Master Limited Partnerships: A View From Their 1986 Tax Returns*

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MASTER LIMITED PARTNERSHIPS: A VIEW FROM THEIR 1986 TAX RETURNS

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I. Introduction: Purpose and Overview of the Paper

A. Purpose

A new form of business organization emerged in 1981, the master limited partnership, or MLP. Master limited partnership is the term applied to limited partnerships traded on organized securities exchanges. MLPs appear to have many of the characteristics of corporations, but they generally have been determined to be partnerships for tax purposes. Until December, 1987, Federal tax law treated all MLPs as partnerships, and, as such, the corporate income tax did not apply to them. With the passage of the Omnibus Budget Reconciliation Act of 1987 (OBRA), certain publicly traded partnerships (PTPs), including some master limited partnerships, became subject to the corporate tax.[1] While that legislation resolved for the moment the uncertainty over the tax treatment of MLPs and other PTPs, it raised new questions about how the line should be drawn between "publicly traded" and "not publicly traded" for tax purposes. It also kept alive the debate on the appropriate tax status of MLPs and other publicly traded partnerships.

A number of factors should be considered in determining "appropriate" tax treatment of PTPs, including the similarities between the entities and corporations, economic efficiency, and, in the era of Gramm-Rudman, Federal tax revenue. A major purpose of this paper is to contribute to that continuing debate by presenting new evidence on those factors from an examination of tax returns for 72 MLPs in 1986.[2]

Most discussions of the proper tax treatment of master limited partnerships have relied on publicly available financial reports, such as those published by Standard and Poors, for data on income and financial structure. For this paper, however, we examined confidential Internal Revenue Service (IRS) tax returns. These returns provide similar types of information, but on a tax reporting basis. Thus, the figures from the two sources often differ for a number of reasons, including differences between financial and tax accounting rules.[3] For some purposes, such as judging the income potential or cash flow of an MLP as an investment vehicle, the financial accounting data available in the firm's annual report might be appropriate. Conversely, if a corporation were interested in creating an MLP, the tax data would be relevant for determining the income for tax purposes of the partnership and of the partners. Similarly, data from tax returns provide more direct evidence for considerations of tax policy towards MLPs.

B. Overview of the Paper

Section II presents the data from MLP tax returns on which analyses in the following sections are based. Tables show the aggregate income and balance sheet information from the MLP returns by major industry in a format similar to the tables published by IRS Statistics of Income (SOI) on partnership and corporate returns.

Sections III through V employ the tax return data to answer questions related to the appropriate tax treatment of MLPs. Section III first quantifies the resemblance between MLPs and other partnerships, and then between MLPs and corporations. It provides a sense of whether MLPS are financially more like one type of entity than the other, and a perspective on the size of the MLP sector relative to the partnership and corporate sectors.

Section IV turns to the implications for economic efficiency of taxing MLPs as corporations. Although partnership taxation of MLPs is often supported as an offset to some of the distortions caused by the corporate income tax, other distortions might be reduced by treating a corporate-like entity as a taxable corporation. Section IV discusses these claims and presents data related to them.

Section V presents data directly related to the tax consequences of MLPs to answer the following questions: What was the bottom line income and loss for tax purposes for MLPs and their partners in 1986, including items of income and expense not usually tabulated by SOI? How much in tax preferences did MLPs generate? Is this share of income higher or lower than for other non-traded limited partnerships? (I.e., do MLPs disproportionately generate tax preferences?)

Section VI presents a summary and conclusions.

II. A Tax Return Perspective on MLPs

The tax return data that we examined came from two sources: copies of the actual paper returns plus attachments filed by MLPs with the Internal Revenue Service, and computer records of MLPs appearing on the Partnership SOI file for 1986. Some MLPs appeared in one source but not the other, and many appeared in both. The paper returns frequently provided information not included in the SOI file, such as deductible amounts for intangible drilling costs and potential depletion allowances, which enabled us to improve our analysis of the MLPs tax position.

A number of MLPs, particularly in the oil and gas industry, technically derive their income as a limited partner in an operating partnership (OP) that runs the business. A corporation is virtually always the general partner of both the MLP and the operating partnership. Because the two entities are legally separate, both the MLP and the operating partnership file tax returns. Thus, to the extent that the income and assets reported by the MLP are, in fact, the income and assets of the operating partnership, aggregate partnership tax statistics represent a double counting of the economic activity and resources residing in partnerships. The tax return of the operating partnership reflects the structure of the economic activity from which the MLP derives its income -- the debt structure, the types of deductions, and the sources of income -- whereas the tax return of the MLP generally reflects only its share of net income and assets. For example, the revenues and expenses associated with oil drilling operations would be reported on the operating partnership's tax return, while the MLP would show only income received from the OP on its tax return.

To provide an accurate picture of the MLP's and the OP's operations, we created a new "consolidated" return for the entity when information supplied on the paper return enabled us to identify both the operating partnership and the MLP. This consolidated return essentially sees through the extra partnership layer, eliminating double counting of the two partnerships while recognizing that the MLP may have assets, revenue, and expenses of its own that are separate from the operating partnership. As a result, the consolidated return reflects the tax posture of the economic activity more accurately than the MLPs return does. However, the duplicated basis more closely reflects the data reported by SOI and used publicly. Our analysis, therefore, discusses the MLP sector on both a consolidated and a duplicated basis.

A. Consolidated Basis

Table 1 draws the tax return picture of income and balance sheet items that emerges when MLPs are consolidated with their operating partnerships. Tax returns for 1986 were available for 72 MLPs and/or their operating partnerships, out of a total of 81 MLPs we identified as having been listed on a stock exchange by the end of that year.[4] Of the 30 MLPs which operated through an operating partnership, we were able to consolidate the returns of 16 MLPs with their OPs. In the remaining 14 cases, data for both returns were not available. The data in Table 1 are similar to that reported by Statistics of Income for all partnerships and corporations. Data are displayed separately for five industry groupings in which MLPs appear: oil and gas; real estate operators and lessors; other holding and investment companies; agriculture, forestry, and timber/lumber; and "all other" which includes MLPs in motion pictures, cable television, water transport, health, and construction.

Several points may be noted from Table 1.

- MLPs average nearly 10,000 partners. Oil and gas MLPs have a substantially higher average number of partners -- 18,000. Excluding the oil and gas MLPs, the average number of partners is closer to 4,000. Both of these figures are well over the average number of partners -- 9 -- in partnerships as a whole. The large number of partners is one of the distinguishing characteristics of MLPs.

- MLPs in oil and gas dwarfed MLPs in other industries in financial respects as well as in number of partners: in gross income, net income, and assets.

