2016 Annual Meeting

REPORT OF THE FEDERAL AFFAIRS COMMITTEE

September 2016

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REPORT OF THE FEDERAL AFFAIRS COMMITTEE

INTRODUCTION AND SUMMARY

Over the past year the Federal Affairs Committee has continued its ongoing work of educating Members of Congress and their staffs about the important role that MLPs play with regard to energy security and economic growth. Its primary mission, as always, has been to ensure that the current tax treatment of publicly traded partnerships (PTPs) under section 7704 of the tax code remains intact when and if Congress undertakes tax reform or any other legislation affecting business taxation.

There has been little action on tax reform this year. However, the emergence of proposals to reform the audit process for large partnerships, and the sudden enactment of a new audit process last October as part of the Bipartisan Balanced Budget Act of 2015, has forced MLPA and its Washington representatives to devote considerable effort to ensuring that both the statutory language of the new regime and the regulations implementing it respect the passthrough status of MLPs and do not pose an unreasonable burden on them.

There has been significant progress to date, with the most objectionable features of the initial proposals removed from the new law and the enactment at the end of 2015 of a favorable modification specific to PTPs. There is still more work to be done, however, particularly on the regulatory side. The Federal Affairs Committee and the Regulatory Committee have worked together on this issue, identifying issues raised by the new regime and addressing each in the proper forum. Some concerns with potential regulations may ultimately have to be addressed on the legislative side, through technical corrections.

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 continues to remain neutral on this proposed legislation.

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. This in in line with the Administration's climate change policies. Until recently the budget did not mention section 7704 or MLPs, but beginning in 2013 and continuing this year, the budget has suggested ending partnership status for what it refers to as "fossil fuel" MLPs as an offset for tax reform. To date, there has been little Congressional interest in these perennial energy tax proposals.

We are currently a month and a half away from the 2016 election, the results of which will determine the legislative environment and the tax and energy policy risk to MLPs for at least the next two years. Possibilities range from a Republican President and Congress, which would be natural resource friendly but could take tax reform in any number of directions, to a Democratic President and Senate (a Democratic House is considered unlikely), which would make comprehensive tax reform less likely but could pose the threat of an environment less friendly to MLPs' businesses which could result in efforts to eliminate specific "tax expenditures." It will be the job of the Federal Affairs Committee and our Washington representatives to survey the post-election landscape and determine where the threats and opportunities lie and suggest ways to address them.

LARGE PARTNERSHIP AUDIT LEGISLATION

The enactment at the end of October of legislation revamping the system for audits of large partnerships was the most significant legislative development for MLPs in 2015.

Background

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.

In 2014 the General Accounting Office (GAO), the audit, evaluation, and investigative arm of Congress issued a series of reports prepared at the request of Senators Ron Wyden (D-OR), Carl Levin (D-MI), and John McCain (R-AZ). The first report noted 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.

Despite Senator Levin's mention of PTPs as part of the problem, MLPs in fact account for a small percentage of large partnerships. 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. Moreover, MLPs are far from audit-free; a number have been audited in recent years—about 10% by one estimate—and because of the potential investor relations issues posed by an audit resulting in an adjustment, are generally conservative in their tax positions and transparent about their assumptions and conventions.

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 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.

Former Ways and Means Chairman Dave Camp's 2014 tax reform proposal (see section on tax reform) included a partnership audit proposal that 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.

The Administration's budget for FY 2016, released in February 2015, also contained a partnership audit proposal. It would have reformed the large partnership audit rules in a manner somewhat similar to that of the Camp proposal but with the adjustment flowing through to the partners who held their partnership interest during the year to which the adjustment related. This proposal carried a revenue estimate of $2.4 billion over 10 years.

2015 Partnership Audit Legislation

In June 2015 the Partnership Audit Simplification Act (H.R. 2821), legislation similar to the proposal in the Camp bill, was introduced 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. H.R. 2821 would have had all audit adjustments determined at the partnership level and a partnership representative specifically designated for the audit. It would have required the tax on any adjustment to be paid by the partnership, along with interest and penalties. Most notably, it would have made the partnership and its partner jointly and severally liable for any underpayment.

