

MLP TAX PANEL

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**IMPACT OF CANADIAN LEGISLATION
ON THE U.S. MLP MARKET**

TAXATION OF INCOME TRUSTS – CURRENT REGIME

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- Trusts treated as quasi-flow-through entities
 - generally taxable on income at top personal marginal rates
 - entitled to offsetting deduction for income made payable to unitholders in year
 - income distributions included in unitholders' income
- Income distributions to non-residents subject to withholding tax
 - rate generally reduced to 15% under treaty

DEPARTMENT OF FINANCE CONCERNS

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- Shift in incidence of tax from corporate level to shareholder level
- Perceived tax leakage
 - Tax-exempt unitholders
 - Non-resident unitholders
 - Provincial tax leakage
- Lack of level playing field
- Impact of high level of distributions on capital reinvestment and productivity
- Level of conversions by “normal” businesses

POLITICAL RESPONSE

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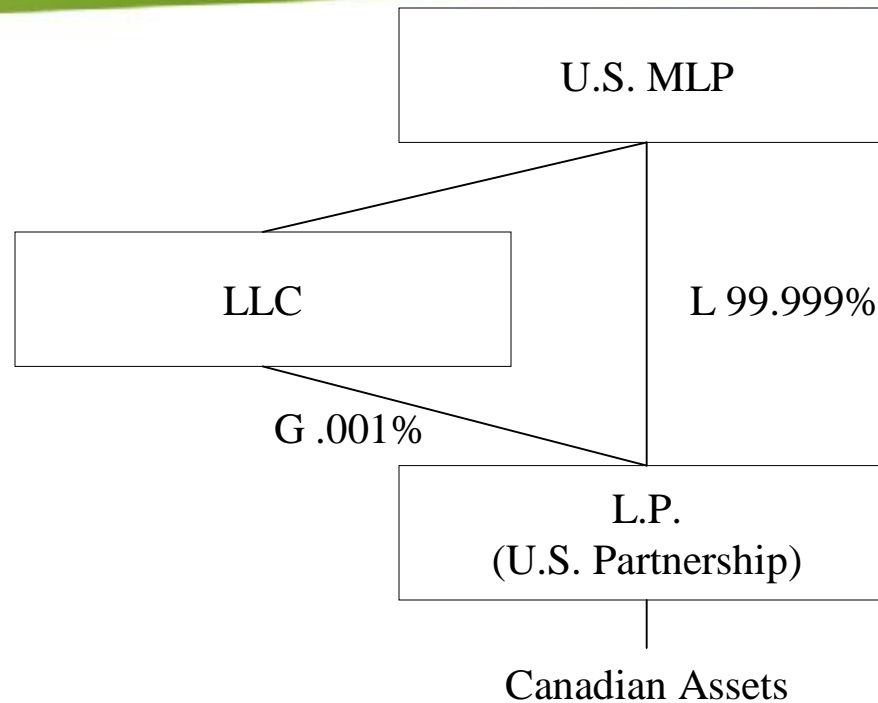
- 2006 Budget
 - Enhanced dividend tax credit
 - leveled playing field for taxable Canadian investors
 - didn't address tax-exempt and non-resident unitholder concerns
- SIFT Proposals
 - announced October 31, 2006
 - draft legislation released December 21, 2006
 - Standing Committee on Finance review – January/February 2007

SPECIFIED FLOW-THROUGH INVESTMENT (SIFT) PROPOSALS

- Apply to publicly listed Canadian trusts and certain publicly listed Canadian partnerships
- Income distributions by SIFTs from non-portfolio properties generally subject to tax at corporate rates in hands of SIFT and treated as taxable dividends in hands of unitholders
- REITs exempted from new rules; no carve-out for royalty trusts
- Generally applicable starting 2007, subject to 4-year holiday for SIFTs listed before November 1, 2006
- “Normal growth” restriction (December 15, 2006 guidelines)

PARTNERSHIP APPROACH: DOUBLE PASSTHROUGH (simplified)

