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INVESTING IN MASTER LIMITED PARTNERSHIPS - CONSIDER TAXES AND TAX PREPARATION COSTS

By Jamey Parker, CPA

If you are considering an investment in a Master Limited Partnership there are several benefits that your broker will point out. For example, distributions are usually not taxable or only partially taxable because of current deductions for depletion, intangible drilling costs, and other such expenses. Of course once your cost basis gets down to zero, distributions will be taxable. However, there may be costs that are often not discussed when you are considering the return these investments may generate.

These investments are structured as privately traded limited partnership (PTP) units. Although they are sold by a broker, just like shares of stock, for tax purposes they are pass-through entities from which you'll receive a K-1. The K-1 includes multiple items to be reported on your tax return. Many of these items have specific reporting requirements that generate additional forms and unique treatment on your tax return. The K-1 is likely to have many pages of additional explanation as to how each of these different items must be treated and reported. The tax treatment may vary depending on the type of business, the type of investment and/or investor, the states in which they are operating, as well as tax preferences specific to the industry. Therefore, these explanations must be carefully analyzed by your tax preparer before proper reporting can be determined. This process can also require additional nonresident state returns to be filed, in which case, if you have multiple K-1s, the state income must be compiled.

If you've been trading in and out of some positions, the basis of your investment must be determined at each sale and purchase date, adjusted for partnership income to the date of sale, gain or loss determined, whether the gain or loss is ordinary or capital and if a wash sale has occurred. The broker's statements generally only report the original purchase cost and sales proceeds. The adjustments for partnership income or loss and distributions is usually provided on the K-1 attachments, but each transaction must be separately calculated and summarized for entry on your tax returns.

All of this tax analysis is going to cost you money when your CPA receives your K-1s. Also, the K-1s often aren't issued until right before the deadline resulting in overtime hours for your CPA to complete your tax returns timely.

You should also be careful when considering a direct investment in MLPs within an IRA or Roth IRA. IRAs are tax deferred accounts. If they have more than $1,000 of unrelated business taxable income (UBTI) in any tax year the income is taxable to the IRA, thus affecting the benefit of tax deferral. This also results in additional filing requirements, tax liability and increased CPA tax preparation fees.

Including your tax advisor in discussions with your broker or investment advisor before making an investment can save you both taxes and tax preparation fees by providing the information you'll need to determine your expected net return on investment.

Please call the TKW tax team if you would like more information on this topic. 503-274-2849