May 3, 2018

Internal Revenue Service
CC:PA:LPD:PR (REG-118067-17)
Room 5207
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Re: REG-118067-17–Comments on the Proposed Regulations for the Implementation of the New Partnership Audit Regime Enacted as Part of the Bipartisan Budget Act of 2015

Dear Sir of Madam:

The Master Limited Partnership Association ("MLPA") is pleased to submit comments on the proposed regulations promulgated on February 2, 2018 (the "Proposed Regulations") relating to the implementation of section 1101 of the Bipartisan Budget Act of 2015, Pub. L. No. 114-74 (the "BBA Partnership Audit and Adjustment Provisions").[2]

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[2] Unless otherwise indicated, all "section", or "subchapter" references are to the Internal Revenue Code of 1986, as amended (the "Code"). All references to the "IRS" are to the Internal Revenue Service and references to "Treasury" are to the U.S. Department of the Treasury.

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The MLPA is the nation's only trade association representing MLPs.[3] For more than three decades, the association has represented the interests of MLPs in Washington, D.C. and the states. MLPs are an integral way our nation's private sector finances the infrastructure needed to fully utilize newly discovered domestic energy resources – leading to greater energy independence for the United States – and to ensure that a wide variety of energy products make their way efficiently and safely from the production fields to American homes, businesses and communities.

We appreciate the continued efforts of the IRS and Treasury to provide taxpayers with guidance on the implementation of the BBA Partnership Audit and Adjustment Provisions. Our comments on these most recent BBA Proposed Regulations are focused on the effect of an MLP's payment of an imputed underpayment on the fungibility of the MLP's publicly traded units. As discussed in greater detail below, the allocation of the partnership-level tax expense in cases where the imputed underpayment has been reduced by modifications permitted under section 6225(c) is likely to adversely affect the fungibility of an MLP's publicly-traded units, making it practically impossible for an MLP to pay the imputed underpayment if modified. Nevertheless, we believe that in some situations it will benefit both MLPs and the government to facilitate payment of the imputed underpayment (without reduction for the modifications permitted under section 6225(c)), e.g., if the imputed underpayment is *de minimis*. In order to facilitate the use of section 6225 in such situations, the successor rules would need to be modified to permit the expenditure related to payment of an imputed underpayment to be spread evenly among all outstanding publicly traded units. Finally, because the election under

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[3] As used herein, the term "MLP" refers to a publicly traded partnership as defined under section 7704.

section 6226 (the "push-out election") will be the only option practically available to MLPs in virtually all cases, it is critical that any additional guidance or final regulations with respect to the effect of the push-out election on partner and partnership tax attributes will not affect the fungibility of publicly traded units.

I. Fungibility Requirement

As discussed in detail in our letter of August 11, 2017, regarding the BBA proposed regulations promulgated on June 14, 2017 (REG-136118-15), transactions in publicly traded MLP units are facilitated by brokers or market makers, and a buyer of an MLP unit typically does not know the identity of the seller. Trading in this manner is possible only because publicly traded MLP units are "fungible," i.e., each publicly traded unit of an MLP has identical tax and economic characteristics in the hands of a buyer. Among other things, this fungibility requirement means that the section 704(b) capital account associated with each MLP unit must be economically equivalent to the section 704(b) capital account of all other units.

II. Discussion of Comments and Recommendations

A. Ability of MLPs to Pay Imputed Underpayment

1. Allocation of Partnership-Level Tax Expense Can Affect Fungibility of MLP Units

The imputed underpayment amount as determined under section 6225(b) and the regulations may be modified as provided in section 6225(c). An MLP could potentially avail itself of several of the modifications enumerated in section 6225(c) to reduce an

imputed underpayment, including adjustments for any previously suspended passive activity losses of the MLP allocated to individuals that are partners ("specified passive activity losses") as well as modifications to the tax rate used in determining the imputed underpayment based on the entity classification of the MLP's partners.

