

## Effect of the Senate Finance Committee's Pass-Through Provision on MLPs

The Senate Finance Committee's "Tax Cuts and Jobs Act" ("the Bill") breaks from the policy positions of the Unified Framework. Rather than reducing the corporate rate to 20% and the rate individuals receive from pass-through business income to 25%, the Bill reduces the corporate rate to 20% permanently and, on a temporary basis, generally provides a 17.4% deduction with a limitation based on 50% on the partnership's W-2 income - essentially resulting in a 31.8% rate at best.

The Bill's current pass-through provision could have serious consequences on the ability of MLPs to raise low cost capital through the public markets for, among other things, the development of critical energy infrastructure. The pass-through tax rate differential under current law for MLPs, relative to corporations, reduces their cost of capital. This drives investment in energy infrastructure that Congress has long held to be economically and strategically important. The Bill would make it more expensive for MLPs to raise capital, risking reduced investment in domestic energy infrastructure. Reduced investment will compromise energy security and force consumers to pay higher prices, which ultimately could undermine the economic growth Congress seeks to stimulate with this Bill.

**Q: Doesn't the Modified Chairman's Mark, which removes the W-2 wage limitation for unitholders earning less than \$500,000 (married filing jointly), provide the advantage of lower rates to MLPs?**

**A:** Approximately two-thirds of MLPs have no employees and no W-2 wages. Many others have very few employees. While some unitholders in these MLPs might benefit from the 17.4-percent deduction for domestic qualified business income under the Bill, MLP units trade publicly, and their prices will be determined by market demand. Potential buyers of MLP units above the income threshold at which the W-2 wage limitation is turned off (\$500,000 married filing jointly) will face lower after-tax returns, driving down unit prices and driving up MLPs' cost of capital.

**Q: Why can't MLPs simply incorporate?**

**A:** Incorporation may trigger an immediate tax liability for the MLPs investors. A large portion of these investors are retirees or people nearing retirement who invested in MLPs, individually or through mutual funds to provide steady retirement income. In 2016, there were approximately 2 million individual investors in MLPs.

A transferor of an asset into a corporation has immediate gain to the extent liabilities associated with the asset exceed the transferor's basis in the asset. Debt of a partnership is allocated to its partners for this calculation. Many long-held interests in pass-through entities have a low or zero basis, so they will generally recognize taxable gain in the incorporation, without receiving any cash proceeds. In addition, some incorporation structures (like sponsor roll-ups of MLPs) are fully taxable transactions. Such transactions upset financial plans of investors and undermine faith in an industry that has already been hard hit by slumping oil prices.

Moreover, MLP unit holders may have no desire to hold corporate stock. MLPs are attractive to yield-oriented investors. MLPs traditionally distribute to owners a higher percentage of their cash from operations than C corporations. Existing MLP owners have purchased units based on that expectation. Consequently, such MLP owners may be inclined to sell any corporate stock they receive in a conversion transaction, which could depress prices.

Further, a policy that forces partnerships to incorporate is completely contrary to the Chairman's desire to move away from the current corporate double tax which produces economic distortions.

**Q: What's the solution?**

**A:** We believe the provision should be modified in a manner that allows MLPs to benefit from the permanent lower pass-through rate proposed in the House bill. At a minimum, all MLP unit holders should be fully exempted from the W-2 wage limitation, putting MLP distributions on par with distributions from REITs. While doing so would not provide a permanent solution, it would avoid causing immediate and irreversible damage to an entire industry, driving up consumer energy prices, and eliminating jobs.