- Gross profits from business operations is the largest source of income to the economic entity behind MLPs. Interest and dividends are the next most important source of income on average. Rental income is important in real estate while income from other partnerships is important in oil and gas.

Table 1. INCOME AND BALANCE SHEET ITEMS OF MLPS ON A CONSOLIDATED BASIS BY INDUSTRY - 1986

	All MLPs	OIL &GAS	REAL ESTATE	HOLDING & OTHER INVESTMENT	AGRICULTURE FORESTRY, & LUMBER	OTHER
	(Dollar Amounts in Millions)					
Number of Partnerships	72	29	14	10	6	13
Number of Partners	704971	533727	41352	76447	21679	31766
Average Partners	9791	18404	2954	7645	3613	2444
INCOME FROM FORM 1065						
Total Receipts	2,123.2	1,762.5	107.2	87.2	71.7	94.2
Gross Profits[1]	1,810.2	1,641.6	35.1	21.3	32.7	79.3
Income from other P/S[1]	50.3	46.1	7.7	(0.0)	(0.1)	(3.4)
Gross Rental Income	51.6	1.4	36.7	0.0	10.7	2.7
Net Rental (+/-)	18.4	1.4	7.2	0.0	10.5	(0.8)
Taxable Interest & Dividends	125.2	34.0	19.2	49.1	19.0	3.9
Other 1065 Income	85.9	39.4	8.5	16.8	9.4	11.8
Total Deductions[2]	1,716.2	1,407.4	81.7	21.9	119.3	85.9
Salaries & Wages	51.3	22.6	13.2	7.8	6.7	1.1
Total Int. Deduction	123.8	99.7	10.8	0.0	6.9	6.2
Depreciation	329.3	284.9	11.1	0.8	6.5	26.0
Other Deductions	1,161.6	971.7	29.6	12.5	98.9	49.1
Other Rental Expenses	18.3	0.0	14.7	0.0	0.2	3.5
Guaranteed Payments	31.9	28.5	2.3	0.8	0.2	0.0
Net Income (less Deficit)	407.2	355.1	25.6	65.5	(47.5)	8.4
Net Income	720.2	584.6	32.5	66.9	19.4	16.8
Deficit	(313.0)	(229.4)	(6.9)	(1.4)	(66.8)	(8.4)
DISTRIBUTIVE SHARE ITEMS						
TOTAL	138.0	(46.4)	21.4	11.9	154.3	(3.4)
Net Short-Term Gain/Loss	13.9	9.2	0.0	4.6	0.0	0.0
Net Long-Term Gain/Loss	15.1	5.1	2.2	7.1	0.8	0.0
Net Sec.1231 Gain/loss	125.3	(53.0)	24.2	0.2	153.8	0.2
Other Income	27.6	27.9	0.0	0.0	(0.3)	0.0
Investment Interest Exp.	19.6	12.6	3.8	0.0	0.0	3.2
Other Deductions	24.5	23.0	1.2	0.0	0.0	0.4
BALANCE SHEET ITEMS						
Total Assets	17,268.3	10,038.5	2,016.7	1,095.6	1,682.7	2,434.7
Total Liabilities	7,383.7	5,090.7	1,126.7	86.7	186.2	893.4
Partners' Capital Account	9,884.6	4,947.8	890.0	1,009.0	1,496.5	1,541.3
Debt/Equity Ratio	0.75	1.03	1.27	0.09	0.12	0.58

1/ Income from other partnerships excludes income of MLPs for which an OP is clearly missing, and allocates the income to gross profits.

2/ Components include rental expenses in relevant categories.

SOURCE: Unpublished tax return data.

- Depreciation deductions are nearly three times as large as interest deductions for MLPs in general because of the oil and gas MLPs. In real estate, however, depreciation and interest deductions are about equally important. For all types of MLPs, the largest expense category is the uninformative "other".

- Ordinary income exceeds deficits in all industries except agriculture, et al. MLPs indeed generally appear profitable.

Table 1 goes beyond the partnerships' ordinary income shared among all partners and examines the "Distributive Share Items" of income and expense which are reported to individual partners on their K-1 tax forms and subject to Federal tax treatment at the partner level (to the extent that the partner is not another partnership). Generally these items are not reflected in either SOI's standard reports on partnerships or in published measures of partnership income, even though they are clearly components of the economic activity and of the income for tax purposes generated by partnerships.[5] The distributive share items indicate that capital gains, including Section 1231 gains on assets used in the course of business, are a significant source of income for many MLPs. The agriculture, forestry, and lumber industry provides a striking example of this discrepancy. This group shows a net loss in terms of ordinary income of $47 million but reports a net gain of $153 million in Section 1231 assets. On the other hand, for the oil and gas industry, ordinary income ignores net losses registered on Section 1231 assets. Therefore, focusing on ordinary income can present a distorted view of the income generated. Section V discusses this issue of the income measure at greater length.

Table 1 also shows that the 72 MLPs examined for 1986 had total assets (reported at book value) of $17 billion and total liabilities of $7 billion on an entity basis. Overall the debt/equity ratio averaged about .75, ranging from a high of 1.27 among real estate MLPs to a low of .09 among holding and investment company MLPs.

B. Duplicated Basis

If we treat the MLPs and the operating partnerships as separate entities, the MLP sector appears somewhat larger in terms of total assets and income, although liabilities remain unchanged. To the extent that tax returns were available for both the MLP and the operating partnership. Table 2 presents the income and balance sheet data on MLPs on a duplicated basis as they would be reported in SOI's partnership tables.[6] This approach allows a more consistent comparison with the partnership sector as a whole. With its double counting, Table 2 shows higher net income before deficit ($774.5 million compared to $720.2 million), greater loss ($501.8 million compared to $313 million in deficit), and more in assets ($22.4 billion vs $17.3 billion) than did Table 1 with its consolidated approach. (The differences would be even greater if the operating partnerships for which returns were unavailable were counted.) The excess of the duplicated amounts (Table 2) over the consolidated amounts (Table 1) is concentrated in the oil and gas industry, where the operating partnership-MLP structure is most common, and in agriculture, forestry, and lumber where Section 1231 gains are most prevalent.

The financial structure of MLPs, as well as their size, differs in two ways on a duplicated basis. The debt/equity ratio notably falls from 0.75 on a consolidated basis to 0.49 on a duplicated basis. For oil and gas, it drops nearly by half, falling from 1.03 to 0.58. On a duplicated basis MLPs appear to be less leveraged than on a consolidated basis because the operating partnerships, not the associated MLPs, undertake the debt involved in the economic activity. Secondly, MLPs appear to depend more heavily on income from other partnerships on a duplicated than a consolidated basis, because the former approach counts the payments, both gains and losses, from an operating partnership to its MLP as "income from other partnerships."