MLPA strongly opposed the audit regime proposed in H.R. 2821, as 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 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 H.R. 2821 was under consideration as a revenue offset for the highway bill, MLPA's legislative team went into immediate action. They contacted Representatives and Senators on the tax committees and made clear that these provisions were damaging to MLPs and should be rejected. The legislative team also met with tax committee staffs, including the staff of the Joint Committee on Taxation (JCT), to further educate them on the technical problems with the proposed legislation and the reasons it should not be imposed on MLPs.

As a result of these efforts and those of other interested associations, H.R. 2821 did not advance at that time. However, as partnership audit reform was on the legislative agenda and could come up later in the year as a revenue offset for other legislation, MLPA continued to keep a close eye on the issue in the following months.

Balanced Budget Act Provisions

Late in October 2015, outgoing House Speaker John Boehner, along with Senate Majority Leader McConnell and the Obama Administration, reached agreement on a two-year budget and debt ceiling deal. The deal, which was enacted as the Bipartisan Budget Act of 2015 (BBA), was negotiated very quietly and surfaced only a short time before it was taken up on the floor. Included in the bill as a revenue raiser was a modified version of the Partnership Audit Simplification Act. Changes had been made in the two areas of greatest concern in the original bill: joint and several liability of the partnership and partners for the adjustment amount had been removed and the bill provided an alternative to payment of additional tax owed at the partnership level that would allow partnerships to elect to "push out" the adjustment to their partners.

Beginning in 2018, the BBA provisions eliminate the TEFRA and ELP audit rules for all partnerships with more than 100 partners and establish a new audit regime in which:

- A partnership under audit must designate a partnership representative with sole authority to act on behalf of the partnership (section 6223). The IRS will examine all tax items for the year under review (reviewed year) and determine whether adjustments should be made.
- If adjustments for the reviewed year are made, under the default rule, all adjustments are netted and an imputed amount of underpayment (imputed underpayment) is determined at the partnership level (section 6225(b)).
- A partnership will be able to modify the imputed underpayment to the extent reviewed year partners have filed amended returns and to take into account the tax rates of reviewed year partners (individuals, tax-exempt organizations, etc.), the type of income in question, and other factors (section 6225(c)).
- The imputed underpayment, as modified, will be paid by the partnership in the year the audit is completed (adjustment year) (section 6225(a)).
- This will result in the adjustment year partners paying the tax for a reviewed year deficiency rather than the reviewed year partners who benefitted from the underpayment.

- Alternatively, the partnership may elect to "push out" the adjustment to the reviewed-year partners by sending them statements informing them of their share of any adjustments. The reviewed-year partners are then required to include their share of the adjustments without modification in their adjustment-year returns. This election to push out the adjustment to the reviewed year partners must be made within 45 days of the notice of final partnership adjustment. Under this election, the additional tax and interest are determined and paid at the partner level, and the underpayment rate is increased from 3% to 5% (section 6226).
- A partnership may also file a request for an administrative adjustment (AAR) of one or more items of income, gain, loss, deduction, or credit for any year and take the adjustment into account in the year the AAR is made. The partnership would have the option of paying the adjustment or sending adjusted returns to the partners in the year of the adjustment. An AAR may not be filed if an audit of the partnership has begun (section 6227).

Passive Loss Language

Part of MLPA's legislative effort leading up to and immediately after passage of the BBA was to obtain clarification that an MLP, in determining the imputed underpayment under section 6225, could take into account suspended passive losses under section 469(k) of its partners. This is something that MLPs are uniquely able to do. The BBA provisions give the Treasury broad authority to determine the procedures for determining imputed underpayment but do not specifically require or authorize the use of such partner-level attributes. Ways and Means Committee Chairman Brady developed language to that effect during the BBA debate in hopes of amending the bill at that time, but the bill was on a fast track and these changes were not considered. Fortunately, Chairman Brady was able to include the suspended passive losses provision in an end-of-the-year tax extenders bill, the "Protecting Americans from Tax Hikes Act of 2015" (PATH), that was enacted shortly before Congress adjourned (P.L. 114-113).

