2015 Annual Meeting

REPORT OF THE FEDERAL AFFAIRS COMMITTEE

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Table of Contents

INTRODUCTION AND SUMMARY 1

TAX REFORM 3

Issue Background 3

Why Tax Reform 3

Comprehensive Tax Reform Proposals 4

Energy PTPs as Tax Expenditures 6

Status at July 2014 Annual Meeting 8

Developments and NAPTP Action During the Past Year 9

MLPA Action for the Next Year 13

LARGE PARTNERSHIP AUDIT LEGISLATION 13

Background—GAO Reports 13

Partnership Audit Legislation 14

MLPA Position and Action 15

MLP PARITY ACT 15

Background 15

MPLA Position and Activity 17

REVENUE PROPOSALS IN PRESIDENT'S BUDGET 18

CONCLUSION 20

2015 Annual Meeting

REPORT OF THE FEDERAL AFFAIRS COMMITTEE

INTRODUCTION AND SUMMARY

The Federal Affairs Committee continues to focus its energies primarily 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 this Congress. Progress on all but the most necessary legislation continues to be blocked by the unrelenting division on Capitol Hill between the two parties and between the House and Senate, as well as by the inability of Congressional leaders and the President to work together. Nonetheless, tax reform continues to be an item of frequent discussion among policymakers and depending on the outcome of the 2016 elections, a renewed effort could occur as early as 2017. We want to be fully prepared for any eventuality.

Many tax reform proposals call for the wholesale removal of "tax expenditures" from the tax code in order to simplify the code and allow lower rates. Since 2008 the Joint Committee on Taxation (JCT) has defined these to include partnership tax treatment for natural resource MLPs, a fact which partially explains why MLPs are a potential target in tax reform. Each year the JCT prepares an estimate of the revenue estimated to be lost by each tax expenditure, which provides an idea of the revenue they believe is lost by allowing MLPs to be taxed as partnerships and how it compares to other tax expenditures. After an initial large jump in 2013, this estimate seems to have moderated a bit.

This year a new issue has come to the fore: efforts to reform the audit rules for large partnerships, including MLPs. Both the Administration's current budget proposals and prior tax reform proposals had raised the issue, but discussion began in the 113th Congress, when the General Accountability Office (GAO) issued a series of reports showing that the IRS is auditing only small numbers of large partnerships. Politicians and some press seized on this as evidence that large partnerships, including MLPs, are "audit proof" and insinuated that tax compliance by such entities

is questionable. Earlier this year, legislation was introduced that would have dealt with this problem in part by collecting additional tax owed at the entity level. While auditing large partnerships and collecting additional tax owed from individual partners does pose some logistical issues for the IRS, collecting tax at the entity level compromises pass-through status--not an acceptable solution for MLPs, which are not the source of compliance problems.

The Federal Affairs Committee also continues to monitor the MLP Parity Act (S. 1656/H.R. 2883), 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 cordial conversations with the bill's sponsor, MLPA remains neutral on this legislation at this time.

The Administration continues to call for elimination of various tax provisions benefiting oil, gas, and coal in its annual budget, as it has every year since 2009. In prior years the budget did not mention section 7704 or MLPs; but this year, for the first time, the budget suggested ending partnership status for what it referred to as "fossil fuel" MLPs as an offset for tax reform. In our view, 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 each Administration budget and by others in connection with tax reform and as a revenue raiser. Recently, several of the Republican Presidential candidates have criticized the current taxation of carried interest, and have proposed changing it as part of tax reform. That has encouraged President Obama and Congressional Democrats to make a renewed pitch for such a change in connection with end-of-the-year budget talks. Most Republicans in Congress, however, remain firmly opposed to the idea.

The most recent versions of the legislation to change the tax treatment of carried interest have been written more narrowly than earlier versions and pose little concern to non-financial MLPs. We assume, but will make sure, that this will be true of any future proposals.

