



2015 State Activities Report

This year marks the 15th year the Association has engaged in state government affairs issues to address tax matters of interest to members as well as the overall master limited partnership space. This year the Association worked hard to address nearly a dozen state issued ranging from the traditional composite return and withholding provisions to filing an amicus brief for a case decided before the U.S. Supreme Court.

As we begin preparing for the 2016 legislative sessions, we are aware of the environment and general financial health of the states are wavering. While states have, for the most part, recovered from the economic downturn, many are now facing deficits or are considering revenue measures to support new spending initiatives. States like Louisiana (\$1.6 B), Pennsylvania (\$2.3 B), Colorado (\$220 million) and Kansas (\$400 million) are in the process of addressing significant deficits. Others like Connecticut (\$133 million deficit, \$2 billion in new taxes), Nevada (\$1.1 B) and Alabama (\$200 million) all took action to raise revenue through a number of tax increases, reductions in exemptions, or other smaller tweaks.

This contradicts information reported by the Rockefeller Institute that relates to tax collections for the first quarter of 2015 that shows state revenue continues to increase. According the [State Tax Revenue Report for Q1 2015](#), solid increases occurred in the four major sectors of government revenue: personal income taxes, corporate income taxes, sales taxes, and motor fuel taxes. The report found that 43 states reported increased revenue during this time period, with ten states reporting double-digit growth. At the same time, population growth and demands to support core government programs are also increasing.

Two trends that the Association will be watching closely over the coming year are efforts to shift tax liability from individuals to businesses, and tax shifting - reducing one (or more) tax in exchange for increases in others, the implementation of new tax requirements, or both.

The following report highlights the efforts and accomplishments of the Association on state tax matters over the last year, and statuses of those we continue to work on.



California

The Association continues to work with the California Franchise Tax Board (FTB) regarding the minimum tax owed by members of limited liability companies (LLCs). This issue has been active for several years with the Association helping to resolve several dozen notices received by individual unitholders indicating they owed the minimum franchise tax. In August of 2014, the Board issued a ruling that raised further concern about the future treatment of LLC members.

In response to the ruling, the Association renewed discussions with the FTB, and confirmed that the existing agreement regarding the treatment of members of LLCs would stand. However, the FTB changed its position in late December. Under their corrected position, any member of a LLC who has the ability to manage or control the LLC, even though they may not today, is subject to the minimum franchise tax. As a result, all unitholders of at least one publicly traded partnership (PTP) may be subject to an \$800 payment each year, regardless of income, or interest in the PTP, simply by owning one unit of the LLC. We believe this change in position is the result of a court case *Swart Enterprises, Inc. vs. the California Franchise Tax Board* in which the FTB issued a tax liability notice to non-resident partners of a limited partnership that has an incredibly small ownership in a California entity. The partners do not control or manage the partnership and are very close to fitting the description of a PTP unitholder. The trial court ruled in Swart's favor; however the FTB has elected to appeal the decision.

At this time, the Association is waiting on further information from the FTB. In trying to address the issue, the Association has had numerous meetings with the Board Ombudsman, lawyers from the FTB, and representatives of the Board and CalTax, the state tax association. Through these discussions, the Board has taken an unwavering position that members of LLCs are subject to the tax. Despite their position, the FTB counsel has indicated that there is a process to formally request an exemption from the requirements if the unitholders do not have the ability to manage or make decisions on behalf of the partnership. However, the Association, or one of the impacted PTPs, must make a formal written request to be considered for the exemption.

In addition to working with the Board, the Association continues to assist those who receive notices from the FTB. The Association has drafted a generic letter to put each taxpayer's notice on hold until the pending Swart lawsuit is resolved. The letter has been used a number of times and we believe all unitholders who have received notices have either had their cases resolved or placed on hold until the issue can be addressed.



There are currently six PTPs that are structured as LLCs operating in California. Three of them are investment partnerships with the remaining PTPs being traditional operators. The Association will be working with those impacted to determine the best path forward. Another option is very targeted legislation and even legal action to support pending litigation.

Georgia

The Georgia Department of Revenue issued several notices to PTPs indicating that composite return and withholding was required for the lower-tiered partnerships of PTPs in the fall of 2014. The Association worked to contact the Department and reinforce the existing exemption found in Georgia law. The Department has since corrected the notices and stopped pursuing the issue with PTPs.

Indiana

Indiana was one of four remaining states that had not formally adopted an exemption from composite return and withholding provisions. The Association renewed efforts to seek a formal solution to the issue in early 2014 as a result of one PTP receiving a notice of noncompliance. The effort was prolonged due to a series of staff changes within the Department, but gained speed in December as the Department started to focus on the upcoming legislative session.

The Association proactively began working with the Department, with the help of the Indiana Chamber of Commerce, to develop mutually acceptable language to address the issue in early 2015. The proposed language included both the exemption from the composite return and withholding provision as well as a process by which lower-tiered entities may also seek an exemption from the requirements. A copy of the provision can be viewed on page 25 of House Bill 1472.