III. Resemblance: MLPs Compared to Partnerships and Corporations

A central issue in the debate on the appropriate taxation of MLPs is the extent to which they are more like partnerships than like corporations. The comparison has generally been made in terms of the six legal characteristics of a corporation: associates, business and profit-oriented, continuity of life, centralization of management, limited liability, and free transferability of interests. If a legal determination concludes that an entity has three or more corporate characteristics, it will be taxed as a corporation. A financial comparison adds another dimension to the calculation of similarities, especially because debt is tax-favored relative to equity at the corporate level.

Table 2. INCOME AND BALANCE SHEET ITEMS OF MLPS ON A DUPLICATED BASIS[1] BY INDUSTRY 1986

	ALL MLPs	OIL & GAS	REAL ESTATE	HOLDING & OTHER INVESTMT	AGRICULTURE FORESTRY, & LUMBER	OTHER
	(Dollar Amounts in Millions)					
Number of Partnerships	88	41	14	11	8	14
Number of Partners	704971	533730	41352	76447	21679	31766
Average Partners	8011	13018	2954	6950	2710	2269
INCOME FROM FORM 1065						
Total Receipts	1988.8	1679.5	107.2	88.7	20.1	93.0
Gross Profits	1,536.6	1,377.1	35.1	17.8	32.7	73.8
Income from other P/S	189.5	227.6	7.7	5.0	(51.7)	0.9
Gross rental income	51.6	1.4	36.7	0.0	10.8	2.7
Net Rental (+/-)	18.4	1.4	7.2	0.0	10.5	(0.8)
Nonqualif. Div & Int	125.2	34.0	19.2	49.1	19.0	3.9
Other Income	85.9	39.4	8.5	16.8	9.4	11.8
Total Deductions[2]	1,716.1	1,407.4	81.6	21.9	119.3	85.8
Salaries & Wages	51.3	22.6	13.1	7.8	6.7	1.1
Total Int. Deduction	123.8	99.7	11.0	0.0	6.9	6.2
Depreciation	329.3	284.9	11.1	0.8	6.5	26.0
Other Deductions	1,162.6	972.4	29.9	12.5	98.7	49.1
Other Rental Expenses	18.2	0.0	14.5	0.0	0.2	3.5
Guaranteed Payments	30.9	27.8	2.0	0.8	0.3	0.0
Net Income (less Deficit)	272.7	272.1	25.6	66.9	(99.1)	7.2
Net Income	774.5	637.5	32.5	68.3	19.4	16.8
Deficit	(501.8)	(365.3)	(6.9)	(1.4)	(118.5)	(9.7)
DISTRIBUTIVE SHARE ITEMS						
TOTAL	302.4	(62.3)	21.4	11.9	334.3	(2.8)
Net Short-Term Gain/Loss	23.0	18.5	0.0	4.6	0.0	0.0
Net Long-Term Gain/Loss	8.9	(1.0)	2.2	7.1	0.5	0.0
Net Sec.1231 Gain/loss	308.7	(50.1)	24.2	0.2	334.4	(0.0)
Other Income	36.7	36.6	0.0	0.0	(0.7)	0.8
Investment Interest	32.0	25.0	3.8	0.0	0.0	3.2
Other Deductions	42.8	41.2	1.2	0.0	0.0	0.4
BALANCE SHEET ITEMS						
Total Assets	22,422.4	13,820.1	2,016.7	1,163.8	2,610.1	2,811.8
Total Liabilities	7,383.7	5,090.7	1,126.7	86.7	186.2	893.4
Partners' Capital Account	15,038.7	8,729.4	890.0	1,077.1	2,423.9	1,918.4
Debt/Equity	0.49	0.58	1.27	0.08	0.08	0.47

1/ Includes tax return data from the MLP and the operating partnership in 15 cases.

2/ Components include rental expenditures in appropriate categories.

SOURCE: Unpublished tax return data.

A. All Partnerships

Comparisons between either Table 1 or Table 2 and Tables 3A and 3B put MLPs into perspective within the partnership sector. Tables 3A and 3B present income and balance sheet data from the 1986 partnership SOI report for all partnerships and for limited partnerships, by the industry groupings used in Tables 1 and 2 above. The comparisons suggest that while MLPs represent a small piece of the overall partnership sector of the economy, they comprise a significant fraction of limited partnerships in oil and gas.

For example, in 1986 the MLPs examined for our study accounted for 4.6 percent of all partners, 1.6 percent of partnership assets, 1.0 percent of the net income, and 0.5 percent of the ordinary income deficit generated by partnerships (Table 3A). Among limited partnerships (Table 3B), MLPs were of course a more significant but still minor component, accounting for 7.2 percent of the partners, 3.2 percent of the assets, 17.2 percent of partners' capital accounts, 1.2 percent of liabilities, 4.6 percent of net income, and 1.0 percent of the net deficit. The aggregate statistics, however, obscure industry differentials. MLPs represent a major part of the economic activity and resources in the oil and gas industry, accounting for 25 percent of all assets held by partnerships and nearly half of the assets held in limited partnerships. Among limited partnerships in non-oil and gas industries, MLPs generally account for a tiny fraction of the resources. An exception is agriculture, forestry, and lumber, where the few MLPs have over half the partners' equity and a large fraction of total assets.

MLPs differ in their financial characteristics from other limited partnerships in the same industries. Most importantly, they are substantially larger than other limited partnerships in terms of average assets and income or loss. The 87 MLPs and operating companies reflected in Table 2 had average assets over $250 million, compared to just $2.5 million for the average limited partnership. In addition, MLPs tend to have lower debt/equity ratios over all and on an industry by industry basis. The most striking contrast appears in the real estate industry. Real estate limited partnerships as a whole are so leveraged that they have negative capital accounts (past losses exceed their capital contributions), whereas MLPs in this industry have almost as much equity as debt. MLPs are also more apt to be profitable (on a tax basis) than