Finally, an important recent Federal Affairs development is MLPA's retention of Steve Ruhlen to serve as our Director of Federal Affairs. In addition to being an additional MLPA presence on Capitol Hill, Steve will work with Mary Lyman and Bruce Heine to coordinate and direct our federal legislative efforts. Having served as Chief of Staff or Legislative Director to a number of House members, as well as worked in government relations in the private sector, Steve has deep legislative experience and a broad network of contacts on Capitol Hill. He is also a native Texan who understands the energy sector well.

TAX REFORM

Issue Background

For a good part of the current administration, both Congressional and executive branch policymakers 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 29 years since then, the Code has once again become cluttered, complex, and inefficient; and every year Congress has enacted legislation that adds new special provisions and more complexity.

Why Tax Reform

The interest in tax reform has been sparked by the tax code's 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 corporate rate in a revenue neutral manner would be to enact tax reform that would eliminate most or all of the current business "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 an indirect 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 have pass-through tax status. The answer to this question could 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

Advisory Panel and Commission 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 interest in comprehensive tax reform began to grow, President Obama in 2009 formed the President's Economic Recovery Advisory Board ("PERAB"), a group headed by Paul Volcker to advise the President on policies to promote economic growth and 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 included a section on "reviewing the boundary between corporate and non-corporate taxation." It discussed 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 included both the pros and cons of such changes.

Also in 2010, President Obama appointed a bipartisan commission, the National Commission on Fiscal Responsibility and Reform, to examine ways to reduce the deficit. The Commission was organized into working groups, including a Tax Reform Working Group. On December 1, 2010, the Commission issued its recommendations for achieving $4 trillion in deficit reduction through 2020. Among the recommendations 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 type of plan which needs to be adopted to deal with budget deficits.

Camp Proposal

In February 2014, then Ways and Means Committee Chair Dave Camp (R-MI) issued a comprehensive tax reform plan that was the result of two years of hearings, research, and discussion by working groups. MLPA was very active during this process, working to educate Ways and Means Committee members, developing relationships with supportive Members, and submitting comments at hearings and to the appropriate working group.

The Camp proposal set a top rate of 25% for both individuals and corporations. High-income individuals would have a 35% effective rate, however, as the proposal imposed a 10% surtax and phased out the benefit of the 10% bracket for higher incomes. 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 achieved 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 retained the natural resources section of section 7704 almost intact, allowing the majority of MLPs to continue as before. This was one of the very few oil and gas tax expenditures that was not cut back under the plan, and we can thank the MLP advocates on the Committee for accomplishing that.

The proposal, however, removed fertilizer and timber income from the qualifying list, and also reversed 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 under section 7704. Income and gain from the sale or rental of real estate, interest, dividends, and income from commodities would no longer be qualifying income.

Association members with substantial income from fertilizer operations ore real estate would thus have been 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 would be affected by the Camp proposal, because dividends from corporate subsidiaries used to hold non-qualifying activities would no longer be qualifying income.

In addition to the practical effects on current MLPs, the proposal represented the first retrenchment of section 7704 since it was enacted in 1987. The precedent of eliminating parts of section 7704, however little it might appear to affect most MLPs now, is not one we want to have set.

The Camp proposal also would have eliminated 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 have treated carried interest income as compensation taxed at ordinary income rates, repealed percentage depletion (but not IDCs), and repealed the passive activity loss exception for working interests in oil and gas property. It made

technical changes in partnership taxation, most of which were included in an 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," and would have changed audit procedures for partnerships with more than 100 partners.

Despite the enormous amount of effort devoted to putting it together, the Camp proposal went nowhere after introduction. 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, stakeholder hostility towards the plan, and the general difficulty of moving any significant legislation through Congress doomed this ambitious proposal.

Nonetheless, the importance of the proposal should not be discounted. It provided a blueprint, if not all the right specifics, of what comprehensive tax reform might look like and what problems would need to be overcome. It also laid out a number of very specific proposals that could be picked up later as revenue raisers or for other purposes. In fact, the proposal on partnership audit reform introduced earlier this year (see later discussion) was taken by Committee staff from the Camp proposal.

