Mastering Reporting of Publicly-Traded Partnership and MLP K-1s on Partners' Returns
Navigating Footnotes and Tying Information to the 1040

TUESDAY, JANUARY 19, 2016, 1:00-2:50 pm Eastern

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Mastering Reporting of Publicly-Traded Partnership and MLP K-1s on Partners' Returns

January 19, 2016

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Investing in Publicly Traded Partnerships
January 19, 2016

Shobana Gopal

Nothing contained on this communication constitutes tax, legal, or investment advice. Investors must consult their tax advisor or legal counsel for advice and information concerning their particular situation.
WHAT ARE PTPs

- Brief overview of PTPs (MLPs)
- Section 7704 carve out
- Qualifying income
- Attractive sector
  - Quarterly cash distributions
  - Little or no taxable income on K-1s
    - ‘return of capital’
  - Cash flow vs taxable income of PTPs
- K-1s – similar to any other partnership investment
  - Review of sample K-1
Relevance of IRC §7704 to PTPs

• §7704(b): A PTP is a partnership in which the interests of the partnership are traded or readily tradable on an established securities market

• 7704(a): Provides the general rule that a PTP is taxed as a corporation

• §7704(c): Provides an exception to the “taxed as corporation” rule for PTPs that have more than 90% of the partnership’s gross income coming from “qualified income
Master Limited Partnerships (MLPs)

• MLPs are a class of PTPs that trade on either a public securities exchange or other over-the-counter market
• MLPs derive over 90% of their gross income from “qualifying sources” as defined in § 7704 (c) and thus are treated for tax purposes as partnerships
• While all MLPs are PTPs, not all PTPs are MLPs
Investors who own MLP interests are referred to as “unitholders.”

Unit holders are taxed on their share of the partnership’s taxable income, whether or not they receive any distributions (similar to any pass through entity).

Distributions from MLPs are not separately taxable to the unitholder.

Distributions in excess of the MLP’s taxable income is treated as ‘return of capital’, which lowers the unitholder’s adjusted basis in the partnership interest.
SAMPLE K-1

- Cover letter
  - Stock splits
  - Date to be corrected
- Schedule K-1
  - Income/Loss; deductions
  - Distributions
- Supplemental K-1 info
- Ownership schedule
- Sales schedule
- State schedule

Please open sample K-1 from Energy Transfer Equity LP (ETE)
Sample K-1 - details

• Income
  • Ordinary income (loss)
  • Rental income (loss)
  • Interest & Dividend income
  • Short term and Long term gains (losses)
  • 1231 gains (losses)

• Deductions
  • Charitable contributions
  • Investment interest

• AMT items

• Distributions

• Supplemental info
Sample K-1 - details

- Passive Activity Income (Loss)
  - Income is taxable in current year
  - Loss is suspended and offset against passive income from the same PTP
  - No loss offset
  - Aggregation of losses from the same PTP

Passive Activity Loss - aggregation example

<table>
<thead>
<tr>
<th>Example 1</th>
<th>Passive loss - line 1, 3</th>
<th>ETE-RGP</th>
<th>RGP</th>
<th>Aggregate loss carryover</th>
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<tr>
<td></td>
<td></td>
<td>(5,134)</td>
<td>(2,500)</td>
<td>(7,634)</td>
</tr>
<tr>
<td>Example 2</td>
<td>Passive loss - line 1, 3</td>
<td>(5,134)</td>
<td>2,500</td>
<td>(2,634)</td>
</tr>
</tbody>
</table>
Sample K-1 - details

- Ownership schedule
  - Verify transactions against custody statements
  - Make corrections by deadline noted
- Sales schedule
  - Breakdown between ordinary gain and capital gain (loss)
  - Basis tracking
- State schedule
  - Breakdown of income (loss) by state
Reporting MLP/PTP K-1s on Partner/Unitholder’s Return

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Rea & Associates, Dublin, Ohio