Table 3A. INCOME AND BALANCE SHEET ITEMS OF ALL PARTNERSHIPS IN 1986, BY INDUSTRY

	ALL	OIL & GAS	REAL ESTATE	OTHER HOLDING & INVESTMENT	AGRICULTURE: FORESTRY, & LUMBER	OTHER
	(Dollar Amounts in Millions)					
Number of Partnerships	1,702,952	48,821	602,166	104,000	149,427	798,538
Number of Partners	15,301,345	2,275,079	6,549,423	1,399,829	657,372	4,419,642
Average Partners	9	47	11	13	4	6
INCOME						
Total Income - Form 1065	298,301	10,670	98,998	9,856	3,475	175,302
Gross Profits	163,261	8,480	5,624	1,860	3,206	144,092
Income from other Part	(10,360)	285	(7,448)	(610)	(250)	(2,337)
Gross Rental Income	107,508	60	90,806	1,504	542	14,596
Net Rental income	(15,766)	37	(16,391)	(88)	173	503
Taxable Interest & Dividends	21,716	334	7,125	5,915	349	7,994
Other 1065 Income	16,177	1,511	2,891	1,188	(372)	10,958
Total Deductions 1/	315,672	13,327	131,807	8,796	4,505	157,237
Salaries & Wages	39,424	359	4,085	647	468	33,865
Total Interest Deductions	69,090	826	43,919	3,722	528	20,094
Depreciation	55,976	3,928	30,334	838	783	20,094
Other Rental Expenses	49,946	17	44,074	586	195	5,074
Other Deductions	93,998	8,147	8,737	2,672	2,199	72,243
Guaranteed Payments	7,238	51	658	331	331	5,867
Net Income (Less Deficit)	(17,371)	(2,657)	(32,809)	1,060	(1,029)	18,065
Net Income	80,215	4,661	17,761	5,757	2,852	49,185
Deficit	(97,586)	(7,318)	(50,570)	(4,697)	(3,882)	(31,120)
DISTRIBUTIVE SHARE ITEMS						
TOTAL	46,010	(653)	25,854	8,546	1,873	[illegible]389
Net long-term Gain/loss	27,954	(53)	13,420	6,635	985	6,967
1231 Gain/loss	26,984	(211)	21,185	1,673	757	3,581
"Other" Ordinary Income	9,732	941	2,162	2,400	329	3,900
Investment Interest	13,530	74	9,740	1,715	44	1,957
Other Deductions	5,131	1,257	1,173	446	153	2,102
BALANCE SHEET						
Total Assets	1,403,750	55,987	687,749	151,684	28,761	479,569
Debt	1,175,727	18,730	675,822	80,707	20,596	379,873
Partners' Capital Account	228,023	37,258	11,927	70,977	8,166	99,696
Debt/Equity	5.16	0.50	56.66	1.14	2.52	3.81

1/ Components include rental expenses in appropriate categories.

SOURCE: 1986 Partnership SOI, Internal Revenue Service.

Table 3B. INCOME AND BALANCE SHEET ITEMS OF LIMITED PARTNERSHIPS IN 1986, BY INDUSTRY

	ALL	OIL & GAS	REAL ESTATE	OTHER HOLDING & INVESTMENT	AGRICULTURE: FORESTRY, & LUMBER	OTHER
	(Dollar Amounts in Millions)					
Number of Partnerships	273,076	17,395	139,506	28,071	9,221	78,883
Number of Partners	9,814,343	1,966,632	4,797,033	945,754	278,270	1,826,654
Average Partners	36	113	34	34	30	23
INCOME						
Total Income - Form 1065	88,695	4,621	45,805	5,619	(111)	32,761
Gross Profits	30,496	3,550	2,186	1,028	381	23,351
Income from other P/ships	(7,347)	290	(5,115)	(470)	(267)	(1,785)
Gross Rental Income	49,623	14	43,893	589	35	5,093
Net Rental income	(18,468)	11	(17,932)	(80)	15	(483)
Taxable Interest & Dividends	11,038	194	3,662	3,842	116	3,223
Other 1065 Income	4,885	573	1,180	630	(376)	2,878
Total Deductions 1/	124,212	4,956	72,506	5,689	847	40,214
Salaries & Wages	8,811	49	2,084	533	64	6,081
Total Interest Deductions	36,034	443	24,452	2,491	142	8,506
Depreciation	25,731	922	17,202	319	200	7,090
Other Rental Expenses	26,838	2	24,503	263	3	2,068
Other Deductions	25,590	3,501	3,976	1,806	411	15,896
Guaranteed Payments	1,208	39	289	279	28	573
Net Income (Less Deficit)	(35,517)	(335)	(26,700)	(70)	(959)	(7,453)
Net Income	16,752	1,949	5,778	2,715	164	6,145
Deficit	(52,269)	(2,284)	(32,478)	(2,786)	(1,123)	(13,599)
DISTRIBUTIVE SHARE ITEMS						
TOTAL	21,764	(875)	12,215	5,279	394	4,752
Net long-term Gain/loss	14,102	(81)	7,458	4,035	29	2,661
1231 Gain/loss	13,034	(205)	9,798	962	395	2,084
"Other" Ordinary Income	3,155	53	503	1,246	12	1,341
Investment Interest	7,018	29	5,165	813	36	975
Other Deductions	1,509	613	380	152	6	359
BALANCE SHEET						
Total Assets	691,611	29,455	370,798	86,040	8,801	196,517
Debt	604,351	11,247	379,288	38,809	4,626	170,381
Partners' Capital Account	87,260	18,208	(8,490)	47,230	4,175	26,137
Debt/Equity	6.93	0.62	-44.68	0.82	1.11	6.52

1/ Components include rental expenses in appropriate categories.

SOURCE: 1986 Partnership SOI, Internal Revenue Service.

other limited partnerships. Limited partnerships as a whole generated $3 of loss for every $1 of net income, whereas MLPs produced only about 65 cents of loss for every $1 of income. MLPs in real estate and other holding and investment companies stand out as being much more likely to generate profits than typical limited partnerships in those industries.

B. Corporations

The size of MLPs leads them to be compared frequently to corporations. Table 4 presents data for the corporate side of the comparison, using the most recently available corporate statistics from 1985. The MLP data on a consolidated basis from Table 1 are appropriate for the MLP side of the comparison because this approach reflects the substance of the economic unit, not the legal form of the entity.

MLPs in the aggregate are substantially smaller relative to the whole corporate sector than they are relative to the partnership sector. Total MLP assets of $17 billion in 1986 amount to only 0.3 percent of total assets in nonfinancial corporations of $6 trillion in 1985.[7] MLP net income of $720 million was equivalent to only 0.2 percent of corporate net income of $321 billion.

In the aggregate, MLPs appear to be slightly less profitable than are corporations, in terms of tax loss generated per dollar of gain and net income less deficit relative to total assets. Corporations showed deficits of 31 cents for every dollar of gain, compared to 43 cents of loss per dollar of gain for MLPs, and net income less deficit of 3.4 percent of assets for corporations and 2.4 percent for MLPs. On an industry basis, however, MLPs generally appear more profitable, with a higher ratio of tax gains to losses, than are corporations in oil and gas, real estate, and other holding and investment companies.[8]

MLPs also differ from corporations in their debt/equity structures. With the tax incentives for corporate debt, corporations are more highly leveraged than MLPs, overall and on an industry by industry basis. However, MLP debt/equity ratios are closer to the corporate ratios than they are to the comparable ratios for partnerships. The overall debt/equity ratio for MLPs is 0.75.