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[1] 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 often are y 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 had gone from $1.2 billion over five years to $6.7 billion while the estimate for PTPs with qualifying income from natural resources and mining had gone from $0.3 billion over five years to $0.8 billion—for a total of $7.5 billion for the period 2013-2017, vs. $1.5 billion for the period 2011-2015 in the 2012 estimate, as shown below.

[1] Tax expenditures are defined by the Budget Act of 1974 as "revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability."

The JCT's annual tax expenditure estimates are shown below, both in a five-year summation and in annual detail.

Joint Committee on Taxation 5-Year Estimates of Natural Resource MLP Tax Expenditure ($billions)			
	Jan. 2012	Feb. 2013	Aug 2014
PTPs engaged in certain energy related activities	1.2	6.7	5.8
PTPs engaged in exploration & mining of natural resources	0.3	0.8	0.5
All Natural Resource MLPs	**1.5**	**7.5**	**6.3**

Joint Committee on Taxation
Annual Estimates of Natural Resource MLP Tax Expenditures
($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	Feb 2013	Aug 2014	Jan 2012	Feb 2013	Aug 2014	Jan 2012	Feb 2013	Aug 2014
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	1.1	0.1	0.1	0.1	0.4	1.3	**1.2**
2015	0.3	1.4	1.1	0.1	0.2	0.1	0.4	1.6	**1.2**
2016	(2)	1.4	1.2	(2)	0.2	0.1	-	1.6	**1.3**
2017	(2)	1.5	1.2	(2)	0.2	0.1	-	1.7	**1.3**
2018			1.2			0.1			**1.3**
2011-2015	1.2	(2)	(2)	0.3	-	-	1.5	-	-
2012-2016	(2)	6.3	(2)	(2)	-	-	(2)	7.0	-
2013-2017	(2)	6.7	(2)	(2)	-	-	(2)	7.5	-
2014-2018	(2)	(2)	5.8	(2)	(2)	0.5	(2)	(2)	**6.3**

(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 calculated the tax expenditure impact for PTPs, the Association hired an economic consultant to provide background on this matter. The consultant believed that the tax expenditure number was based upon distributions and was calculated as the difference between the tax collected when income distributed to the investor is taxed at both the entity level and the investor level, and the tax collected when it 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 for 2010. Later the same consultant did an analysis suggesting a much lower revenue estimate for the five-year period beginning in 2014 and shared it with the JCT. Whether because of that or for other reasons, the estimate released in August 2014 was somewhat lower. A 2015 estimate has not been issued to date.

It is important to remember, as the JCT itself states, that the *tax expenditure* estimate, which is 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.

The JCT had not previously estimated the revenue that would be gained by changing natural resource PTPs' taxation. As part of its annual estimate of the tax proposals in the Administration's budgets, however, the JCT estimated earlier this year that taxing "fossil fuel" MLPs would increase revenue by $1.159 billion over five years.

It is also worth noting that even at its highest, the tax expenditure estimate associated with PTPs is dwarfed by the cost of such major tax expenditures as the mortgage interest deduction ($405 billion), nontaxed employer-provided health insurance ($785 billion), and income deferral for controlled foreign corporations ($418 billion).

Status at July 2014 Annual Meeting

At the time of the last Annual meeting, while the Camp proposal was still fresh in everyone's mind, it was quite clear that tax reform would not be an issue in the House for the remainder of the 113th Congress. On the Senate side, action in the Finance Committee had been halted by former Chairman Baucus' sudden departure to become Ambassador to China. His successor, Ron Wyden (D-OR) was interested in tax reform and had introduced a tax reform bill which, similar to the Camp proposal, would have lowered tax rates while eliminating a number of tax benefits, including many used by the oil and gas industry. With regard to MLPs, Chairman Wyden appeared to favor a "level playing field approach" as embodied in the MLP Parity Act, discussed below. Because he Finance Committee was several months behind Ways and Means in its tax reform work, it was not expected to produce a comprehensive tax reform proposal before the 113th Congress ended.

