MLP Developments and Taxation Issues

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Building a better working world

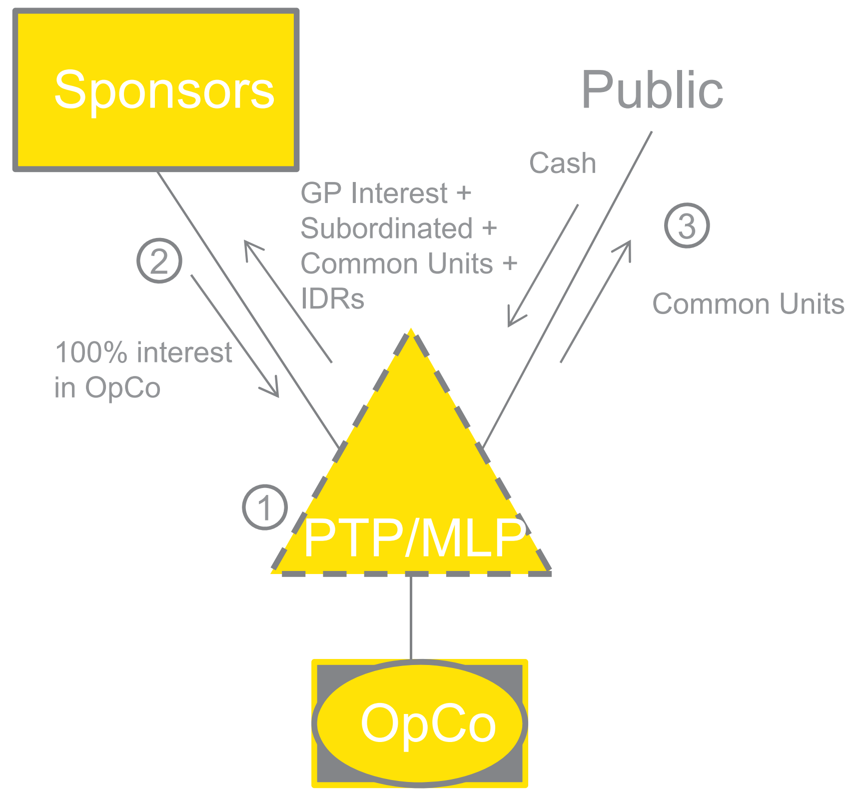
What is an MLP?
Typical classes of interests

- Common units
  - Publicly traded
  - Senior to other classes of units
- Subordinated units
  - Issued to sponsor in exchange for property contributions and to financial investors in some private placements
  - Subordinated right to distributions for period of years
  - Convertible into common units over time as performance measures are achieved
- General partner interests
  - 1 or 2 percent sharing ratio; sometimes 0% “non-economic”
  - Generally *pari passu* with common units
- Incentive distribution rights
  - Issued to sponsor
  - Share in up to 50% of partnership profits and distributions
  - Resets and other strategies

MLPs

Representative Formation Transaction Steps

- Step 1: Sponsors form a new master limited partnership (MLP) / PTP
- Step 2: Sponsors transfer entire interest in OpCo to MLP in exchange for a general partner interest ("GP Interest"), subordinated limited partner interests ("Subordinated Units"), limited partner units ("Common Units"), and Incentive Distribution Rights ("IDRs") in MLP
- Step 3: MLP issues Common Units to the Public in an initial public offering



Why use an MLP?
Sponsor's economic perspective

- Tax-efficient access to capital for publicly traded corporate sponsor
  - New source of capital for growing business
  - Preferred stock equivalent
  - Gain-deferral opportunities
- Unlock value of selected assets
- Incentive distribution rights
- Costs of formation and operations
  - Financial reporting and SEC compliance
  - Investor tax reporting
  - Governance

Why use an MLP?
Investor's economic perspective

- Typical investor profile
  - Attractive to individuals
  - Barriers for tax-exempt and foreign entities
- Income stream
  - MLP yield compares favorably to alternative investments
- Tax shield
- Growth potential
  - Particularly publicly traded general partner/IDR interests
- "Quarantined" passive income and losses
- Administrative Complexities (and related costs)
  - K-1 vs. 1099
  - State tax compliance

Qualification as an MLP

- 90% or more of gross income from qualifying sources
- Qualifying income includes:
  - Interest
  - Dividends
  - Real property rents and gains
  - Capital gains
  - Certain income from the exploration, development, extraction, processing, refining, marketing or transportation of certain minerals and natural resources

MLP Current Tax Developments

- Proposed Regulations on Qualifying Income
- Partnership IRS Examination Rules
- Disguised sale and liability allocation changes

MLP Current Tax Developments

Proposed Regulations on Qualifying Income

- Proposed regulations provide guidance on publicly traded partnerships' activities regarding minerals or natural resources
- Qualifying income includes income generated from exclusive list of "section 7704(d)(1)(E) activities," which represent different stages between extraction and delivery to market, and "intrinsic activities"
- List of activities may be expanded
- Guidance on transportation and storage of fuel under Section 6426 and biodiesel fuel under Section 40A is not provided
- Query extent to which PLRs will be granted in this area once regulations are finalized

MLP Current Tax Developments
Partnership IRS Examination Rules

- New partnership rules and procedures enacted by the Bipartisan Budget Act of 2015 ("Budget Act")
- Budget Act partnership rules affect
  - Who pays tax
  - How much tax is paid
  - Procedures
- Many questions are unanswered
- Further guidance needs to be issued in order for the system to function
- Applies to partnership tax years beginning after December 31, 2017

MLP Current Tax Developments

Proposed Regulations on Qualifying Income

- The IRS has issued final (TD 9787), final and temporary (TD 9788), and proposed (REG-122855-15) regulations relating to disguised sales of property to or by a partnership under Section 707 and to the treatment of partnership liabilities under Section 752.
- In a major change to the 2014 Proposed Regulations, the temporary and proposed Section 707 regulations modify the manner in which liabilities are allocated among partners for purposes of the Section 707 disguised sale regulations. Solely for purposes of the disguised sale rules, to the extent liabilities are not allocated to another partner as recourse liabilities under the Section 752 regulations, the liabilities are allocated to a partner only in proportion to that partner's share of partnership profits under Reg. Sec. 1.752-3(a)(3). This rule applies regardless of whether the partnership liability is a recourse or nonrecourse liability.

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