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Master Limited Partnerships and Renewable Energy Producers

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Lawmakers have introduced legislation that would allow renewable energy producers to form Master Limited Partnerships (MLPs). MLPs are taxed as limited partnerships but publicly traded on the stock market. In the energy sector, the ability to form MLPs is available for mineral extraction, natural gas, oil, pipelines, geothermal, and the transportation and storage of ethanol, biodiesel, and other alternative fuels. Other renewable energy generation and commercial nuclear activities do not qualify.

Congress should allow all energy project investors to form MLPs, but it should also remove economically unjustified tax credits for both conventional and renewable energy sources and technologies while lowering the corporate tax rate to encourage investment. Congress can further spur investment by allowing all companies the ability to expense their full capital costs immediately.

What Are MLPs? Under an MLP, businesses have the tax structure of a partnership or a limited liability company, but ownership equity trades publicly on a securities exchange. The partnership structure allows the business's owners to pay its tax on their individual tax returns while providing the flexibility and opportunity to raise capital from smaller investors directly from the stock market.

Apache Oil Company formed the first MLP in 1981, and the idea quickly spread to other industries including restaurants, hotels, and even a team in the National Basketball Association.[1] Six years later, Congress limited publicly traded partnerships (including MLPs) to partnerships in which 90 percent or more of their income comes from qualified sources, such as energy-related activities. Included in those qualifying sources are "income and gains derived from the exploration, development, mining or production, processing, refining, transportation (including pipelines transporting gas, oil, or products thereof), or the marketing of any mineral or natural resource (including fertilizer, geothermal energy, and timber)."[2] Congress added industrial source carbon dioxide, biofuels, and other alternative fuels with the Emergency Economic Stabilization Act of 2008.

About 81 percent of MLPs today are in the energy and natural resources industry, with investment and financial services making up most of the rest.[3] Most of the energy MLPs constructed today are related to oil and gas activities; 52 percent of MLPs are in midstream and downstream activities,[4] and 14 percent are in oil and gas exploration and production.[5] Coal leasing and production comprises only 4 percent.[6]

MLPs Only a Part of Complicated Energy Tax Code. There is already too much congressional favoritism for preferred activities in the tax code, and numerous targeted tax credits for all energy sources exist beyond MLPs. In fact, the tax code has been an increasingly popular method for the federal

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government to favor one industry over another as the number of targeted tax credits more than tripled from 1999 to 2007.[7]

Economically destructive tax credits remove the incentive for producers to innovate and lower costs to be competitive with other generating sources, and they incentivize companies to lobby to receive and extend these targeted tax credits. If a technology is profitable, however, the investments will occur with or without the tax credit. Thus, the tax credit is either artificially propping up uncompetitive companies or handing taxpayer dollars to companies that do not need them. Either way, it is bad policy.

Market-distorting tax credits actually hurt the long-term economic viability of industries that are dependent on the preferential treatment. Patrick Jenevein, CEO of the clean energy firm Tang Energy Group, affirmed in *The Wall Street Journal* the problems with his own industry's dependence on subsidies:

> Government subsidies to new wind farms have only made the industry less focused on reducing costs. In turn, the industry produces a product that isn't as efficient or cheap as it might be if we focused less on working the political system and more on research and development.[8]

Expensing Capital Costs. For exploration and production, companies have the ability to expense capital costs in the year of purchase. Immediate expensing allows companies to deduct the cost of capital purchases at the time they occur rather than deducting that cost over many years based on cumbersome depreciation schedules.

Expensing is the proper treatment of capital expenditures for any business. Depreciation raises the cost of capital, which causes businesses to purchase less. Less capital means businesses create fewer jobs and are not able to increase wages as much as they otherwise would have for existing employees.

What Congress Should Do. The entire U.S. tax system needs fundamental reform that moves aggressively toward a system like the New Flat Tax.[9] Such a tax system would eliminate existing problems that arise from the bad habit of using the tax code to pick winners and losers in the energy marketplace. Absent that fundamental change, Congress should:

- **Allow all energy projects to form MLPs.** The combination of the partnership tax status and the liquidity of a publicly traded company make MLPs an attractive investment opportunity.

- **Remove targeted tax credits for all energy sources and broadly lower the tax rate.** Doing this would allow for a more market-based energy economy that benefits economically viable producers and, ultimately, consumers with reliable, affordable energy.[10]

- **Make immediate expensing permanently available for all business investments.** Immediate expensing for all new plant and equipment costs—for any industry or type of equipment—would allow newer equipment to come

1. National Association of Publicly Traded Partnerships, "Master Limited Partnerships 101: Understanding MLPs," March 1, 2013, http://www.naptp.org/documentlinks/Investor_Relations/MLP_101.pdf (accessed April 18, 2013).
2. 26 U.S. Code § 7704.
3. National Association of Publicly Traded Partnerships, "Master Limited Partnerships 101: Understanding MLPs."
4. Midstream and downstream activities including processing, compression, transportation, storage, refining, distribution, and marketing.
5. National Association of Publicly Traded Partnerships, "Master Limited Partnerships 101."
6. Ibid.
7. Molly Sherlock, "Energy Tax Policy: Historical Perspectives on and Current Status of Energy Tax Expenditures," Congressional Research Service *Report for Congress*, May 2, 2011.
8. Patrick Jenevein, "Wind-Power Subsidies? No Thanks," *The Wall Street Journal*, April 1, 2013, http://online.wsj.com/article/SB10001424127887323501004578386501479255158.html?mod=WSJ_Opinion_LEADTop%20 (accessed April 12, 2013).
9. J. D. Foster, "The New Flat Tax—Easy as One, Two, Three," Heritage Foundation *Backgrounder* No. 2631, December 12, 2011, http://www.heritage.org/research/reports/2011/12/the-new-flat-tax-easy-as-one-two-three.
10. See Nicolas D. Loris, "EFEPA Eliminates Corporate Welfare and Corporate Dependence," Heritage Foundation *Issue Brief* No. 3828, January 15, 2013, http://www.heritage.org/research/reports/2013/01/energy-tax-credits-impact-of-energy-freedom-and-economic-prosperity.

online faster, which would improve energy efficiency and overall economic efficiency.

Remove All Market Distortions. All energy projects, including renewable and nuclear, should be able to form MLPs, but that is only one step to bring parity to the energy tax code. Congress should also remove economically unsound tax credits and lower the corporate tax rate permanently. Further, Congress should extend immediate expensing to all businesses to remove a sizeable impediment in the way of new investment.

Although many distortions exist in the energy marketplace that need removal, these three policy changes would go a long way to empower producers and consumers to determine America's energy future.

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