It was considered likely that the Republicans would take back the Senate in the 2014 elections, so that there would be new Chairs for both tax-writing committees—most likely Orrin Hatch (R-UT) for Finance, and for Ways and Means either Paul Ryan (R-WI) or Kevin Brady (R-TX), who is a strong supporter for MLPs on the Committee. It was generally agreed that it would be difficult to plan next year's actions until it was known who would control the Senate and who the new Committee leadership would be.

Developments and MLPA Action During the Past Year

For the remainder of 2014 MLPA continued education efforts and closely monitored the sentiments regarding MLPs and tax reform in both the House Ways Means and Senate Finance Committees. As expected, the 113th Congress ended without meaningful action on tax reform, and with a sentiment that little was likely to happen until after the next Presidential election.

The 114th Congress began, as expected, with a Republican majority in the Senate as well as an increased Republican majority in the House. Senator Hatch became the Finance Committee Chair and Representative Ryan the Ways and Means Committee Chair, and there were changes in membership on both Committees.

On the Ways and Means Committee side, no comprehensive tax reform has emerged so far this year, but Chairman Ryan has shown great interest in international tax reform. MLPA's efforts there have been focused on reinforcing our existing relationships with Ways and Means members and educating the new Committee members on the benefits of the MLP structure.

On the Finance Committee, Chairman Hatch has shown a strong interest in comprehensive tax reform. In December 2014, before the start of the new Congress, Chairman Hatch issued a 350-page report compiled by Republican Finance Committee staff titled "Comprehensive Tax Reform for 2015 and Beyond." The report was a comprehensive examination which included a history of the federal income tax, a history of previous tax reform efforts, and an extensive discussion of the individual and corporate income taxes and how they might be reformed. The report did not contain specific tax reform proposals, but rather was a survey of the landscape meant to serve as the basis for future discussions.

The report did, however, make it clear that Chairman Hatch's personal preference for business tax reform would be the integration of the corporate and individual taxes to eliminate double taxation and tax all income at a single level, as is the norm for MLPs. Under his preferred system, all publicly traded entities would be taxed at the entity level, with dividends and distributions either fully deductible by the entity or excluded from the recipient's income. Non-publicly traded entities would follow a pass-through regime.

Publicly traded partnerships are mentioned a few times in the report, both as part of the summary of past history and current law, and in connection with integration of business taxes.

1) The report notes in a discussion of past tax legislation that the changes to the tax code made by the 1987 Revenue Act included "application of the corporate tax rules to publicly traded partnerships" (p. 22).

2) The report makes the following observation on public trading as the dividing line for corporate vs. partnership taxation (pp. 123-124; footnotes omitted):

> In 1987, Congress made a decision to distinguish partnerships taxed at the entity level or at the owner level depending on whether the ownership of the partnership was publicly traded. Under the law, if the ownership was publically [sic] traded, the partnership would be taxed under the corporate tax regime. If the ownership was not publicly traded, then the partnership would be treated as a pass-through with the income taxed at the owner level. That distinction made sense in 1987 and may still make sense today. Having access to the capital markets is a reasonable and sensible dividing line between taxable and non-taxable entities. A dividing line based on gross receipts or total assets appears to be purely artificial and random.
>
> Publicly traded entities should be subject to tax under the corporate tax regime. The earnings of such entities should be taxed at the entity level. However, any distributions made by such entity should either be deductible by the entity ("dividends paid deduction") or excludable by the recipient ("dividend exclusion"). Integration of the corporate and individual taxes could be achieved by either method.

3) In a section titled, "Distortions Created by a Classical System of Taxing Corporate Earnings," the report states (pp. 150-151; footnotes omitted):

> Investors who want to invest in publicly traded companies may have an incentive to invest in publicly traded partnerships (PTPs) rather than publicly traded corporations. If certain requirements are met, PTPs are subject to a single level of tax at the partner level. The main tax limitation on the use of PTPs is that 90 percent of more of a PTP's gross income must be qualifying income, which includes interest, dividends, real property rents, gain from the sale of real property, income and gain from mineral or natural resources, and income or gain from commodities or commodity futures. If a PTP does not meet the qualifying income test, it will be taxed as a corporation.

