

PLI on MLPs

By Milan N. Ball • Wood LLP

If you mention IDRs to a tax lawyer, he or she is likely to think of information document requests, something the IRS issues liberally in

tax audits. But that could change, as a recent PLI course made clear to me. I attended the MLP portion of the PLI seminar *Tax Planning*

for *Domestic & Foreign Partnerships, LLCs, Joint Ventures & Other Strategic Alliances 2015*.

MLPs, or Master Limited Partnerships, are attractive because they avoid double taxation, have limited partnership units that are publically traded and tend to provide investors with consistent distributions over time, similar to bonds. These benefits provide MLPs with greater liquidity and a lower cost of capital. As a consequence, MLPs are able to engage in projects and acquisitions that are not feasible to similarly situated public corporations.

However, these benefits can be greatly reduced by incentive distribution rights ("IDRs"). IDRs are essentially a form of carried interest. They encourage the MLP's general partner to increase the MLP's cash flow and yield by tying general partner compensation to the MLP's cash distributions. IDRs provide the general partner with an increasing share of cash distributions that

correspond with the general partner meeting certain targets.

How big can this share of cash be? A general partner's share of the MLP's cash distributions can vary from two percent to 50 percent. Nevertheless, as the general partner's share of cash distributions approaches 50 percent, IDRs may eliminate the benefits an MLP was intended to create. Where IDR distributions are mandatory, the MLP's cash available for projects and acquisitions is reduced.

The result is a change in capital cost, with the MLP's cost of capital increasing. In addition, where the general partner is a corporation, a substantial portion of the MLP's income will be subject to double taxation. This situation can cause a corporate general partner to abandon its MLP structure and return to a corporate structure. Sound familiar, Kinder Morgan?

PLI's *Tax Planning for Domestic & Foreign Partnerships, LLCs, Joint Ventures & Other Strategic Alliances 2015* is available at www.PLI.edu.

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