Master Limited Partnerships (MLPs)
Brief Sheet
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The Essentials

- A Master Limited Partnership (MLP) is a business structure that is taxed as a partnership but has the ability to issue stock ownership interests much like a corporation.
- Federal legislation has boosted market capitalization investments in MLPs from $2 billion in 1994 to ~$480 billion in 2013.
- The MLP Parity Act (introduced to the House and Senate on April 24, 2013) proposes to expand MLP eligibility to the renewable energy.

What is a Master Limited Partnership[1]? A Master Limited Partnership (MLP) is a business structure that is taxed as a partnership, but may issue stock ownership interests like a corporation. Eligible participants in an MLP can benefit from easy access to capital without being subject to the "double taxation", or having earnings taxed first as corporate annual income earnings and once more as dividend income for investors, as is imposed on corporations. The types of industries that typically utilize MLPs include gas and oil pipeline operators and oil product shipment and transportation, exploration and production.

Currently, the Internal Revenue Service (IRS) requires that corporations wishing to restructure as a MLP must meet certain requirements. The corporation must have existed on or before December 17, 1987, and that 90% of gross income is derived passively from dividends, interest, rents, capital gains, and natural resources.[2] If either of these conditions are not met, then corporations are given a 10-year grace period to reorganize in order to qualify.[3] After this period of time, an alternative option[4] to pay a 3.5% tax on its gross income is available to corporations that remain unqualified. When income generated through MLPs became a qualified source of income for mutual funds in 2004, a significant barrier to investments from mutual funds was lifted.[5]

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[1] In 1986, FERC had originally allowed utilities participating in partnerships to include the costs of taxes, which they were not required to pay, into the rate base.
[2] Recently, the definition of qualifying income was expanded to include income from the transportation and storage of ethanol and biodiesel, and activities involving industrial source carbon dioxide through the Emergency Economic Stability Act of 2008 (P.L. 110-343)
[3] IRC § 7704
[4] Granted by the Taxpayer Relief Act of 1997 (P.L. 105-34)
[5] American Jobs Creation Act of 2004 (P.L. 108-357) Expanded capital pool for MLPs by allowing mutual funds to consider MLP distributions as qualified income, avoiding the Unrelated Business Income Taxation (UBIT) issue. For more information on UBIT, see Internal Revenue Service, *Tax on Unrelated Business*

Under the Internal Revenue Code § 7704(b), a partnership is defined as an MLP if: 1) "interests in such partnership are traded on an established securities market," or (2) "interests in such partnership are readily tradable on a secondary market (or the substantial equivalent thereof)." An MLP is typically composed of thousands of investing partners with at least one general managing partner[6] who manages the partnership for maximum returns in exchange for a percentage of the income (known as an incentive distribution right, or IDR).

Given the favorable tax benefits and easy access to capital, investments in MLPs have increased dramatically from $2 billion in 1994 to $241 billion in 2012,[7] and cited to currently be as high as $445 billion.[8] Of the capital currently in the market, approximately 89 percent ($400 billion) has gone into qualifying energy and natural resources. Of that, almost 80 percent has gone into midstream oil and gas pipeline projects, such as Kinder Morgan Energy Partners, L.P. projects.[9]

What is the MLP Parity Act? On April 24, 2013, the U.S. Senate[10] and the U.S. House of Representatives[11] both introduced similar bills promoting the MLP Parity Act, a bipartisan bill that would give renewable energy projects access to billions of dollars of lower cost capital that has been available to the fossil fuel industry for decades.

The Senate and House bills would expand the definition of MLPs to include several renewable energy technologies such as wind, solar, biomass, marine, hydropower, and biodiesel.[12] Additionally, it would include building energy efficiency measures, as well as several technologies that could use either renewable

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Income of Exempt Organizations, March 2010, p. 8, http://www.irs.gov/pub/irs-pdf/p598.pdf.

[6] For more information on the differences in partnerships, see CRS Report R40748, *Business Organizational Choices: Taxation and Responses to Legislative Changes*, by Mark P. Keightley.

[7] Bloomberg New Energy Finance (BNEF)

[8] Morgan Stanley Research. April 17, 2013. Midstream Energy MLPs Primer. Retrieved from http://www.morganstanleyfa.com/public/projectfiles/4735a09e-c35d-4545-a059-8873c8d057f0.pdf.

[9] Id.

[10] S. 795: Sponsored and written by Senators Coons (D-DE); Co-sponsors and additional information can be found at: http://www.govtrack.us/congress/bills/113/s795

[11] H.R. 1696: Sponsored and written by Rep. Ted Poe [R-TX2]; Co-sponsors and additional information can be found at: http://www.govtrack.us/congress/bills/113/hr1696

[12] Includes all technologies stated within sections 45 and 48 of the tax code

or fossil fuels such as fuel cells, combined heat and power (CHP), carbon capture and storage (CCS), and electricity storage.

The "Passive Income" challenge

If renewables are allowed to qualify for MLPs, then individual investors may face difficulty continuing to also use tax equity in their renewable energy investments due to the current 'passive losses' rule. This rule stipulates that losses from an MLP can only be used to offset 'passive income' (not active income like salaries and gains from stocks and bonds). To investors without passive income, the tax equity benefits decrease in value due to the inability to offset taxes from other sources of income with losses from investments in an MLP. Allowing renewable projects to gain MLP status, and restructuring passive loss rules may attract potential investors and help to lower financing costs due to decreased risk, as well as reduce reliance on tax incentives with uncertain futures.

The latest During the 113th Congress, IRC § 7704 has been amended by the U.S. Senate[13] and the U.S. House of Representatives[14] to extend the publicly traded partnership ownership structure to energy power generation projects and transportation fuels, and for other purposes. There is currently a debate as to how expansion of the definition of "qualified" to include renewable energy resources may affect the industry. Kristopher Settle of *The Energy Collective* highlights how the expansion of available capital will act as a boon for the renewable energy sector,[15] while Michael Lewis of the *Industry Market Trends Green & Clean journal* notes that there are objections to whether or not the renewable energy industry even deserves more tax breaks.[16] Considerably prohibitive tax complexities may alienate average investors from considering MLPs as investment options, possibly creating an imbalance within the solar energy sector where distributed generation gives way to the larger utility-scale operations that can better take advantage of the lucrative tax benefits.

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[13] S.795.IS. Retrieved from: *<http://thomas.loc.gov/cgi-bin/query/D?c113:1:./temp/~c113qhltFS::>*

[14] H.R.1696.IH. Retrieved from: *<http://thomas.loc.gov/cgi-bin/query/D?c113:2:./temp/~c113qhltFS::>*

[15] For full article, see: http://theenergycollective.com/ecskris/221411/mlp-parity-act-would-drastically-benefit-renewables-industry

[16] For full article, see: http://theenergycollective.com/ecskris/221411/mlp-parity-act-would-drastically-benefit-renewables-industry