4) A discussion of the need for corporate integration states (pp. 162-163; footnotes omitted):

Some publicly traded companies are able to avoid the two levels of taxation by utilizing the partnership form of business. Publicly traded partnerships (PTPs) are limited partnerships (or limited liability companies) in which the interests are traded on an established securities market. A share in a PTP is called a "unit," and PTP shareholders are called "unit holders." PTPs are traded on the New York and NASDAQ stock exchanges. A subset of PTPs is master limited partnerships (MLPs). An MLP is a PTP that operates an active business. There are about 117 MLPs on the market with a majority of them in the energy and natural resources areas.

In 1987, Congress enacted changes in the tax law to tax PTPs as corporations. However, it provided two forms of relief for PTPs from the corporate tax. First, PTPs that were in existence on December 17, 1987, were transitioned for 10 years until December 31, 1997. After that time, these grandfathered PTPs had to meet a qualifying income test or be taxed as a corporation. However, in 1997, Congress permitted the grandfathered PTPs that did not meet the qualifying income test to elect to pay tax at 3.5 percent of their gross income for the taxable year from the active conduct of trades or businesses. Second, PTPs that meet a qualifying income test will not be taxed as corporations. To meet the test, PTPs must have 90 percent or more of their gross income for the taxable year consist of qualifying income. Qualifying income includes interest, dividends, real property rents, gain from the sale of real property, income and gain from mineral or natural resources, and income or gain from commodities or commodity futures.

Under an integration proposal based on whether the entity is publicly traded, PTPs would be taxed under the corporate tax regime. As a result, a tax would be imposed at the entity level on the taxable income of the PTP. However, any dividends paid by a PTP would either be deducted by the PTP (under a dividends paid deduction approach) or excluded from the recipient's income (under a dividend exclusion approach) thereby alleviating the two levels of taxation.

Integration of the individual and corporate income taxes has been discussed by economists and tax policy theorists for years as the ideal regime for business taxation. However, given that integration has never been seriously considered by Congress and would add a whole new layer of complexity to the already difficult process of tax reform, the odds of such a regime being enacted are extremely low.

Once the 114th Congress was up and running, Chairman Hatch formed five bipartisan working groups to examine various aspects of tax reform. These included working groups on 1) the Individual Income Tax, 2) Business Income Taxation, 3) Savings and Investment; 4) International Tax; and 5) Community Development and Infrastructure. The groups held tax reform education

sessions in February and March, conducted roundtables in April, and were to prepare reports during May for submission to Chairman Hatch and Ranking Member Wyden on May 25; however the reports were delayed and ultimately released in early July. MLPs and other pass-through entities fell under the jurisdiction of the Working Group on Business Income Tax, which was led by Senators John Thune (R-SD) and Benjamin Cardin (D-MD). The Finance Committee also held a series of hearings on comprehensive tax reform during February and March.

MLPA's primary legislative focus during this period was to educate and develop relationships with the members of the Finance Committee, with a particular focus on the members of the Business Income Tax working group. The Association submitted a statement to this group as well as to the working group on Community Development and Infrastructure.

The final report of the Business Income Working Group, which is included in the supplementary material to this report, contains a few mentions of MLPs, but none that suggested narrowing or eliminating their tax status under section 7704. The report begins with an extensive discussion of the principles and challenges of business tax reform. One of the challenges discussed at length is that of treating pass-through entities equitably. MLPs are mentioned briefly as one form of pass-through entity at the beginning of the discussion. The report goes on to discuss several suggestions for dealing with this challenge, along with the pros and cons of each.

The next section discusses desirable structural reforms, one of which is the integration of the individual and corporate income taxes and various proposals to accomplish this, some of which would place the tax burden at the entity level and some at the individual/investor level.

As part of a section titled "Promoting American Innovation," the report discusses the objective of promoting American energy independence beginning on p. 51. It states that working group members "differed on whether the federal government should continue to favor certain types of energy resources or production over others." Those working group members "who did not foreclose the possibility of a continued role for the tax code in the energy sector" considered both general principles and specific provisions or issue areas. One of these, discussed at pp. 51-52, is the extension of MLP treatment to renewable energy, with a specific mention of the MLP Parity Act, discussed below.