2016 Developments

JCT Bluebook

The JCT periodically issues a "General Explanation" (referred to as the Bluebook) of the tax legislation enacted by Congress the previous year. While the Bluebook is not legislative history, deference has been given by agencies and sometimes the courts to its explanations. The March 2016 Bluebook description of the partnership audit provisions implies that the push-out election is not available to an upper-level partnership that has adjustments pushed out from a lower tier partnership under section 6226: "The recipient partnership pays the tax attributable to adjustments with respect to the reviewed year and the intervening years, calculated as if it

were an individual." In other words, in JCT's view, the push-out is only available to an audited partnership, and any partnerships that are partners in the audited partnership are not allowed to make a section 6226 election. Further, it appears that any such upper tier partnership would have to pay the pushed out amount of tax without the benefit of the modifications allowed under section 6225.

The Bluebook interpretation is without statutory support and is contrary to the intent of the provision to give MLPs and other large partnerships the ability to avoid the payment of tax at the entity level. The JCT interpretation would eliminate the push-out election for many MLPs and other large partnerships, as the use of tiered partnership structures is common. IRS officials have indicated a preference for following this interpretation, as it makes tax collection easier.

MLPA Legislative Efforts

MLPA is working in the regulatory as well as in the legislative arena to counter this interpretation and make sure the section 6226 election is available at all levels of a tiered partnership, and that such a partnership may also avail itself of the provisions of section 6225 if desired. Efforts on the regulatory side are discussed in the Regulatory Committee report.

On the legislative side, MLPA representatives have met with the staff of the Ways and Means Committee, where the legislation originated, and have been told that the intent of the legislation was to allow an upper tier partnership receiving a pushed out adjustment from a lower-tier partnership to file an AAR under section 6227. As a result, the upper-tier partnership could either elect to pay the tax on the adjustment as modified under section 6225 or push out the adjustment under section 6226 to its partners. MLPA is working with our supporters in Congress to effect the needed correction as soon as possible, possibly as part of a broader technical corrections bill which Chairman Brady has indicated is under consideration.

During the 3rd quarter of 2016, Federal Affairs Committee representatives joined Regulatory Committee representatives in a meeting with Treasury officials to discuss the tiered partnership issue and statements that seemed to indicate that Treasury approved of the Bluebook interpretation. Treasury stated that no firm decisions had been made on whether the push-out election would be permitted through tiers of partnerships, but noted that the collection of tax deficiencies from the partners of large partnerships through multiple partnerships would result in "very expensive tax dollars." In addition, Treasury asked if it would be possible for an MLP to provide the names of the taxpayers that would ultimately pay the tax after a push-out election was made and MLPA explained that an MLP would not have such information. Treasury also expressed interest in potential procedures that could facilitate collection from ultimate taxpaying partners if a push-out election through partnership tiers was allowed in implementing regulations.

Based on this conversation, MLPA currently does not anticipate that Treasury regulations implementing the partnership audit rules will allow a push-out election through multiple tiers of partnerships absent Congressional clarification of intent. To this end, as mentioned above, the MLPA legislative team, which includes the technical assistance of PricewaterhouseCoopers, is actively engaged with the Congressional tax committees in pursuing this and other potential clarifications to the partnership audit rules.

TAX REFORM

Issue Background

For a number of years, both Congressional and executive branch policymakers have devoted 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 30 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 recent interest in tax reform has been sparked by the tax code's ever-growing complexity, corporate inversions, and 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. This has caused the focus of tax reform to be on "business tax reform" rather than "comprehensive tax reform" which would impact individuals. One approach being discussed to achieve a lower corporate rate in a revenue neutral manner is the elimination of 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, banks and other financial institutions, asset intensive industries, and of course the energy sector, it has proven to be politically difficult to achieve. Those attempting to draft comprehensive reform proposals have found that achieving a satisfactorily low tax rate while maintaining sufficient revenue requires eliminating or cutting back on some popular and widely used tax benefits.

When comprehensive business 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 that it be at the entity level for large or publicly traded companies.

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, 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 to examine ways to reduce the deficit. 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 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 groups.

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. 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 did, however, remove 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.

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[1]. It would have treated carried interest income as compensation taxed at ordinary income rates, repealed percentage depletion (but not

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[1] This is a common and difficult issue for tax reform plans; accelerated depreciation involves so much revenue that it is difficult to lower rates very much without cutting it back. It is also a very valuable economic tool; many economists believe it provides more of an economic stimulus than lower rates do.

