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Publicly Traded Partnerships

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Introduction – Master Limited Partnerships/Publicly Traded Partnerships

- No precise, official definition of the term, “master limited partnership” exists. Usually applied to units registered with the SEC and freely traded on an established marked.
- Internal Revenue Code Section (“IRC”) 7704 was adopted in order to prevent most publicly traded entities from adopting an entity form that allows for “pass-through” income tax treatment.

General Rule

- A publicly traded partnership (“PTP”) is classified as a corporation for U.S. federal income tax purposes.
- A PTP is any partnership the interests in which are either (1) traded on an established securities market or (2) readily tradable on a secondary market or the substantial equivalent of a secondary market, with the participation of the partnership.

Determining Publicly Traded Status

Partnership interests (and not merely debt interests) are traded.

- Includes interests in capital or profits.
- Includes a financial instrument the value of which is determined by reference to the partnership.
- Does not include non-convertible debt treated as debt for federal income tax purposes.

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Determining Publicly Traded Status

Established securities markets include:

- (i) a national securities exchange registered under Section 6 of the 1934 Act;
- (ii) a national securities exchange exempt from registration under Section 6 of the 1934 Act;
- (iii) a foreign exchange analogous to (i) or (ii) above
- (iv) a regional or local exchange; and
- (v) an interdealer quotation system.

Determining Publicly Traded Status

- A partnership interest is readily tradable on a secondary market if, taking into account all of the facts and circumstances, the partners are readily able to buy, sell, or exchange their partnership interests in a manner that is comparable, economically, to trading on an established securities market.
- Occurs if (i) interests are regularly quoted, (ii) any person regularly makes public bids, (iii) the holder of an interest has a regular opportunity to sell or (iv) buyers have a regular opportunity to buy.

Determining Publicly Traded Status

Transfers which are disregarded in determining publicly traded status include gifts, bequests, transfers between family members, issuance of interests by the partnership, distributions from a qualified plan or IRA, redemptions or repurchases under an agreement.

Determining Publicly Traded Status – Private Placement Safe Harbor

The interests in a partnership are not publicly traded if:

- All interests were issued in a transaction exempt from registration under the 1933 Act; and
- The partnership has < 100 partners during the taxable year of the partnership.

Determining Publicly Traded Status – Private Placement Safe Harbor

Interests are not treated as readily tradable on a secondary market or the substantial equivalent thereof if the sum of the percentage interests in partnership capital or profits transferred during the partnership's taxable year (other than private transfers, qualifying redemptions, and transfers through a qualified matching service) do not exceed 2% of the total interests in capital or profits.

Limited Exception for Publicly Traded Partnerships With “Qualifying Income”

- If 90% or more of a PTP’s gross income is “qualifying income,” it is not treated as a corporation under IRC 7704.
- PTP must meet the 90-percent test for its first taxable year after 1987 in which it is a PTP and every year thereafter.
- PTPs registered under the 1940 Act generally do not qualify for the passive income exception, and thus are treated as corporations.

Qualifying Income Which Allows PTPs to Have Pass-Through Treatment

- Interest, dividends, rent from real property.
- Gain from the sale of property.
- Income and gains from “natural resources.”

What are "Natural Resources?"

- 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, industrial source carbon dioxide, or the transportation or storage of any fuel, any alcohol fuel or any biodiesel fuel.

Grandfather Rule

- IRC 7704 does not apply to an "electing 1987 partnership."
- Generally, a publicly traded partnership that was grandfathered in 1987, subject to a sunset that was supposed to occur at the end of 1997. These entities can elect to retain partnership tax treatment permanently if they pay a 3.5% excise tax on their gross income from the active conduct of trades and businesses.

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Useful References

- BNA Bloomberg, *Publicly Traded Partnerships*, Portfolio 723-1st
- Riley, Nathan, *Discover Master Limited Partnerships*, http://www.investopedia.com/articles/basics/07/ml_partnerships.asp

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Further information

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