An Appendix to the report discusses various business provisions in the tax code and options for changing them. On pp. A-58 - A-59, the rules for publicly traded partnerships are discussed. One option for change, the MLP Parity Act, is discussed on p. A-59.

Since the reports came out in July the Finance Committee and Congress as a whole have been preoccupied with other matters. The only major tax reform actively discussed has been the international tax reform, which could in part be used as a revenue raiser for the highway bill.

MLPA Action for the Next Year

With other issues such as the highway trust fund and the debt ceiling predominating in Congress for the rest of 2015 and a Presidential election in 2016, most people do not expect any serious action on tax reform in this Congress. MLPA will, however, continue to closely monitor this issue and to educate and strengthen relationships with key Members of Congress, particularly those serving on the tax-writing committees.

LARGE PARTNERSHIP AUDIT LEGISLATION

Background—GAO Reports

For over three decades, IRS audits of large partnerships, including MLPs, have been conducted under audit procedures enacted as part of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA). Before 1982, the IRS had to audit each partner separately, which was difficult to undertake and often led to disparities in treatment among partners. Under TEFRA, a Tax Matters Partner (TMP) is appointed as the primary representative of the whole partnership, and the IRS works with that partner. Certain other partners may have notification rights at points along the way of the audit and may challenge IRS findings in court if the TMP does not.

Any audit adjustment determined under the TEFRA rules is passed through to the taxable partners who were partners during the year being audited. Under another audit regime available to partnerships with 100 or more partners, the Electing Large Partnership (ELP) rules, the adjustment is passed through to those who are partners in the year of the audit adjustment.

On April 17, 2014, 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 audit, evaluation, and investigative arm of Congress. The GAO report stated 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, 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, and MLPs would be a subset of that group.

A second GAO report issued in May 2014 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.

GAO's final report issued on September 18, 2014 discussed in detail the challenges that the growing numbers and complex structures (including many layers of tiering) of large partnerships pose for the IRS in its efforts to audit these entities and ensure compliance under current law. Like the earlier GAO report, it made several recommendations as to how the IRS could improve its audit performance. It also discussed possible legislative changes, including requiring large partnerships to designate a qualified TMP that the field auditors could contact and requiring large partnerships to pay any added tax due at the entity level.

Partnership Audit Legislation

Compliance measures such as those proposed for large partnership audits are appealing to some legislators, both as an element of tax reform and as a revenue-raiser that ostensibly does not increase anyone's taxes but helps collect those already owed. As noted above, the 2014 Camp tax reform proposal included large partnership audit provisions.

The Camp partnership audit tax reform proposal would have repealed the TEFRA and ELP rules and replaced them with one audit regime under which audits would be conducted at the partnership level (partnerships with 100 or fewer partners could opt out). Any adjustment would be paid at the partnership level, although the partnership could show that the amount owed would be lower if the adjustment included partner-level information from the reviewed year. The partnership and all partners would be jointly and severally liable for the underpayment and any penalties. The audit provisions were estimated to raise $13.4 billion over ten years.

This year, the proposal was introduced in June as the Partnership Audit Simplification Act (H.R. 2821) by Rep. Jim Renacci (R-OH), a member of the House Ways and Means Committee, and was discussed as a possible revenue offset for the highway bill. Our understanding is that the legislation was suggested as an offset by Committee staff, who took it from the Camp proposal and advanced it with Members as a "noncontroversial" revenue raiser.

MLPA Position and Action

MLPA strongly opposes to the audit regime proposed in H.R. 2821. Forcing partnerships to pay tax owed after an adjustment at the partnership level is antithetical to partnership tax status. Moreover, imposing joint and several liability on a partnership and its partners for taxes owed would compromise the limited liability status of partnerships like MLPs, which is an important factor in their marketability. It would be particularly unfair to apply these provisions to MLPs because, as noted above, they are not where the problem lies.