The requirement in Prop. Reg. § 1.704-1(f)(2) that the expenditure related to payment of an imputed underpayment be allocated to a reviewed-year partner or its successor in proportion to the notional item described in Prop. Reg. § 301.6225-4(b) "taking into account modifications under §301.6225-2 of this chapter attributable to that partner" will make it practically impossible for an MLP to pay an imputed underpayment that is modified under section 6225(c), because doing so would make the MLP's units non-fungible. As illustrated in Example 2 of Prop. Reg. § 301.6225-4(e), if a modification that reduces the imputed underpayment is based on a partner's tax attribute (e.g., tax-exempt status) the rule in Prop. Reg. § 1.704-1(f)(2) in effect requires a reduction to the amount of tax expense allocated to the partner(s) with the tax-reducing attribute. Thus, unless each partner has identical tax attributes (a practical impossibility in an MLP), the allocation of the expense relating to payment of an imputed underpayment modified under section 6225(c) will cause the partners to have different section 704(b) capital accounts. In an MLP, different section 704(b) capital accounts generally mean that the units are non-fungible.

This problem is illustrated by the following example. Suppose an MLP has three groups of partners: Group J, Group K, and Group L. Group J partners are individuals with

aggregate specified passive activity losses[4] of $100 attributable to the MLP that were previously suspended under section 469(k). Group K partners are individuals with no specified suspended passive activity losses. Group L partners are classified as C Corporations.

In 2021 (the adjustment year), the MLP's 2018 tax year is audited, and the IRS determines that the MLP understated its 2018 taxable income by $300 of ordinary operating income. Before any modifications under section 6225(c), the imputed underpayment would be $111.[5]

The MLP requests modification of the imputed underpayment pursuant to section 6225(c) to reflect that (1) one-third of the income adjustment would be allocable to Group J partners with sufficient specified passive activity losses to offset the adjustment, and (2) one-third of the income adjustment would be allocable to Group L

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[4] Specified passive activity losses for these purposes meet the requirements of such definition in section 6225(c)(5)(B).

[5] The understated ordinary income of $300, multiplied by highest marginal tax rate for 2018 of 37%, equals $111 of imputed underpayment.

partners that are classified as C Corporations with a 21 percent income tax rate.[6] After modification, the imputed underpayment would be reduced to $58.[7]

Pursuant to Prop. Reg. § 301.6225-4(b)(3)(ii), a "notional item of income or gain is created in an amount equal to the partnership adjustment." In general, the allocation of this notional item does not have substantial economic effect, but the allocation is "deemed to be in accordance with the partners' interests in the partnership if the notional item is allocated in the manner in which the corresponding actual item would have been allocated in the reviewed year."[8] In this case, the partnership adjustment of $300 would be allocated equally among the partners (i.e., $100 to each partner group).

If the partnership forgoes the push-out election of section 6226 and opts to pay the imputed underpayment, the $58 expenditure is considered a section 705(a)(2)(B) expenditure that would be allocated to the three groups of partners in proportion to the notional item to which the $58 expenditure relates, after taking into account the

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[6] The example does not address the possibility that there could be additional modifications to address the availability of the section 199A deduction for individuals.

[7] The $100 income adjustment allocable to Group J would be reduced to $0 after fully offsetting the income adjustment, while the applicable tax rate to apply to the $100 income adjustment allocable to Group L would be reduced to 21%. As such, the imputed underpayment would be calculated as follows:

> Group J: $0 x 37% = $0
> Group K: $100 x 37% = $37
> Group L: $100 x 21% = $21
> Modified Imputed Underpayment = $58

[8] Prop. Reg. § 1.704-1(b)(4)(xi).

modifications attributable to each partner.[9] Therefore, Group J partners are allocated $0 of the expenditure, since the partners' $100 share of the partnership adjustment would have been fully offset by specified suspended passive activity losses under section 6225(c)(5). Group K partners are allocated $37 of the expenditure, since no modification was made to the $100 adjustment allocable to the partners. Group L partners are allocated the remaining $21 of the expenditure, based on the reduced applicable tax rate of 21 percent applied to the $100 adjustment allocable to the Group L partners.

The net allocation of the notional item and the associated partnership expenditure (i.e., the total effect on section 704(b) capital) amounts to $100 for Group J partners, $63 for Group K partners, and $79 for Group L partners.[10] The MLP units held by each group of

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[9] *See* Prop. Reg. § 1.704-1(b)(2)(iii)(f).