Table 4. SELECTED INCOME AND BALANCE SHEET ITEMS OF NONFINANCIAL CORPORATIONS IN 1985, BY INDUSTRY

	NONFINANCIAL CORPORATIONS (+REAL EST. & HOLDING COs)	OIL &GAS	REAL ESTATE	HOLDING & OTHER INVESTMENT COMPANIES	AGRICULTURE FORESTRY & LUMBER	OTHER
Number of Corporations	2,948,485.0	33,635	144,266	45,432	103,156	2,621,996
	(Dollar amounts in millions)					
INCOME						
Total Receipts 1/	7,371,209.8	102,855.0	30,264.2	124,416.8	70,383.8	7,037,652.4
Business Receipts	6,946,746.5	90,259.4	16,989.1	62,212.2	65,419.4	6,711,866
Interest	127,678.9	2,710.0	1,689.9	34,333.9	642.2	88,303
Rents	70,423.9	448.6	8,194.7	1,649.2	471.4	59,660
Dividends, Domestic & Foreign	31,681.7	1,485.5	176.1	2,536.1	92.5	27,391.5
Net Gains, LT & ST 2/	57,373.7	1,696.3	1,654.4	13,103.8	959.8	39,959.4
Other income	137,305.1	6,255.2	1,560.0	10,581.6	2,798.5	110,472.2
Total Deductions 3/	7,162,581.1	105,593.0	29,233.4	79,490.8	70,451.8	6,872,174.5
Cost of Sales and Operations	4,710,301.3	61,456.3	5,594.3	48,030.8	45,085.5	4,550,134
Interest Paid	219,397.2	6,291.5	5,187.7	8,573.4	2,759.0	196,586
Depreciation	282,434.9	6,519.9	3,112.9	1,835.2	3,639.3	267,328
Other Deductions	1,950,447.7	31,325.3	15,338.5	21,051.4	18,968.0	1,858,126.9
NET INCOME (LESS DEFICIT) 4/	221,996.1	(1,941.3)	973.2	41,574.4	(74.3)	181,464
Net Income - Total	321,250.3	5,082.0	3,818.0	44,111.8	2,930.9	265,308
Deficit, Total	99,254.3	7,023.2	2,844.9	2,537.4	3,005.2	83,844
BALANCE SHEET ITEMS						
Total Assets	6,496,135.2	183,291.5	88,059.4	664,433.8	52,651.2	5,507,699
Capital 5/	2,732,662.0	79,782.9	25,659.6	565,270.1	15,406.1	2,046,543.3
Debt 6/	3,763,473.2	103,508.6	62,399.8	99,163.7	37,245.1	3,461,156.0
DEBT/EQUITY	1.38	1.30	2.43	0.18	2.42	1.69

NOTE: Nonfinancial corporations here include corporations in real estate and holding and other investment companies.

1/ Total Receipts here includes net loss, noncapital assets.
2/ Net gains, LT & ST includes: net ST capital gain less net LT loss; net LT capital gain less net SI loss; net gain, noncapital assets; and net loss, noncapital assets.
3/ Total Deductions here excludes net loss, noncapital assets.
4/ Unlike Total receipts minus Total deductions, Net income (less deficit) includes "constructive taxable income from related foreign corporations" and excludes "interest on State and local government obligations."
5/ Capital equals the sum of: capital stock, paid-in or capital surplus; appropriated and unappropriated.
6/ Debt equals the difference between total assets and capital.

SOURCE: Corporation Source Book of Statistics of Income, 1985, Internal Revenue Service, 1988.

and for corporations 1.38, while for partnerships it is 5.16 and 6.93 for limited partnerships. This pattern of MLPs with leverage ratios more like corporations than like partnerships is repeated in individual industries. In oil and gas, the MLP debt/equity ratio is again closer to the corporate than the partnership ratio, but MLPs and corporations have higher debt/equity ratios than do partnerships.

C. Averages

On an entity basis, the average MLP has much larger assets than either the average partnership or average corporation. Although corporations are frequently viewed as being large, in fact the vast majority of corporations and partnerships are relatively small, with assets under $10 million (Table 5). The distribution of firms by asset size is remarkably similar for

Table 5. PERCENTAGE DISTRIBUTIONS OF ASSETS AND MLPS, PARTNERSHIPS, AND NONFINANCIAL CORPORATIONS (1985) BY ASSET SIZE

Asset Size	MLPs		All Partnerships		Limited Partnerships		Corporations	
($ millions)	#	$	#	$	#	$	#	$
0	0.00	0.00	30.18	0.00	13.34	0.00	3.87	0.00
0-10	8.33	0.19	68.73	46.73	82.71	40.57	95.27	15.50
10-50	20.83	2.60	0.94	22.50	3.44	26.31	0.67	6.49
50-150	37.50	14.11	0.12	11.66	0.41	12.80	0.11	4.36
150-250	11.11	9.29	0.02	4.07	0.05	3.76	0.03	2.34
250-1,000	16.67	40.62	0.01	8.02	0.05	8.89	0.03	8.15
1,000+	5.56	33.18	0.00	7.01	0.01	7.67	0.02	63.17
Total	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

Sources: Unpublished tax return data: 1986 Partnership SOI; and Corporation Source Book of Statistics of Income, 1985 (IRS).

partnerships and corporations. Ninety-nine percent of all corporations and all partnerships, and 96 percent of all limited partnerships have fewer than $10 million in assets. Only 8 percent of the MLPs examined have less than $10 million in assets. Corporations stand out in the distribution of assets, with nearly two-thirds of all corporate assets held by the 0.02 percent of firms with over $1 trillion in assets. MLPs do not quite match this extreme, but they do show 33 percent of the assets held by similarly gigantic MLPs.

IV. Economic Efficiency Considerations of Tax Treatment of MLPs

Taxing MLPs as partnerships rather than as corporations is frequently supported on grounds of improving economic efficiency by providing ad hoc integration of the corporate and individual income tax systems. While partnership taxation of MLPs would improve efficiency in some respects, it might worsen it in others. Although efficiency is not the only consideration in determining a desired tax policy, understanding the efficiency implications of alternative treatments is important for making informed tax policy decisions.