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, 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. As noted earlier, the partnership audit reform legislation enacted last year was taken 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[2] in the list issued annually by the 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 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 for PTPs released on February 1, 2013 was considerably higher, with qualifying income from energy-related activities rising from $1.2 billion over five years to $6.7 billion, while the estimate qualifying income from natural resources and mining increasing from $0.3 billion over five years to $0.8 billion—for a total of $7.5 billion for the period 2013-2017. The combined number dropped to $6.3 billion in 2014, and changed only slightly, to $6.4 billion, in 2015.

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[2] 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 four-year summation and in annual detail.

Joint Committee on Taxation 5-Year Estimates of Natural Resource PTP Tax Expenditure ($billions)				
	Jan. 2012	Feb. 2013	Aug 2014	Dec 2015
PTPs engaged in certain energy related activities	1.2	6.7	5.8	5.9
PTPs engaged in exploration & mining of natural resources	0.3	0.8	0.5	0.5
All Natural Resource PTPs	**1.5**	**7.5**	**6.3**	**6.4**

Joint Committee on Taxation Tax Expenditure Estimates for Natural Resource PTPs ($billions)												
Year(s)	**PTPs engaged in certain energy related activities**				**PTPs engaged in exploration & mining of natural resources**				**All Natural Resource (Approximate Total[1])**			
	Jan 2012	Feb 2013	Aug 2014	Dec 2015	Jan 2012	Feb 2013	Aug 2014	Dec 2015	Jan 2012	Feb 2013	Aug 2014	Dec 2015
2011	0.2				0.1				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	1.1	0.1	0.2	0.1	0.1	0.4	1.6	1.2	1.2
2016		1.4	1.2	1.2		0.2	0.1	0.1		1.6	1.3	1.3
2017		1.5	1.2	1.2		0.2	0.1	0.1		1.7	1.3	1.3
2018			1.2	1.2			0.1	0.1			1.3	1.3
2019				1.2				0.1				1.3
2011-2015	1.2				0.3				1.5			
2012-2016		6.3				0.7				7.0		
2013-2017		6.7				0.8				7.5		
2014-2018			5.8				0.5				6.3	
2015-2019				5.9				0.5				6.4

(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.

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.

Before 2015, the JCT had not released an estimate of the revenue that would be gained by changing the tax treatment of natural resource PTPs. As part of its annual estimate of the tax proposals in the Administration's budgets (see p. 20), however, the JCT estimated in March 2015 that taxing "fossil fuel" PTPs beginning in 2021 would increase revenue by $1.159 billion over five years. In 2016 the estimate (which begins in 2022) dropped to $802 million.

JCT Estimate of Taxing Fossil Fuel PTPs
($millions)

Year	2021	2022	2023	2024	2025	2026	2021-2025	2022-2026
2015 estimate	131	239	250	263	276		1,159	
2016 estimate		92	166	173	181	190		802

It is also worth noting that even at its highest, the tax expenditure estimate associated with MLPs 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 October 2015 Annual Meeting

At the time of the last Annual Meeting, at the beginning of October 2015, there had been little action on tax reform, although then-Ways and Means Committee Chairman Paul Ryan (who became Speaker of the House a few weeks later and was replaced as Chairman by Rep. Kevin Brady) had shown considerable interest in international tax reform. MLPA's efforts on the House side were focused on reinforcing our existing relationships with Ways and Means members and educating the newer Committee members on the benefits of the MLP structure.

On the Senate side, in December 2014 Finance Committee 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 was 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 as outlined in the report, all publicly traded entities, including publicly traded partnerships, 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.

The report made 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.

Similarly, a discussion of the need for corporate integration stated (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....
>
> 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 new layer of complexity to the already difficult process of tax reform, the odds of such a regime being enacted have been considered low.

During 2015 Chairman Hatch formed five bipartisan working groups to examine various aspects of tax reform. 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 groups held tax reform education sessions, conducted roundtables, and submitted reports to Chairman Hatch and Ranking Member Wyden in early July. The Finance Committee also held a series of hearings on comprehensive tax reform early in the year.

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. MLPA 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, contained a few mentions of MLPs, including the possibility of extending the MLP structure to renewable energy, with a specific mention of the MLP Parity Act, but none that suggested narrowing or eliminating their tax status under section 7704.