Christopher Cuzzourt, CPA, Tax Supervisor
Bennett Thrasher, Atlanta GA
Reporting K-1 Information onto Unitholder’s 1040 Return

• Several important starting points:
  – As mentioned, the cover letter to the K-1 often contains material information
  – Unlike more basic pass-through investments, the reportable information is not only found on Page 1, Part III of the K-1, but must also be extracted from the supplemental information statements and/or footnotes
Reporting K-1 Information onto Unitholder’s 1040 Return

• Several important starting points (continued):
  – We will reference the 2014 Sample K-1 From Energy Transfer Equity LP (ETE) (see the Reference Materials for complete K-1)
  – The Reference Materials also contain a sample reconciliation worksheet in .xls format
Identifying a PTP

PTPs are identified in Part I Box D
What makes Reporting of a MLP K-1 so challenging?

• Unitholders are required to treat each PTP separately for purposes of calculating passive activity losses pursuant to IRC Sec 469(k)
• Unlike more basic pass-through activities, MLPs often hold multiple PTPs as assets
• A portion of sale proceeds can be treated as ordinary gain pursuant to IRC Sec 751
• IDC Costs and Depletion
Passive Activity Loss Rules and PTPs

• Passive activity loss (PAL) rules for MLPs differ from PAL rules for non-traded partnerships

• General rule found in IRC §469 is that losses from a passive activity may be offset against other passive activity income

• Passive activity limitations are applied separately to income and loss items attributable to each separate publicly traded partnership
PTPs: Entity-level approach to PALs

• This means that passive income from one PTP cannot be used to allow losses from another passive activity and
• Net losses from one publicly traded partnership cannot be allowed to offset passive income from other passive or non-passive activities unless the PTP is disposed in a fully taxable transaction
• Excess/disallowed losses must be carried forward until either
  – The PTP has passive income that can be applied to offset the carry-forward loss, or
  – The unitholder disposes of their entire PTP interest in a fully taxable transaction
Example

A taxpayer has a loss carryover from publicly traded partnership (PTP) A of $10,000. For the current year, PTP A has $5,000 of passive income. The taxpayer also owns PTP B which has $10,000 of income.

The taxpayer’s net loss is from PTP A is $5,000. This loss cannot be deducted against income from PTP B and is suspended.

In year two, PTP B has losses of $10,000 and PTP A has income of $10,000. Taxable income from PTP A is $5,000. The entire $10,000 loss from PTP B is suspended.

In year three, the taxpayer disposes of their entire interest in PTP B in a fully taxable transaction. The taxpayer has no other income or loss from PTP A or PTP B. The net loss from PTP B of $10,000 is treated as non passive and deducted in full.
Reporting PTP passive losses

• PTP passive income, gains and losses are not reported on Form 8582
• Unitholder must calculate share of income and gain items and subtract deductions and losses:
  – If this results in positive net income, the income is reported as investment income
  – Income and loss offsets are treated as passive and reported in appropriate places on 1040
Entering Separate PTP Ordinary Income (Loss) onto Reconciliation Schedule and 1040

• As previously mentioned, MLPs often hold multiple PTPs

• Because of the rules of IRC Sec 469(k), the activity from each PTP should be reported separately

• Critical for tax advisers of unitholders to calculate on a per-PTP basis, since the reporting of tiered PTPs is uncertain
MLPs holding multiple PTPs in their portfolio will provide supplemental information for PAL purposes.

SUPPLEMENTAL K-1 INFORMATION STATEMENT FOR TAX YEAR 2014

ENERGY TRANSFER EQUITY, L.P. (NYSE:ETE)