When economists say that taxes (such as the corporate income tax) reduce economic efficiency, they mean that the tax distorts the decisions that would have been made in the absence of the tax. This leads to an "inefficient" allocation of resources because, as the market equalizes after-tax rates of return on marginal investments, pre-tax rates of return will differ and resources will not move to their highest valued uses.

Distortions can come in several areas: (1) in the decision between consuming now or saving for future consumption (taxes on capital generally distort this choice, encouraging more consumption and less saving, but lower tax rates distort this choice less than high tax rates do); (2) in the decision on the choice of assets (by encouraging investment in equipment, the investment tax credit, for example, distorted the allocation of investment funds between equipment and structures); (3) in the choice of portfolio, whether to use debt or equity finance, and whether to pay out earnings as dividends or retain them within the business; and (4) in the decision of whether to undertake an activity in the corporate or noncorporate sectors (presuming there are nontax reasons that a given enterprise would prefer one sector over the other). The relevant efficiency question for the taxation of MLPs is whether, taking the existence of a corporate tax as given, treating MLPs as partnerships minimizes the distorting effects of the corporate income tax.

Taxing MLPs either as partnerships or as corporations would have little effect on efficiency in the first two of these four areas, or margins. On the first margin, the corporate tax does not necessarily distort the saving versus consumption decision any more than an alternative revenue-neutral tax on capital would. Consequently, the lower taxes imposed on MLP income by treating MLPs as partnerships instead of as corporations should not be seen as necessarily reducing the distortion in the saving/consumption choice. On the second margin, the primary components of the tax law that distort the choice of assets, such as the schedule of depreciation deductions and the pre-TRA investment tax credit, are generally available regardless of the form of business. The minimum tax might provide some differential distortion, to the extent that investment decisions of corporations respond to the corporate minimum tax more than MLP behavior responds to the individual minimum tax, but this effect is likely to be small. Consequently, there is probably little distortion in the choice of assets from taxing MLPs as partnerships.

The main efficiency considerations regarding MLP taxation relate to the third and fourth margins -- the choice of portfolio and the choice between corporate and noncorporate form. The corporate tax is not neutral among different financing arrangements. It favors debt relative to equity, and favors retention of earnings over payout as dividends. The corporate tax also distorts a firm's choice of sector by encouraging partnership status on businesses that, in the absence of the tax, would prefer the benefits of incorporation, which include limited liability, liquidity, and administrative simplicity for handling business transactions with a large number of owners.

The efficiency consequences differ among firms. (1) For partnerships that would have preferred corporate status apart from tax considerations and that can become MLPs, taxing MLPs as partnerships would improve efficiency in the choice of organizational form by providing them much of the limited liability, liquidity, and access to capital markets of corporate form, although at the expense of added operational and administrative complexities. (2) For corporations that switch to MLP status to receive partnership taxation, efficiency in the choice of organizational form would decline because they would give up administrative simplicity, although keeping much of the limited liability and liquidity, but efficiency in the portfolio decisions would improve. The net effect would depend on the importance of the administrative complexity relative to the reduced distortion in financing and payout decisions. (3) For corporations that choose not to switch to MLP status because the costs of switching are higher than the tax benefits, partnership taxation of MLPs puts them at a disadvantage relative to competitors that do switch. While this does not necessarily reflect an inefficiency from the perspective of the economy, it does point out that MLPs can undertake less productive investments in terms of pre-tax rate of returns than can corporations and still pay the required after-tax rate of return. (This assumes that the shift to MLPs is small enough that it does not affect the market-determined required after-tax rate of return.) To the extent that MLPs put their capital to lower-valued uses than do corporations, there would be a less efficient use of resources in the economy.

While quantifying the various efficiency consequences of MLP taxation is beyond the scope of this paper, comparisons of the debt/equity and payout ratios for MLPs, corporations, and all partnerships would suggest whether the distortions in those ratios are apt to be large or small. Tables 6A and 6B suggest that MLPs did respond to partnership taxation by choosing lower

TABLE 6A. DEBT/EQUITY RATIOS OF MLPS, PARTNERSHIPS (1986) AND NONFINANCIAL CORPORATIONS (1985) BY INDUSTRY

	All	Oil & Gas	Real Estate	Holding & Investment Companies	Agriculture, Forestry & Lumber	Other
MLPs						
Entity Basis	0.75	1.03	1.27	0.09	0.12	0.58
Duplicated Basis	0.49	0.58	1.27	0.08	0.08	0.47
All Partnerships	5.16	0.50	56.66	1.14	3.34	3.73
All Limited Partnerships	6.93	0.62	-44.68	0.82	1.77	6.10
Corporations (1985)	1.38	1.30	2.43	0.18	2.42	1.69

Source: Tables 1-4.

Table 6B. DISTRIBUTIONS AND WITHDRAWALS BY MLPS, ALL PARTNERSHIPS (1986), AND NONFINANCIAL CORPORATIONS (1985), BY INDUSTRY

In Millions of Dollars and as a Percentage of Assets

	ALL	OIL & GAS	REAL ESTATE	HOLDING & INVESTMENT COMPANIES	AGRICULTURE, FORESTRY & LUMBER	OTHER
MLPS						
Distributions & Withdrawals	4374	2820	429	232	674	220
As % Assets	25.3	28.1	21.3	21.2	40.0	9.0
ALL PARTNERSHIPS						
Distributions & Withdrawals	242739	48847	51650	74323	2982	64938
As % Assets	17.29	87.2	7.5	40.8	12.0	14.3
LIMITED PARTNERSHIPS						
Distributions & Withdrawals	125388	40395	19530	51941	917	12605
As % Assets	18.1	137.1	5.3	57.4	14.5	6.5
CORPORATIONS (1985)						
Distributions to Stockholders	149968	2097	2396	42286	520	102669
As % Assets	2.3	1.1	2.7	6.4	1.0	1.9

SOURCES: Unpublished tax return data; 1986 Partnership SOI; and Corporation Source Book of Statistics of Income, 1985 (IRS).

debt/equity ratios and higher distribution-to-asset ratios than did corporations. These differences would be consistent with, but are not proof of, distorting effects of the corporate income tax. Factors other than taxes could contribute to these differences. For example, the assertion that cash flow is an important ingredient in the stock market's valuation of the firm provides a non-tax explanation for high distribution rates by MLPs.

Table 6A summarizes the debt/equity ratios (based on book value of assets) presented in Tables 1 through 4 for MLPs, for partnerships as a whole, and for corporations. Overall, and by industry, MLP tax returns showed lower debt/equity ratios in 1986 than corporation returns did in 1985. MLPs had an average debt/equity ratio of 0.75, compared to the corporate average of 1.38. Table 6B presents data on distributions and withdrawals by MLPs, partnerships in general, and nonfinancial corporations. As expected, MLP distributions and withdrawals are larger relative to assets than are corporate distributions to stockholders and by substantial amounts: 25.3 percent for MLPs compared to only 2.3 percent for the corporations. The differences are substantial within specific industries as well. For example, oil and gas MLPs distribute 28 percent of assets while oil and gas corporations distribute just 1.1 percent of assets.