Developments and MLPA Action During the Past Year

In 2015, both houses of Congress were preoccupied with other matters. The only major tax reform actively discussed was international tax reform, which had some potential as a

revenue raiser. MLPA continued to closely monitor the issue, educate the tax committees, and strengthen relationships with key Members of Congress.

This has been largely true of 2016 as well. With the unlikelihood of any serious action on tax reform until 2017, the introduction and enactment of the partnership audit provisions soon after the 2015 Annual Meeting, and the continuing need to resolve items of concern in that legislation, MLPA's legislative team has devoted the lion's share of its outreach to the audit issue.

We have kept our eye on tax reform, however, and the issue, while not progressing, has continued to occupy the minds of Congress. On June 24, the House Republicans released a tax reform "Blueprint." The Blueprint would lower the top corporate rate to 20% and the individual rate to 33%, with only three tax brackets for individuals. Individual taxpayers could deduct 50 percent of their capital gains, interest, and dividends, and the net investment income and other taxes enacted as part of Obamacare would be repealed. There is no specific mention of MLPs or large pass-through entities, but the plan does specifically preserve the status of small pass-through entities and creates a special tax rate of 25% for income from pass-throughs.

In addition to a 20% corporate rate, businesses would be allowed immediate expensing of investment in new assets. As with other tax reform plans, the Blueprint would eliminate or consolidate a number of deductions and credits in the interest of simplicity and lower rates. The Blueprint is primarily aimed at setting forth Republican policy for the election and is not intended to be in itself a legislative document. What happens in 2017 will depend largely on which party takes the Senate and the White House.

On the Senate side, Finance Committee Chairman Hatch has been promising for several months to introduce tax reform legislation based on corporate integration, as discussed in the December 2014 report. As of the writing of this report, the legislation has not been introduced, although the Chairman has discussed it extensively. According to reports, the plan would achieve integration through a dividends-paid deduction. No specifics on the treatment of PTPs have been released, but based on the 2014 report they might not fare well under the Hatch plan. Like the House Blueprint, the Hatch plan is not intended for enactment this year but rather is intended to lay the groundwork for a serious tax reform effort in the next Congress.

MLPA Action for the Next Year

What happens with tax reform next year will be determined to a large extent by the results of the November election. At this time, control of the Senate in the next Congress is a toss-up. If the Democrats assume control, Senator Ron Wyden (D-OR) will most probably become Finance Committee Chair. Senator Wyden does not appear to favor corporate integration and is known to support development of alternative energy sources. To achieve this

goal, he has proposed eliminating all of the energy tax incentives and implementing green technology incentives. The MLP Parity Act (see next section) could be advanced under a Wyden chairmanship. Wyden introduced this year a proposal to simplify depreciation rules which was fairly well received and represents a more piece-by-piece approach to tax reform.

If the Democrats retain the White House as well, Senator Wyden would be expected to work with President Clinton on her tax agenda, which does not include comprehensive reform but rather proposes higher rates on upper income taxpayers, measures to discourage businesses from relocating in other countries, and other corporate revenue raisers, along with proposals to aid small business and provide increased benefits for middle-class taxpayers. Knowing that these measures would have little to no chance of passage in the Republican House (where no change in control is expected), but recognizing House Republicans' desire to reform the business tax structure, it would remain to be seen if a President Clinton might move to bridge the gap in an effort to end years of gridlock and reach some degree of tax reform.

If the Senate remains in Republican hands, but the Democrats retain the White House, Chairman Hatch can be expected to continue his work on corporate integration and the House to proceed with its own version of tax reform, with progress stymied in a manner similar to today. The wild card would be a Trump presidency. Tax reform would undoubtedly be on the agenda; however, Trump's tax proposals, while continuing the traditional Republican emphasis on rate cuts, go much farther than either Hatch or the Blueprint and have been criticized for losing unacceptable amounts of revenue. They could be good for MLPs, however, as Trump has proposed a top rate of 15% on passthrough income and is friendly to the natural resource industry. Which, if any, plan would ultimately advance in these circumstances remains an unknown at this point.