<table>
<thead>
<tr>
<th>Schedule of Separate Passive Activities</th>
<th>FEIN</th>
<th>Type of Activity</th>
<th>Disposed</th>
<th>PTP</th>
<th>Pass-through</th>
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<td>ETE: Energy Transfer Equity, L.P.</td>
<td>30-0108820</td>
<td>trade/business</td>
<td>x</td>
<td>x</td>
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<td>ETP: Energy Transfer Partners, L.P.</td>
<td>73-14893906</td>
<td>trade/business</td>
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<td>RGP: Regency Energy Partners L.P.</td>
<td>16-1731891</td>
<td>trade/business</td>
<td>x</td>
<td>x</td>
<td>x</td>
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<td>APU: Amerigas Partners, L.P.</td>
<td>23-2787918</td>
<td>trade/business</td>
<td>x</td>
<td>x</td>
<td>x</td>
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<tr>
<td>SXL: Sunoco Logistics Partners L.P.</td>
<td>23-3068389</td>
<td>trade/business</td>
<td>x</td>
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<td>x</td>
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<td>SUN: Sunoco LP</td>
<td>30-0740483</td>
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</table>

The passive activity loss limitations provide that individuals and some other types of investors that do not meet certain business participation thresholds may only deduct losses from these activities to the extent of the taxpayer’s income from such activities. One of the unique tax issues related to investments in PTPs provides that the passive activity loss limitations are generally applied separately with respect to each PTP that is owned by the taxpayer. However, the application of the passive loss limitations to tiered PTPs is not entirely clear, so you should consult your personal tax advisor as to whether you are subject to the passive loss limitations, and if so, how the information presented below should be reported to your federal and state income tax returns.

Absent material participation in the operations of Energy Transfer Equity, L.P. or another exception, the partnership expects that all of the items of income, gain, loss and deduction reported to you on this Schedule K-1 would be considered net investment income for purposes of IRC Section 1411 and potentially subject to a 3.8% surtax.

This schedule identifies your direct and indirect share of ETE's, ETP's, RGP's, APU's, SUN's and SXL's income or loss that is allocable to each PTP’s separate business activities. Current year losses generated by each PTP that are not deductible due to the passive loss limitations may either be deducted in future tax reporting periods to offset passive income generated by the same PTP, or (ii) deducted in full in the tax year that you dispose of your entire investment in the Partnership in a fully taxable transaction with an unrelated party.
ETE Supplemental Schedule

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<th>SXL</th>
<th>SUN</th>
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<td>Net Rental Real Estate Income (Loss)</td>
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<td>Other Net Rental Income (Loss)</td>
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<td>6b</td>
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<td>Net long-term capital gain (loss)</td>
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<td>Net Section 1231 Gain (Loss)</td>
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<td>17B</td>
<td>Adjusted Gain or Loss</td>
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<td>18C</td>
<td>Nondeductible expenses</td>
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<td>Cash and marketable securities</td>
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<td>Cost Depletion</td>
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<td>Percentage Depletion in Excess of Cost Depletion</td>
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<td>24</td>
<td>Percentage Depletion in Excess of Basis</td>
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<td>Net Equivalent BBLs of Production</td>
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<td>Total unrelated business taxable income included on Schedule K-1, page 1</td>
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<td>27</td>
<td>UBTT included on Schedule K-1, lines 1, 2, and 3</td>
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<tr>
<td>28</td>
<td>UBTT from debt financed dividend and interest income included on Schedule K-1, page 1</td>
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<td>29</td>
<td>E&amp;P adjustment due to depreciation and asset sales</td>
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<td>30</td>
<td>Gross Receipts</td>
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<td>31</td>
<td>NonTaxable Adjustment to Capital Account</td>
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ETE Supplemental Schedule (cont’d)

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### Sample K-1 Reconciliation sheet for MLPs

This is a crop of a sample K-1 reconciliation with inputs from the sample K-1. The complete working sheet is included in the Supplemental materials on the webinar web page.
Sample K-1 Reconciliation sheet for MLPs
Reconciliation sheet showing entries from PTPs 4-6 (see Slide 13)
Sales of MLP Interest

• Sales of MLP and PTP units are reported on Form 1099-B (reported as the disposition of a traded security)

• However, due to the nature of MLPs, some component of the sale proceeds is treated as ordinary income for tax purposes