When it was learned that the proposal was under consideration as a revenue offset for the highway bill, MLPA's legislative team went into immediate action. They contacted our supporters on the Ways and Means Committee and made clear that these provisions are damaging to MLPs and should be rejected. We believe that the provisions in H.R. 2821 will not advance in the Ways and Means Committee.

In addition and concomitantly, MLPA's legislative team contacted Senators and their staffs to voice their concerns with H.R. 2821. On July 14 a group of MLPA representatives, including two MLP reporting experts from PricewaterhouseCoopers, met with Finance Committee and JCT staff to discuss the provisions of H.R. 2821. The PricewaterhouseCoopers representatives were very successful in pointing out to tax staff the technical problems with the proposed legislation and the reasons it should not be imposed on MLPs.

It is our understanding that the partnership audit legislation remains in play and may well be bought up again in the context of the highway bill or some other legislation needing a revenue offset. We believe, however, that our representatives have had an impact on Members' and staff's thinking and are hopeful that future proposals will take a different approach, at least with regard to MLPs. In any case, we will be keeping a very close eye on this issue in the coming weeks and months and will be prepared to take action against harmful legislation if necessary.

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, MLPA 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 several years, a serious effort has been underway to expand section 7704 to include renewable energy sources. On June 7, 2012 Senator Chris Coons (D-DE), along with Senator Jerry Moran (R-KS) and five other cosponsors first introduced "The Master Limited Partnerships 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 that 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. Thompson 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 as S. 795 / H. R.1696, respectively. The new bill was 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.

Senator Coons and Rep. Poe reintroduced the bill in the 114th Congress on June 24, 2015 as S. 1656 / H.R. 2883, respectively. S. 1656 is cosponsored by Senators Jerry Moran (R-KS), Lisa Murkowski (R-AK), Debbie Stabenow (D-MI), Susan Collins (R-ME), Michael Bennet (D-CO), Corey Gardner (R-CO), and Angus King (I-ME). Senators Stabenow and Bennet are Finance Committee members and Senator Murkowski chairs the Senate Energy and Natural Resources Committee. On the House side, H.R. 2883 is cosponsored by Mike Thompson (D-CA), Mark Amodei (R-NV), Peter Welch (D-VT), Paul Gosar (R-AZ), Earl Blumenauer (D-OR), Mike Coffman (R-CO),

and Jerry McNerney (D-CA). Reps. Thompson and Blumenauer are members of the Ways and Means Committee.

This year's bill is substantially identical to the 113th Congress version: but there are changes in three areas:

- Language has been added to section 2(a)(4) (ii) allowing MLPs to lease property for electric power generation from renewables in addition to actually generating such power.
- Language has been added to the provisions on carbon capture and sequestration in section 2(a)(4)(xii) requiring new power plants (those placed in service after January 8, 2013)to capture at least 50 percent of their CO_2 and existing power plants (placed in service before January 9, 2013) to capture least 30 percent of their CO_2.
- Several new requirements for qualification as a "renewable chemical" that can be produced, transported or stored by an MLP under section 2(a)(ix) have been added to section 2(b).

The legislation's advocates, several of whom formed an advocacy organization called the Financing American Investment in Renewables (FAIR) Coalition, 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 for a time an Administration endorsement appeared possible, but it has never materialized.

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 under Senator Baucus and the working group reports under Senator Hatch, 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, 2013 the JCT estimated that enactment of the MLP Parity Act would result in a revenue loss at $307 million over five years, $1.3 billion over ten. This does not include the changes to the passive loss and at-risk rules that would be necessary to make the bill's provisions really useful in raising capital from MLP investors.

MPLA Position and Activity

As directed by the Board of Directors, with input from the Federal Affairs Committee, the official position of MPLA is a positive but neutral stance towards the MLP Parity Act. The recognition by the bill's proponents of the value of MLPs in raising capital for energy projects is a positive development and helps us make our case, and MLP Parity Act supporters may prove to be valuable allies if tax reform threatens MLPs' tax status. There are, however, a number of

uncertainties associated with the use of the MLP structure in these different industries that are best answered by the proponents, and MLPA'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 MLPA members on this issue.

