National Association of Publicly Traded Partnerships

What Investors Need to Know About Master Limited Partnerships (MLPs)

What is an MLP?

An MLP (master limited partnership) is more accurately called a publicly traded partnership or PTP, and is exactly what that name suggests – a limited partnership, or an LLC taxed as a partnership, whose interests (called "units") are traded on the public exchanges just like corporate stock. The owner of MLP units is known as the unit.

What kinds of companies are MLPs?

Because of constraints imposed by the tax code, most MLPs today are in energy related businesses such as oil and gas pipelines, propane, transportation of petroleum products on tankers and barges, and oil and gas production. There are also MLPs in a few other industries, but over 80% of MLPs, representing almost 90% of MLP market capital, are in energy or natural resource businesses.

Why are MLPs important?

MLPs play an essential role in the production and transportation of our nation's energy resources, particularly the abundance of oil and natural gas in the shale deposits. Because their low cost of capital allows them to thrive in industries with capital intensive, low-return assets, it is increasingly MLPs that undertake oil and gas midstream activities such as gathering, processing, and pipeline transportation. MLPs are making the investments in energy infrastructure that we need to unlock the resources in the shale deposits and transport them to where they are needed. From 2007 through 2012, MLPs invested $88 billion in energy infrastructure, with another $25 billion projected for 2013.

Why should I consider MLPs as part of my portfolio?

MLPs generally provide a reliable income stream to unitholders, much of which is tax-deferred. MLPs pass through most of their cash flow to their unitholders in the form of quarterly cash distributions. Unlike a fixed income security like a bond, however, there is a potential for distributions to rise as the MLP grows and increases its revenue. In addition, MLPs allow investors to participate in an industry for which there is rising demand and which is essential to the United States.

How is an MLP investment taxed?

An MLP is a pass-through entity; rather than the MLP paying tax, its income and deductions flow through to the unitholders, who pay tax on their share. A small portion of the distribution reflects the unitholder's share of the MLP's taxable income and is taxed on a current basis. The rest is considered to be return of capital and reduces the partner's basis in the partnership units, thus adding to gain when the units are sold. When the units are sold, the difference between the sales price and the adjusted basis equals the taxable gain (or loss). Some of the tax on the capital gain from selling the interest will be taxed at the capital gains rate. That portion of the gain that results from a downward adjustment of the basis after allocation of depreciation or other deductions will be taxed at the ordinary income rate.

How can I find out more about MLPs?

Visit the website of the MLP trade association, the National Association of Publicly Traded Partnerships (www.naptp.org) for a list of MLPs, further details about their tax treatment, and other information.

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