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Corporate characteristics associated with master limited partnership formation

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U.S. tax policy favors partnerships as organizational forms by double taxing corporate earnings. Until the early 1980s, the partnership tax advantage was offset by (1) the corporation's superior capacity for generating capital, (2) the administrative compliance burden for partnerships with many partners, and (3) high personal tax rates. By the mid-1980s these corporate advantages were mitigated because (1) partnership interests (units) with limited liability could be publicly traded so that in theory partnerships had as much capital generating power as corporations and (2) the highest personal tax rate was lowered below the highest corporate tax rate.

In the late 1980s, the effect of taxes on the choice of organizational form generated a great deal of debate in the media and in Congressional subcommittees (e.g., Joint Tax Committee 1987; Forbes 1986; The Wall Street Journal 1987). One of the central issues was the tax treatment of master limited partnerships (MLPs). Policy makers were alarmed by the rapid increase in the sale of new equity MLPs after the Tax Reform Act of

1986. Erosion of the corporate tax base was a major concern because policy makers believed that MLPs would be attractive to many firms in the corporate sector.

Advocates of corporate taxation for MLPs stressed changes in the Tax Reform Act of 1986 that made these entities more attractive than corporations for tax purposes and argued that increased investment in these entities was primarily tax motivated (Joint Committee 1987, J-9). Opponents of corporate taxation for MLPs argued that MLPs facilitated desirable economic and business goals that may have been enhanced by the tax advantages but were not primarily motivated by those advantages (Joint Committee 1987, J-10). The increase in the number of MLPs during 1985, 1986, and 1987 prompted Congress to impose corporate taxation on most new and already established MLPs...