• MLP/PTP K-1s include a Sales Worksheet, which generally break out the portion of the proceeds which must be reported as ordinary income
Sales Worksheet Disclosure

**ENERGY TRANSFER EQUITY, L.P. (NYSE:ETE)**

<table>
<thead>
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<th>PARTNER NAME:</th>
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<th>PARTNERSHIP FEDERAL ID:</th>
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If you sold units during 2014 and ETE has received information regarding such sales from you or your broker, this Sales Worksheet may be used to calculate your gain or loss from the disposition of units during this year. To calculate your gain or loss, enter your Sales Proceeds (net of brokerage commissions) in Column 4 and your Original Purchase Price (including any brokerage commission) in Column 5. The Partnership has provided you with Adjustments to Basis in Column 6, which includes your share of partnership income, deductions, distributions, etc. Subtract the sum of the Original Purchase Price in Column 5 and the Adjustments to Tax Basis in Column 6 from the Sales Proceeds in Column 4. Enter this amount in Column 7 to arrive at your Total Gain or Loss. To calculate your Capital Gain or Loss in Column 9, subtract the Ordinary Gain (provided of applicable) in Column 8 from your Total Gain in Column 7. Use the amount in Column 10 to adjust your total gain or loss for alternative minimum tax purposes.

Unless you have advised the Partnership to use a different method, this Sales Worksheet reflects unit dispositions on a “first in, first out basis”, so that you are considered to sell units in the order in which they were acquired by you. This approach has been applied solely for administrative convenience, and is not consistent with IRS Revenue Ruling 84-53, which provides that a partner has one unified basis in its total partnership interest, and would generally yield a different result than that presented. Each partner must make his or her own determination of the amount of basis to be associated with units that are sold. The partnership expresses no opinion on the appropriate methodology to be used in making this determination, and has provided this worksheet solely as a courtesy. Please consult your tax advisor to obtain advice on how this determination should be made, and update the Sales Worksheet to reflect the manner in which you determine that the basis in your units should be attributed to units that have been sold, and return it to Tax Package Support for a reprocessing of your Sales Worksheet.

Please note that some information included on this sales schedule is to be reported on an individual’s Form 8949. Basis information related to the sale is not reported to the IRS by the Partnership.

NOTE TO TAX-EXEMPT UNITHOLDERS: If you are following the position communicated by the IRS in TAM 9651001, a portion of the Partnership’s liabilities may be allocable to you and these liabilities may be treated as acquisition indebtedness for the purpose of determining your income that is subject to tax as unrelated business income. If necessary, you must contact the Support Center to request the required information to perform your calculations. Please consult your tax advisor regarding Unrelated Trade or Business Income reportable from the sale of your units.
Reporting on 1099-B

• The sale proceeds will be reported on a Form 1099-B
• Broker will provide cost of units with sales proceeds on a FIFO basis
• Tax advisers and preparers will need to reconcile the 1099-B statement with the Sales Worksheet to back out ordinary income from capital gains
Basis for units sold is reported on K-1 sales statements

• K-1s will provide Sales Worksheets reporting units sold

• These sales worksheets generally contain the following information:
  – Number of units sold
  – Acquisition and disposition dates
  – Adjustments to basis
  – Ordinary Gain component of proceeds
  – AMT Adjustments (reported on Form 6251)
Sales Worksheet reporting Ordinary Gain (Form 4797) and AMT Adjustments (Form 6251 Line 17)

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<th>ACQUISITION DATE</th>
<th>DISPOSITION DATE</th>
<th>SALES PROCEEDS</th>
<th>ORIGINAL PURCHASE PRICE</th>
<th>ADJUSTMENTS TO TAX BASIS</th>
<th>TOTAL GAIN/LOSS</th>
<th>ORDINARY GAIN</th>
<th>CAPITAL GAIN/LOSS</th>
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PARTNER TOTALS
-56,892

REFERENCES
FORM 4797, PART II, LINE 10
FORM 1040, SCHEDULE D
FORM 6251, LINE 17

If you have disposed of ALL of your ETE units in 2014, you will also be able to recognize your prior year(s) cumulative suspended ETE passive losses, if any, in the current year.
Basis calculations

