Creative Planning Inc.

Basic Tax Principles for MLP Investors

- Each unitholder is allocated **on paper** a proportionate share of the MLP's income, deductions, and credits. This is reported annually on Form K-1.
- The unitholder enters these items on his tax return and pays tax on the net income at his own tax rate.
- If there is a net loss, it cannot be used to offset the unitholder's other income. Losses can only offset future income from the same MLP, until the units are sold when they can offset other income.
- Cash distributions are **not** the same as your share of the MLP's income.
- Distributions are a return of capital and are not taxed when received.
- Your basis in your partnership units equals:
    - What you initially paid for the units
    - Increased by income allocated to you, decreased by losses and deductions allocated to you
    - Decreased by the amount of your distributions
- Basis is used to determine your gain or loss when you sell your units.
- Not all of the gain when units are sold is taxed at capital gains rates.
    - The gain resulting from basis reductions due to depreciation is taxed at ordinary income rates—this is called "recapture."
    - This information will be reported on the K-1 for the year in which you sell your units.
- As long as your adjusted basis is above zero, tax on your distributions is deferred until you sell your units. If it reaches zero, future cash distributions will be taxed as capital gain in the year received.
- If a unitholder dies and the units pass to his heirs, the basis is reset to the fair market value of the units on the date of death, and the prior distributions are not taxed.
- Often you will hear someone say that "80% (or a similar number) of the MLP's distribution is tax deferred." What they mean is that your share of the MLP's net taxable income, as reported on the K-1 form, equals about 20% of the tax-deferred cash distribution.

Simplified Example

Year 1: 1,000 units purchased @ $50.00. **Basis is:**	**$**	**50,000**
Investor receives total cash distributions of $4.00/unit	$	(4,000)
Investor is allocated and pays tax on net taxable income of $1.00/unit, including $3.00 of income and $2.00 of depreciation	$	1,000
Adjusted Basis	**$**	**47,000**
Year 2: All units sold @ $52.00	$	52,000
Gain per unit: $52.00 - $47.00 = $5.00	**$**	**5,000**
Depreciation recapture-taxed at ordinary income rates	$	2,000
Taxed at capital gain rates*	$	3,000
*Assumes MLP has no "ordinary income" assets		

This fact sheet is for informational purposes only and should not be construed as offering tax advice. Consult your tax advisor regarding your own situation.

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