Interestingly, however, MLPs do not appear typical of partnerships in general. MLP leverage is closer to that of corporations than of partnerships. The difference between MLPs and the overall partnership sector may largely result from the prevalence of non-MLP real estate partnerships, which are traditionally highly leveraged, and from the influence of tax shelters. The partnership sector as a whole and limited partnerships in particular had much higher levels of debt -- a debt/equity ratio of 5.16 -- than did the corporate sector. When real estate partnerships are excluded, the ratio falls to 2.31, but remains above corporations. Tax shelters undoubtedly account for some of this remaining difference. When only partnerships with positive ordinary income (including real estate) are considered, the debt/equity ratio falls to 1.84, much closer to the corporate leverage rate. For positive income and non-real estate partnerships, the ratio is 1.25, slightly below the overall corporate figure. With the passive loss limitations of the Tax Reform Act of 1986, partnership debt is likely to drop in the future. On the corporate side, the reduction in corporate tax rates may reduce their debt/equity ratios as well, and the lower personal tax on dividends and higher tax on capital gains may increase corporate payout rates and lower retained earnings, an important source of corporate equity.

V. MLP Income for Tax Purposes

The ordinary income and losses that MLPs generated in 1986 and that are reported in Tables 1 and 2 above provide only part of the picture of MLPs for tax purposes that year because of the flow-through nature of partnership income. A number of items of income and expense generated by many partnerships are excluded from the ordinary income of the partnership because they are subject to separate limitations and treatment at the level of the individual partners. Such items include long-term capital gains (and losses), Section 1231 gains and losses (on trade or business assets), investment interest expenses, oil and gas depletion allowances, and intangible drilling costs. Consequently, in many cases ordinary income provides neither a complete measure of partnership income nor an accurate measure of partnership income for tax purposes.

Table 7 shows the derivation of a more complete measure of income for tax purposes for MLPs (on a consolidated basis) and for partnerships in general. Because certain items which are reported on attachments to the regular tax schedules, most notably intangible drilling costs and potential depletion allowances, are not entered into the computer files by IRS, the full measure of income for tax purposes is available only for the MLPs for which we had actual tax returns on hand. This measure does not indicate how much partnership income is actually included in the partners' taxable income that year because of the limitations and special treatment to which these distributive share items are subject at the partner level. Nevertheless, we judge that this measure of "partnership income for tax purposes" better approximates income subject to tax than does ordinary income which simply excludes all specially treated items.

We define "Income for Tax Purposes--Pre-TRA" to equal: Form 1065 ordinary income plus 40 percent of long-term capital gains, plus other ordinary income (principally nontaxable dividends and "other" schedule K income), minus distributive share deductions (principally investment interest expenses; "other" schedule K deductions; and intangible drilling costs (IDC's), potential depletion allowances, and windfall profit taxes for the MLPs with those items reported on the paper copy of their tax returns.) "Income for Tax Purposes-Post-TRA" is the same except that it includes 100 percent of capital gains.[9]

Table 7. DERIVATION OF INCOME FOR TAX PURPOSES OF MLPS AND ALL PARTNERSHIPS BY INDUSTRY, 1986

	Form 1065 Ordinary Income +	Capital Gains +	Other Ordinary Income −	Other Deductions =	Income for Tax Purposes Pre-TRA	Income for Tax Purposes Post-TRA	Tax Preferences
	(In Millions of Dollars)						
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
MLPs							
All	407.2	154.3	27.6	414.6	90.3	174.6	252.1
Oil & Gas	355.1	-38.7	27.9	402.9	-29.8	-58.4	88.4
Real Estate	25.6	26.3	0.0	5.0	31.1	47.0	0.2
Holding & Other	65.5	11.9	0.0	0.0	73.0	77.4	0.2
Agric., Forestry & Lumber	-47.5	154.5	-0.3	0.0	14.0	106.8	156.4
Other	8.4	0.2	0.0	6.7	1.8	1.9	6.9
ALL PARTNERSHIPS							
All	-17390.9	54938.3	9732.4	18660.4	-4343.6	28619.4	7130.2
Oil & Gas	-2657.2	-263.8	914.2	1330.3	-3178.8	-3337.1	356.4
Real Estate	-32809.2	34605.5	2161.6	10913.2	-27718.6	-6955.3	3952.8
Holding & Other	1060.2	8307.5	2400.0	2161.1	4622.1	9606.6	280.0
Agric., Forestry & Lumber	-938.4	1362.7	328.4	196.5	-261.4	556.2	232.2
Other	17973.7	10926.4	3901.2	4059.3	22186.2	28742.0	2308.8
LIMITED PARTNERSHIPS							
All	-35517.1	27135.9	3155.2	8527.0	-30034.5	-13753.0	4698.5
Oil & Gas	-334.6	-285.8	52.9	641.9	-1037.9	-1209.4	167.0
Real Estate	-26700.2	17256.2	503.3	5535.9	-24830.3	-14476.6	2901.8
Holding & Other	-70.2	4997.1	1246.4	964.6	2210.4	5208.7	194.2
Agric., Forestry & Lumber	-958.9	423.8	11.8	41.6	-819.1	-564.9	201.8
Other	-7453.0	4744.3	1339.4	1334.0	-5548.8	-2387.9	1233.7

Col. (3) – Other Ordinary Income includes principally nontaxable dividends and "other" Schedule K income.

Col. (4) – Other Deductions include principally: investment interest expenses, "other" Schedule K deductions, and for MLPs intangible drilling costs, potential depletion allowances, and windfall profits taxes.

Col. (5) – Income for Tax Purposes -- Pre-TRA: includes only 40 percent of long-term capital gains.

Col. (6) – Income for Tax Purposes – Post TRA: includes all capital gains.

SOURCES: Unpublished tax return data and 1986 Partnership SOI, Internal Revenue Service.

Column (1) in Table 7 (Form 1065 ordinary income) presents quite a different picture of MLP and partnership income from the picture that emerges from columns (5) and (6) (income for tax purposes, pre-TRA and post-TRA, respectively). In a few instances, the sign even differs on ordinary income and income for tax purposes. For MLPs, this occurs in oil and gas, which switches from a gain of $355 million in ordinary income to a loss for tax purposes because of IDC's, depletion, and windfall profits taxes, and in timber and agriculture, which move from an ordinary loss of $47.5 million to a gain for tax purposes because of capital gains.

