



Tracking Tax Reform: The House and Senate Conference Committee's Conference Report on the Tax Cuts and Jobs Act and MLPs

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December 19, 2017

On December 15, the House and Senate Conference Committee released the conference report on the Tax Cuts and Jobs Act (the "Conference Committee Report" or "Report"), containing the specific details on the tax plan they hope to pass. The Report comes after weeks of negotiations to reconcile the differences between the Senate Bill and the House Bill. A vote on the Conference Committee's bill in the House and Senate is likely to occur prior to Christmas. If signed into law, the Tax Cuts and Jobs Act would become effective as of January 1, 2018.

Below are a summary of certain proposals in the Report which may significantly impact MLPs.

Preservation of IRC Section 7704(c).

The Report does not repeal IRC Section 7704(c), which provides an exception from the general rule that a publicly traded partnership ("PTP") is classified as a corporation for U.S. federal income tax purposes. IRC Section 7704(c) provides that a PTP is not classified as a corporation if 90% or more of the PTP's gross income consists of "qualifying income."

Lower Tax Rate for Business Income from Pass-Through Entities.

Because MLPs are pass-through entities, MLP income is passed directly through to investors, where it is currently taxed at individual tax rates, the highest of which is 39.6%. The Report provides that taxpayers will determine their "qualified business income" and then subtract 20% of that amount from their taxable income, thus in effect reducing their tax rate. The deduction is specifically allowed for qualified publicly traded partnership income. The deduction is usually limited to the greater of (a) 50% of the W-2 wages paid with respect to the qualified trade or business, or (b) the sum of 25% of the W-2 wages with respect to the qualified trade or business plus 2.5% of the unadjusted basis, immediately after acquisition, of all qualified property; however, this deduction limitation does not apply to income earned through publicly traded partnerships. MLP unit holders will be eligible to receive the full 20% deduction off of their individual rates. The rate reduction with respect to business income derived by MLPs may make MLPs a more attractive investment for a number of investors.

Corporate Tax Rate.

The Report sets a permanent corporate tax rate of 21%, reduced from the current 35%, that will apply for tax years beginning after December 31, 2017. This could potentially make MLPs less appealing to investors due to the lower corporate tax rate. However, taxable income derived from the operations of an MLP would continue to be subject to one layer of taxation, as opposed to the additional 21% tax that would continue to apply on corporate profits.

Partnership Technical Terminations.

Under current law, a partnership has a "technical termination" if there is a sale or exchange of 50% or more of the total interests of the partnership within a 12-month period. When a technical termination occurs, the business of the partnership continues in the same legal form; however the partnership is treated as newly formed and must make new elections for accounting methods, depreciation

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lives, etc. The Report repeals this rule after 2017. A partnership would be treated as continuing even if more than 50% of the interests of the partnership are sold or exchanged, thus new elections would not be required or permitted. Since MLP units are traded, MLPs run the risk that a technical termination may occur outside of their control. A repeal of the technical termination rule would benefit MLPs by alleviating this risk and would allow more flexibility for MLPs when undertaking various restructurings or reorganizations.

Limitation of Interest Deduction.

Under current law, business interest is generally allowed as a deduction in the year in which the interest is paid or accrued. The Report caps interest deductions at 30% of a company's "adjusted taxable income" which is taxable income without regard to interest expense, interest income, NOLs, depreciation, amortization and depletion. The net interest expense disallowance would be determined at the partnership rather than the partner level.

Changes to Depreciation Deductions.

The Report allows taxpayers to fully and immediately expense 100% of the cost of qualified property acquired and placed in service after September 27, 2017 and before January 1, 2023. Qualified property includes tangible personal property with a recovery period of 20 years or less under the modified accelerated cost recovery system ("MACRS"), certain off-the-shelf computer software, water utility property, and qualified improvement property, but specifically excludes certain public utility property. The Report expands the definition of qualified property from its definition under current law by repealing the requirement that the original use of the property begin with the taxpayer; instead, property is qualified if it is the taxpayer's first use. For qualified property acquired and placed in service after January 1, 2023, the expensing percentage drops 20% per year until 2027.

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