worked with the Department to secure an exemption for the lower-tier partnerships of the PTPs when the lower-tiers are considered to be disregarded entities. Those subject to the requirement should provide the tax ID of the disregarded entity's parent in transactions, in this case, the production company, which would allow the impacted PTP to be exempt from withholding directly.

Texas

The Association continues to monitor tax developments in the great State of Texas. Revenues continue to be strong due to the active oil and gas development. The Comptroller has projected a revenue surplus of at least $2.6 million for the 2014-2015, and many expect that it could be double that amount. Additionally, the Rainy Day Fund will be approaching $8 to $10 billion.

The oil and gas industry has primarily been the driver for tax collections. Specifically,

- Sales tax collections are up 5 percent
- Severance tax collections are up 32 percent
- Natural gas taxes are up 24 percent

The one area of state tax collections that is not meeting projections continues to be the state franchise tax.

Many believe that the additional revenue, in conjunction with the conservative budget and the pending school funding lawsuits, increases the likelihood of additional tax relief in 2015. Some members of the legislature have begun offering potential ways to eliminate the existing franchise tax, including through the taxation of internet sales.

The Association will continue to monitor developments and work with the standing state tax committee to address issues and proposals of concern.