• As previously noted, distributions are not taxed but are considered return of capital
• Unless elected otherwise, unitholders are required to calculate basis using the “Average Basis” method, adding up the cost basis for the entire investment and then dividing that basis by the total number of units
• Partnership income reported on K-1 increases basis; distributions and deductions decrease basis
• Most individual unitholders default to picking up the MLP basis with the issuance of the sales statement at the time of disposition
Special considerations for Oil & Gas MLPs

• Most Oil & Gas investment vehicles are organized as MLPs due to specific built-in tax advantages granted to Oil & Gas partnerships

• While the tax reporting of Oil & Gas MLPs would require an entire webinar, there are some considerations on Oil & Gas K-1s worth mentioning here
IDC and Depletion: Considerations Specific to Oil & Gas Partnerships

• Two considerations specific to Oil & Gas/Energy investments are Intangible Drilling Costs (IDC) and Depletion Allowances

• Each of these present calculation and reporting challenges
Intangible Drilling Costs (IDC)

• IDCs are costs that are
  – Necessary and incidental to the drilling of wells
  – Expenditures that have no salvage costs in themselves

• IDC are currently deductible

• Some K-1s will report “Excess IDC” in Box 17; this is a preference item that must be backed out on Form 6251 AMT Line 26 (for tax year 2015) pursuant to IRC Sec 57(a)(2)
Depletion

• The IRS defines depletion as “the using up of natural resources by mining, drilling, quarrying stone, or cutting timber. The depletion deduction allows an owner or operator to account for the reduction of a product's reserves.”

• Oil & Gas partnerships will report a depletion amount annually on each unitholder’s K-1 in proportion with the unitholder’s “economic interest”

• Ultimate depletion deduction determined at the partner level pursuant to IRC Sec 613A(c)(7)(D)
Percentage Depletion

• Taxpayers may elect to utilize either a percentage depletion or a cost depletion and deduct the greater of the two calculated numbers.

• Percentage depletion is calculated on a percentage of gross income from the property. The property must have net income for a unitholder to claim a depletion deduction based on the percentage depletion method.
Percentage Depletion deduction

• In general, taxpayers may deduct depletion in an amount up to 15% of the “gross income from the property” for properties with net income.

• The depletion amount cannot exceed 65% of the taxpayer’s taxable income for the year computed without regard to the depletion allowance or any net operating loss carryovers or carry backs as governed by IRC Sec 613A(d)(1).

• Any disallowed depletion is carried forward to future years.
Illustration of Depletion Allowance  
(from attendee question)

• Assume the following entries for Depletion:
  • Line 20T1 – Total Sustained assumed allowable depletion $25,000
  • Line 20T2A- Total Cost Depletion Working Interest $24,400
  • Line 20T2B- Total Cost Depletion Royalty Interest $400  (Royalty Income exceeds this)
  • Line 20T3A- Total Percentage Depletion in Excess of Royalty Interest $200

• Assume the unitholder has sufficient basis to cover the depletion deduction, and sufficient income to avoid the 65% limitation on depletion
Depletion Reporting

- Tentative Depletion or assumed allowable depletion = total depletion calculated by partnership
- Cost Depletion - deductible and credited against inside capital account
- Percentage depletion in excess of cost - deductible and credited against inside capital account
- Percentage depletion in excess of basis - deductible but reduces outside basis and at-risk amount
Depletion Example (cont)

• The unitholder would claim the entire $25,000 allowable depletion amount in Box 20T1, and report the excess 200 (Box 20T3A) on Form 6198 as a decrease in basis/at-risk amount.

• The Excess Percentage depletion is not reflected as an adjustment to the partner’s capital account inside the partnership. In this case, inside and outside basis would be different.

• Percentage Depletion in excess of basis is an AMT preference item, reported on Form 6251 Line 9
Final Thoughts....