While not taking a position on the MLP Parity Act, MLPA and its lobbyists have stayed in touch with the bill's advocates and on two occasions have had the opportunity to speak directly to Senator Coons. On both occasions 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 continues to be optimistic about the prospect of advancing his bill and has tried on a few occasions to add it to other legislation; however, it is considered unlikely to advance outside of tax reform.

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 2016 was released on February 2, 2015, along with the Green Book. The budget proposed $4 trillion in spending for the next fiscal year, which begins October 1, 2015, and $3.5 trillion in revenue. As has been the case with all of President Obama's budgets, the carried interest proposal was included, along with perennial proposals to eliminate a list of "tax expenditures" for oil, gas, and coal. In previous years, this list has not included the MLP "tax expenditure."

This year, however, one of the revenue provisions was a proposal to tax PTPs "with qualifying income and gains from activities relating to fossil fuels," beginning in 2021. It was estimated by the Treasury Department to total of $1.699 billion through 2025. A later JCT estimate of the Administration's revenue proposals put the figure somewhat lower, at 1.159, as shown in the table below. The JCT estimate is the one that counts for legislative purposes.

Revenue Gain from Taxing Fossil Fuel MLPs ($millions)		
	Treasury Estimate	JCT Estimate
2021	303	131
2022	322	239
2023	341	250
2024	358	263
2025	375	276
Total	1.699	1.159

These proposals are not part of the general budget—i.e., not included in the estimate of receipts and expenditures—but rather are put forward along with a number of other proposals as revenue items for future revenue-neutral business tax reform.

While it is never good news to see such a proposal, we have not been overly concerned by this development. First, this proposal was tacked onto a long list of "fossil fuel tax preferences" that the Administration has proposed to eliminate since 2009, a list that has consistently been ignored by Congress. This Congress is no more likely than past ones to adopt something just because the President has suggested it. In addition, as we have noted in the past, when there is talk of business tax reform, as there has been in recent years, proposals such as this are likely to emerge as part of the discussion.

Moreover, the low revenue number associated with the proposal strengthens the argument that we continue to make to Congress that the revenue supposedly lost to MLPs is dwarfed by the billions they invest each year in energy infrastructure and the benefits that MLP investments provide in terms of increased employment, lower energy prices, and greater energy security.

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;

- Extending partnership basis limitation rules to nondeductible expenditures; and

- Reforming the large partnership audit rules in a manner somewhat similar to that of the Camp proposal and H.R. 2821 but with the adjustment flowing through to the partners who held their partnership interest during the year to which the adjustment relates.

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

CONCLUSION

While the FY 2016 budget proposal would eliminate traditional energy MLPs as part of tax reform, overall we feel positive about our tax reform position in the near future. Aside from the fact that there is virtually no chance of tax reform occurring until after the 2016 elections, MLPs enjoy a solid base of support among Republicans on the Ways and Means Committee. In addition MLPs have a number of good friends in the Senate, including 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 MLPAs' champion when and if the Senate takes up tax reform.

We believe that our message to Congress regarding the success of section 7704 in contributing to America's energy renaissance and enhancing our domestic energy security resonates with both Republicans and Democrats. With the help of our recently strengthened legislative team, as well as our public affairs firm Story Partners, we will continue to educate Congress, the press, and others who shape public opinion about the valuable role that MLPs play in our economy and the importance of maintaining their tax status intact.

The more pressing concern at present is the partnership audit legislation, which continues to be in play and which may well appear again in coming weeks as Congress approaches the deadline for action on must-pass legislation that needs to be paid for. We believe that we have had an impact here and will continue to work on this issue to ensure that any legislation that advances through Congress does not contain provisions that would be harmful to MLPs, and in particular avoids any entity level tax payment.

As always, we encourage all MLPA members, particularly our MLP members, to participate in MLPA's legislative efforts and to share ideas and information. Information about your company's activities in each state and how they would be impacted by proposals adverse to MLPs is particularly valuable. The more we know about the value that our member MLPs bring to the home states of Members of Congress, the better able we are to educate Members and turn them into allies.