Even where the signs on ordinary income and income for tax purposes are the same, the sizes are frequently quite different, particularly when the comparison involves post-TRA income for tax purposes. For the partnership sector as a whole, an ordinary loss of $17 billion drops to a loss of only $4 billion for pre-TRA tax purposes and becomes a gain of $29 billion for post-TRA tax purposes. For real estate, an ordinary loss of $33 billion drops by 16 percent to a loss of $28 billion for pre-TRA tax purposes, but by almost 80 percent to $-7 billion for post-TRA tax purposes. Limited partnerships also display differences between ordinary and tax purpose income that are substantial, though somewhat smaller proportionately.

For MLPs, all partnerships, and limited partnerships, the most common difference is for income for tax purposes to exceed (or have a smaller loss than) ordinary income, indicating that the specially treated income items (mainly capital gains) exceed the distributive share deductions. A notable exception is the oil and gas industry, where ordinary income is larger (or the loss smaller) than is income for tax purposes (both pre-TRA and post-TRA) for MLPs as well as for all partnerships and limited partnerships. If all IDC's and depletion allowances were included in the data as they are for many of the MLPs, the excess of ordinary income over income for tax purposes would be even larger.

In addition to the regular income tax, corporations and individuals may be subject to the alternative minimum tax on specified tax preferences. To the extent that MLPs, and other partnerships generate tax preferences, and to the extent that the partners are subject to minimum tax, ordinary income moves farther from being the relevant measure of income subject to tax. Since MLPs are promoted as being income generators, not tax shelters, it would be interesting to see in fact whether they have a higher or lower rate of tax preferences than do other partnerships. (In spite of their promotion, over one-quarter of the MLPs examined for this paper indicated that they were required to file an "Application for Registration of a Tax Shelter" with the IRS, indicating investors could expect deductions in excess of twice their investments.)

Column (7) of Table 7 presents the amount of tax preferences reported on Schedule K (but not on attachments to it) for MLPs, all partnerships, and limited partnerships. These preferences primarily include the preference component of depreciation allowances, the excluded portion of capital gains, and excess IDCs. The preference component of oil and gas depletion allowances is not reported on the Schedule K because it depends in large part on information available only to the specific partner.

For MLPs, tax preferences are significant in the oil and gas; agriculture, forestry, and lumber; and "other" industries, but surprisingly not in real estate. In agriculture, etc. the preferences come mainly from the excluded portion of timber gains, in oil and gas from excess IDCs. For partnerships in general, tax preferences are important, relative to the various measures of income, in industries where they are important for MLPs (in oil and gas, agriculture, etc. and "other") and not important where they are not important for MLPs (other holding and investment companies). The exception is real estate where partnerships in general generate substantial amounts of tax preferences, while MLPs do not, suggesting that real estate MLPs are doing different things or operating in different ways than are ordinary real estate partnerships.

VI. Summary and Conclusion

This paper has presented data from tax returns of master limited partnerships in 1986 that allows them to be compared with partnerships in general and with corporations. From some perspectives MLPs seem important, while from others they seem almost inconsequential. From the perspective of the partnership sector as a whole, MLPs represent a very small share; however, they conduct a large percentage of the activity of oil and gas limited partnerships. Compared to the corporate sector, the aggregate amount of income and assets in MLPs is minor.

In the respects examined here, a picture of MLPs emerges as entities that in some ways resemble partnerships, in others corporations, while overall they are perhaps unique. MLPs are larger than the vast majority of both corporations and partnerships, though smaller than the largest corporations. MLPs are more likely to be profitable than are all partnerships or limited partnerships. They appear less profitable than corporations overall, but the opposite is true for some industries. In terms of financial structure, MLPs have lower leverage ratios than either corporations or other partnerships.

In a world with a corporate income tax, the efficiency consequences of taxing MLPs as partnerships instead of as corporations are complex and to some extent unclear. As the paper discusses, for partnerships that became MLPs there would be a gain in efficiency; for corporations that switched to MLP status a gain on the portfolio margin but at the expense of the complexities of operating an MLP; and corporations that remained corporate might find themselves unable to attract investment for projects that were more profitable in pre-tax terms than the projects undertaken by their counterparts that became MLPs. The sum of these effects is uncertain.

Whether MLPs are taxed as partnerships or as corporations, the paper also reports that ordinary income is a poor measure of income for tax purposes. Income that is relevant for the tax system includes many distributive share items that ordinary income excludes, most notably capital gains. When such items are taken into account, MLPs generally look even more profitable than they do in terms of ordinary income.

ENDNOTES

[1] MLPs are a subset of PTPs. OBRA added Section 7704 to the Internal Revenue Code. Subsection (b) states: "...the term 'publicly traded partnership' means any partnership if --

(1) interests in such partnership are traded on an established securities market, or

(2) interests in such partnership are readily tradable on a secondary market (or the substantial equivalent thereof)."

[2] Because there is at present no reliable list of partnerships viewed as publicly traded outside the major exchanges, the analysis here is confined to partnerships traded on the exchanges, referred to as master limited partnerships. Indeed, IRS has only recently issued regulations regarding the definition of "publicly traded" (Notice 88-75). Having been listed on a major exchange or NASDAQ by the end of 1986 was the criterion we used for determining whether a partnership was or was not an MLP in 1986.

[3] A comparison of the different pictures one obtains of MLP's depending upon the source of data is beyond the scope of this paper.

[4] MLPs listed in 1986 for which we could not obtain tax return data generally were first listed on a stock exchange in the last part of the year.

[5] An exception to this is Lowell Dworin, "An Analysis of Partnership Activity, 1981-1983," SOI Bulletin, Spring 1986.

[6] Thirty of the 72 MLPs examined in this paper appear to function through operating partnerships. In 16 of those 30 cases, returns were available for both the MLP and the OP.

[7] Nonfinancial corporations here include corporations in real estate and other holding and investment companies, since many MLPs operate in these industries.

[8] Changes in the economy between 1985 and 1986 might affect the comparisons between MLPs and corporations somewhat. A drop in oil prices depressed the energy sector of the economy in 1986 relative to 1985. Consequently, 1986 corporate data will probably show oil and gas corporations even less profitable than they were in 1985. This would strengthen the conclusion that, at least in that industry, MLPs appear more profitable than corporations.

[9] This measure is similar to Dworin's (1986) income measure termed "Contribution to partners' taxable income before ITC adjustment." The primary differences are that the measure here: (1) keeps guaranteed payments to partners as a deduction to the partnerships, and (2) except for MLPs, includes income or loss from other partnerships.

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