On April 30th, the Indiana legislature passed the provision to exempt PTPs formally from the composite return and withholding requirements. The Association does expect a rulemaking on the issue - specifically to address the treatment of lower-tier partnerships. However, the Department has not initiated that process.

Maryland

Few tax issues over the last year gained as much attention as that of the *Comptroller of Maryland v. Brian Wynne, No. 13-485*, case that was heard and decided by the U.S. Supreme Court. The challenge seeks to determine whether it was constitutional to deny a credit against Maryland's county tax for residents who pay tax to another jurisdiction on income earned in those jurisdictions. The decision confirms that States and localities must offer a credit to



individual taxpayers for income taxes paid to other jurisdictions if the state taxes income of non-residents sourced to the state.

Ultimately, the Court affirmed the MD Court of Appeals decision, in a 5-4 vote finding Maryland's personal income tax scheme failed the dormant Commerce Clause's "internal consistency test because if every State adopted Maryland's tax structure, interstate commerce would be taxed at a higher rate than intrastate commerce."

The Association was one of several stakeholders to submit an amicus brief in opposition of the Maryland statute. A finding for Maryland could have led to more states denying resident investors in MLPs (and other pass-through entities) a credit against tax on their share of the income earned by the MLP in other states.

Montana

The Association continues to work proactively with the Montana Department of Revenue to address several legislative and regulatory treatments of master limited partnerships. The most recent issue stems from an informal waiver process that was established last year to address reporting issues relating to lower-tier partnerships. Under the informal process, PTPs were asked to provide specific documents — partnership agreements as well as structure documents — in exchange for the waiver process to be developed.

While the informal solution was successful for a number of PTPs, the Department sought to codify the exemption process formally during the 2015 legislative session. While most Association member entities were very supportive of this proposal, eliminating the requirement would have actually removed the provision from statute that provided the ability for PTPs to secure an exemption from lower-tier withholding, which would have been contradictory to the previous efforts of the Association and others.

The Association worked cooperatively with the Department to develop legislative language to clarify that the Department may grant waivers to PTPs and their lower-tiered entities, and that existing waivers granted prior to 2016 will be honored by the Department. The amendment also directs the Department to develop rules that outline the requirements for securing a waiver in the future. The amendment, which was vetted by members of the Association, was formally enacted via Senate Bill 386. We still expect further rulemaking by the Department, but no action has been taken at this point.

Another issue that we continue to monitor is that of the State's current methodology for calculating apportionment. We are aware that at least one PTP has been warned that if it does



not change its calculation going forward, the Department will do it for them. We are now waiting to see whether this becomes a larger issue, or if the Department drops the issue with the PTP.

North Dakota

North Dakota has adopted composite return and withhold as well as a provision that requires the withholding on royalty payments. The Association has worked closely with the Department to secure exemptions from the requirements for both PTPs, and their disregarded entities, respectively. Despite the exemptions, the Association just recently (last week) became aware of notices that have been issued by the Department of Taxation indicating that an entity was required to withhold pursuant to §57-38-31.1. While the notice outlined a number of the exemptions under the statute, it failed to acknowledge the existing exemption for PTPs.

At this point, it is unclear whether the notice was sent to all entities as a reminder of the requirement and legislative changes adopted in 2014, or whether some other issue has triggered the letters. The Association will be working with PTPs that receive notices to resolve any issues with the Department, as appropriate.

Pennsylvania

Pennsylvania is a state the Association is closely monitoring as several events over the last year have raised concern by a number of members. The issues primarily relate to composite return withholding provisions and penalties imposed for late filings. We believe these efforts are related to many actions being taken by the State to address a \$2.3 billion deficit.

The first issue was brought to the attention of the Association after a PTP received notice from the Pennsylvania Department of Revenue regarding composite return and withholding for a specific list of corporate unitholders. The Association contacted the Department and confirmed that the existing exemption for PTPs from the composite return and withholding provision remains in place, and a note will be made on the PTPs account to that effect. We do not believe additional action by the Association is necessary at this time.

The other issue relates to a new statutory provision that results in a per partner K-1 penalty in the event that statutory provisions are not met. The issue was identified after a PTP was not able to meet a deadline after filing a permitted federal extraordinary extension. While the Department appears willing to avoid evoking the possible penalties, they are not willing to put anything in writing to that effect. The Association will continue to monitor the situation to determine whether a legislative solution is warranted. At this point, the Association is hesitant to pursue this matter unless absolutely necessary due to a highly political landscape and looming budget deficit.



Nevada

Governor Sandoval has been an outspoken proponent of enacting a new business tax similar to that of the Texas margin tax in order to raise additional revenue for the State's education system. Efforts to pass the proposal resulted in a ballot initiative that ultimately failed, but this did not thwart the Governor. Ultimately, and in an unexpected move, the legislature (recently) adopted the "Commerce" Tax. The tax will be imposed annually on any "business entity" whose Nevada gross revenues for the fiscal year exceed \$4 million at a rate of 0.052 to 0.331 percent.