We expect the remainder of 2016 to be devoted primarily to trying to obtain technical corrections to the BBA partnership audit provisions, an effort that may well go into November and December as a lame-duck Congress finishes its business post-election. MLPA's action plan for 2017 will depend on a number of factors yet to be determined, including the makeup of the 115th Congress, which party occupies the White House, and the outcome of our efforts on technical corrections. One given, however, is that the effort to educate Congress about the value of MLPs and to build and strengthen our relationships with key Members, will continue.

MLP PARITY ACT

Background

Section 7704(d)(1)(E) of the tax code 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 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.

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. 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), and Martin Heinrich (D-NM). 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 currently has 13 cosponsors, including Ways and Means Committee members Mike Thompson (D-CA) and Earl Blumenauer (D-OR)

The current 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 CO2 and existing power plants (placed in service before January 9, 2013) to capture least 30 percent of their CO2.

- 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 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. The bill has not advanced at all in the 114th Congress, despite efforts by Senator Coons to add it to various bills in the Senate. If the Senate is controlled by the Democrats after the election, however, its prospects could be brighter in the 115th.

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. In order to be truly effective in raising capital from alternative energy investors, however, additional changes to the tax code would be needed that are not included in the revenue estimate. The key to financing alternative energy projects is the flow-through of a number of tax benefits to investors. MLP unitholders' ability to use these benefits would be severely limited by the at-risk rules, which limit the amount of loss deductions to the amount at risk, i.e., the amount invested, and the passive loss rules, which allow MLP unitholders to deduct losses only against income from the same MLP. Changing these rules would be politically difficult and would add significantly to the revenue cost.

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 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. Senator Coons, the bill's sponsor, has reaffirmed to MLPA 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, including both spending and revenue proposals, for the next fiscal year. At about the same time, the Treasury Department issues its "Green Book" providing details and estimates on the revenue proposals in the budget.

Every budget submitted by the current administration has included proposals to eliminate a list of "tax expenditures" for oil, gas, and coal. From 2009 through 2014, this list did not include the MLP "tax expenditure." Last year, however, the Administration's budget for FY 2016 included among the revenue provisions 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 raise a total of $1.699 billion in revenue through 2025. A later JCT estimate of the Administration's revenue proposals put the figure somewhat lower, at $1.159 billion, as shown in the table below. The JCT estimate is the one that counts for legislative purposes.

The FY 2017 budget, which was released on February 9, 2016, once again proposes the perennial list of oil, gas, and coal tax expenditures for elimination, including taxation of fossil fuel PTPs. Treasury's revenue estimate is once again considerably higher than the one issued in

March by the JCT. Both estimates are somewhat lower than in 2015, no doubt reflecting economic conditions in the industry.

Revenue Gain from Taxing Fossil Fuel PTPs ($millions)				
	Treasury Estimate		JCT Estimate	
	2015	2016	2015	2016
2021	303		131	
2022	322	201	239	92
2023	341	280	250	166
2024	358	295	263	173
2025	375	309	276	181
2026		323		190
2021-2025	1,699		1,159	
2022-2026		1,408		802

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, as noted, 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. However, 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 carried interest from investment services partnerships as ordinary income subject to self-employment tax
- Taxing gain from sale of a partnership interest by foreign partner on look-through basis;
- Expanding the definition of substantial built-in loss for purposes of partnership loss transfers; and
- Extending partnership basis limitation rules to nondeductible expenditures.

The pages from the Green Book describing these partnership proposals are included in the supplemental materials for this report.

CONCLUSION

Despite the Administration's proposal to eliminate traditional energy MLPs as part of tax reform, overall we feel positive about our tax reform position in the near future. Even if the outcome of the elections results in a favorable environment for tax reform, it will not happen quickly or easily. MLPs enjoy a solid base of support among Republicans on the Ways and Means Committee and have a number of advocates 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 continue working to solidify both our House and our Senate support and in particular to identify and engage 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 legislative and public affairs teams, 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 for the immediate future is obtaining corrections and clarifications to the partnership audit provisions so that they will be workable for MLPs and accurately reflect the intent of their authors. We will continue to work with Members and staff on Capitol Hill for the remainder of 2016 and, if necessary, in 2017 to achieve this. We will also continue to coordinate with the Regulatory Committee and their efforts with Treasury and the IRS.

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.