[10] Group J partners are allocated $100 of income with respect to the notional item related to the partnership adjustment, but none of the partnership expenditure for the imputed underpayment due to the modification related to their specified passive activity losses. Group K partners are allocated a similar amount of income with respect to the notional item, but are allocated $37 of the partnership expenditure. While Group L partners are also allocated $100 of income with respect to the notional item, these partners are only allocated $21 of the partnership expenditure due to the tax rate modification applied with respect to their allocable share of the partnership adjustment.

partners are therefore no longer fungible due to the differing section 704(b) capital accounts associated with each following the net allocation.[11]

If the MLP instead did not seek any modifications under section 6225(c) to the imputed underpayment, each group of partners still would be allocated $100 of the partnership adjustment, but also would be allocated an equal share of the $111 imputed underpayment (i.e., $37 each). In this instance, the MLP's units would maintain fungibility accordingly, due to the proportionate sharing of allocations among the partners for purposes of section 704(b).

Since the cost to an MLP of forgoing any modifications generally will be a larger imputed underpayment, we expect that MLPs will instead make the push-out election under section 6226 in most cases.

2. Provide MLP Ability to Pay *De Minimis* Imputed Underpayments if not Modified under Section 6225(c)

Even in cases in which an imputed underpayment is not modified under section 6225(c), the successor rules of the Proposed Regulations, which generally require the expenditure for the imputed underpayment to be allocated to the persons who were partners in the reviewed year or their successors if such persons are no longer

[11] While it might be possible to make the units fungible by forcing the allocation of other items, such allocations could distort the economic arrangement of the partners, would be very difficult to administer, and only would be made as a last resort.

partners,[12] still can cause the expenditure for the imputed underpayment to be allocated disproportionately among an MLP's partners. For example, if an MLP issued new equity in a year between a reviewed year and the adjustment year (an "intervening year"), the successor rule would prevent any expenditure for an imputed underpayment from being allocated to any partner (or successor) that acquired equity in the issuance during the intervening year. Because the expenditure for the imputed underpayment would not be spread evenly among the outstanding units, the units would cease to be fungible.

Particularly in the case of *de minimis* imputed underpayments (not modified under section 6225(c)), payment of the tax by the MLP may benefit both the IRS and the MLP. The MLP would be relieved of the administrative burden associated with facilitating the push-out, and the IRS's collection of the tax due (without reduction under section 6225(c)) would be streamlined. In order to allow MLPs to pay such *de minimis* imputed underpayments, regulations should permit MLPs to allocate the expenditure for an imputed underpayment not modified under section 6225(c) evenly among all adjustment year partners, regardless of whether such partners were reviewed-year partners or are successors to reviewed year partners. MLPs would only avail themselves of such a rule for *de minimis* amounts of tax, i.e., cases where the administrative cost of the push-out is relatively high compared to the tax due. Thus, there is no need to set an actual *de minimis* amount.

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[12] *See* Prop. Reg. § 1.704-1(f)(2).

B. Administration of the Push-out Election

1. Availability of Push-out Election to MLPs as Critical Option

The Proposed Regulations provide that reviewed-year partners (or affected year partners, in the case of tiered partnership structures) must take into account all items in the reporting year with respect to their share of a partnership adjustment as contained on a section 6226 statement. Partnerships adjust tax attributes affected by reason of pushed-out items in the adjustment year, but these adjustments are calculated with respect to each year beginning with the reviewed year and for each subsequent intervening year through the adjustment year.[13] Prop. Reg. § 301.6226-4(c) provides an example illustrating the mechanics of these adjustments.

With the clarification provided by the Consolidated Appropriations Act of 2018 for push-out elections with respect to tiered partnerships, we expect that the push-out election is now available to MLPs in all cases. While we do not anticipate that attribute adjustments in connection with a push-out election will cause fungibility issues for MLPs, there is only one example in the Proposed Regulations to detail how tax attributes would be adjusted in the case of a push-out election. We would welcome additional examples and the opportunity to comment.

Finally, because fungibility issues will make it practically impossible for an MLP to pay an imputed underpayment, the availability of the push-out election is critical to any

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[13] *See* Prop. Reg. § 301.6226-4(b).

MLP in the event of an adjustment. Please consider the comments in our letter of August 11, 2017, focused on ensuring that requirements for the push-out election are drafted in a manner that makes the push-out election a practical option for MLPs, in this light.

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We look forward to continuing to work together to help create a set of rules that works for all parties.

If you have any questions please do not hesitate to contact Robert Baldwin or Michael Hauswirth.

Sincerely,

Master Limited Partnership Association