Under the tax scheme, a business entity's category is determined based on its NAICS code (the 2012 North American Industry Classification System published by the Bureau of the Census of the United States Department of Commerce.) The Commerce Tax is calculated by making certain adjustments to the business entity's gross revenue, and then using the adjusted revenue base to Nevada under principles set forth in the Act.

Following the furor that came in the wake of the new business "Commerce" tax along with several tax hikes, it should come as no surprise some lawmakers and activists already began organizing efforts to repeal the new tax through a ballot initiative. Supports of the tax have countered by filing against those pushing for the ballot initiative to repeal the tax.

Oklahoma

The State of Oklahoma has long recognized the need to exempt PTPs from composite return and withholding requirements. However, a similar provision related to the withholding of royalty proceeds does not include the same exemption. Under Oklahoma statute §68-2385.26 any person who distributes revenue to a royalty interest owner must deduct and withhold an amount of five (5) percent of the payment. Royalty owners who meet certain conditions are entitled to a credit for income taxes paid. Despite this provision, refunds to PTPs owning royalty interests are not occurring because the PTP does not have a state income tax liability, and there is no formal way to recoup the taxes withheld.

Prior to this year, the Tax Commission had worked with representatives of PTPs to refund income that had been withheld under the provision. However, a position has been taken that would prohibit the refund of taxes withheld unless the refund is provided directly to the unitholders. This presents an impossible situation that results in the over-withholding of income and the inability to refund the tax to the unitholders.

The Association is seeking to meet with the Commission in October in an effort to resolve the issue. It is unclear whether the Department will be able to address the issue informally, through formal guidance, or whether a statutory change would be required.



Texas

Texas is in a unique position in that the State has benefitted from record tax collections as a result of the boom in shale energy production in recent years. The State Comptroller identified \$113 billion in revenue available for the 2016-17 biennial budget. The projections are optimistic and based on oil prices ranging between \$65 and \$75 a barrel. At the same time, the State's school financing system has once again been found unconstitutional and many are calling for a repeal of the margin tax.

At the beginning of the legislative session, there was no question as to whether tax reductions were to occur — the question was what and how much would be cut. From the start, the House and Senate took very different approaches to the discussion. The Senate was aggressive and steadfast on some type of property tax reductions. The House, however, proposed across the board cuts to the margin and sales tax rates. Throughout the discussion, the House remained defiant of the Senate proposal as it would not deliver relief for business or alleviate relief from excessive local property value assessments.

In the end, leaders were able to meet in the middle, providing an across the board permanent margin tax cut of 25 percent to both tiers, as well as an additional \$10,000 homestead exemption. To take effect, this exemption will need to be approved by voters in November of 2015. The margin tax cuts will be applicable starting in May of 2016.

Going forward, the story is much different. State revenue is clearly being impacted by the significant fall in oil prices. Sales tax collections are down significantly and oil is nowhere near the Comptroller's projected \$65 to \$75 a barrel. Pressure continues to mount to provide adequate funding for education, health care and transportation infrastructure.

The Association will continue to monitor the activities of the legislature closely. Texas is at the beginning of a two-to-five-year period in which tax policy will be fully vetted and is likely changed in a number of ways - including property and business taxation. We will continue to call working groups as needed to seek solutions and policy to benefit the activities of PTPs.

Vermont

The Association worked with the State of Vermont in 2008, and again in 2012, to change and then confirm the exemption of PTPs from the composite return and withholding provisions. However, in August of last year, several PTPs began receiving notices of tax due as the result of composite return requirements. The Association contacted the Department of Taxes as well as several organizations at the State level and learned the State had changed its position on the well-documented exemption for PTPs. This was done without any formal legislative or



regulation, and without the knowledge of the Association. The Association then requested a formal meeting with the Commissioner, which occurred in mid-December to discuss the situation and its impact on PTPs. At the meeting, Department staff continued to push for composite returns and the withholding of tax on PTPs. However, the Commissioner felt that she did not want to take a position opposite of all of the other states, and agreed the issue should be clarified in statute - providing a permanent exemption from the requirement for PTPs.

During this time, the Vermont legislature faced a \$100 million deficit, which resulted in a prolonged discussion of any issue that even potentially impacted revenue. Despite support from the Department of Taxation to confirm the exemption for PTPs (which included a letter from the Commissioner, and repeated testimony before the key committees) the amendment to address the Associations issues was not considered until fairly late in session.

Ultimately, the legislature adopted a provision in May that reinstates (confirms) the exemption from composite return and withholding requirements. The Association continues to engage on the issue as PTPs continue to receive notices of taxes due, including one issued for nearly \$22 million after the legislation had passed. We understand that the Department is behind in processing notices, but has acknowledged that they are working through the issues.