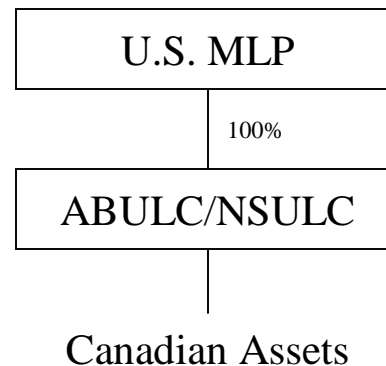
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- No entity level taxation in Canada
- U.S. Investors required to file Canadian tax returns (and pay taxes)
 - Canadian individual rates progressive
- U.S. Investors pay tax on Canadian activity reported on U.S. returns
 - U.S. foreign tax credit available, but difficult to use
- Canadian withholding on distributions
 - No withholding if activity involves a sale of a product
 - 15% withholding on gross revenue if providing a service

ABULC/NSULC APPROACH: SINGLE PASSTHROUGH (simplified)

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- ABULC = Alberta Unlimited Liability Company
- NSULC = Nova Scotia Unlimited Liability Company
- ABULC/NSULC taxed as a corporation in Canada
 - Canadian assets generate after-tax cash flow
 - Canadian withholding of maximum 15% on distributions (under U.S.-Canada Tax Treaty)
 - Plan to debt finance acquisitions, to the extent possible under Canadian thin capitalization rules, to create interest expense and thereby lower Canadian taxes
- ABULC/NSULC treated as a passthrough in the U.S.
 - U.S. Investors pay tax on Canadian activity reported on U.S. returns
 - U.S. foreign tax credit available (entity tax and withholding), but difficult to use

**UPDATES ON FERC POLICY
STATEMENT**

FERC TREATMENT OF INCOME TAXES

- Cost of service ratemaking for regulated assets is premised on setting rates to provide the regulated entity an opportunity to recover its legitimate, prudently incurred costs, including a return on its investment sufficient to attract necessary levels of capital
- Income taxation has long been recognized as among the legitimate costs of operating a regulated entity that may be recovered in rates
- Traditionally, FERC has recognized this cost through provision of an income tax allowance (ITA), designed to “gross up” the regulated entity’s return to account for the tax burden such that the entity’s return, post-tax, is at the appropriate level to attract necessary capital
 - This approach developed in an era when most regulated entities were owned by C-corporations
- The advent of ownership of regulated entities through tax pass-through entities (e.g., MLPs) changes the structure of ownership, but has not altered the reality that the regulated entity’s income is burdened by taxation

UPDATE ON FERC POLICY STATEMENT



- Prior to 1995: The allowable recoverable costs in the rate structure included an allowance for income taxes, even if the regulated entity was not a corporation
- 1995: FERC implemented the Lakehead policy, which provided that a partnership-owned oil pipeline could only include an ITA to the extent its limited partner interests were owned by corporate partners, which FERC over time applied in gas and electric settings
- July 2004: D.C. Circuit in SFPP case rejected the FERC's Lakehead policy. The issue of the appropriate form of tax allowance for SFPP was remanded to FERC
- May 2005: FERC issued new Policy Statement (PL05-5) on ITA

“Commission concludes that it should return to its pre-*Lakehead* policy and permit an income tax allowance for all entities or individuals owning public utility assets, provided that an entity or individual has an actual or potential income tax liability to be paid on that income from those assets.” Parag. 32

FERC new Policy Statement was appealed to D.C. Circuit

UPDATE ON FERC POLICY STATEMENT

- June 2005: FERC issues order on remand of SFPP case, stating it would apply the new policy statement; parties appeal to D.C. Circuit
- December 2006: Oral arguments in D.C. Circuit on both the policy statement and the SFPP case

IMPACT OF FERC POLICY STATEMENT

- Limitations on Eligible Holders in Certain MLPs
 - Boardwalk restrictions
 - IPO Certification
 - Boardwalk transfer application
 - “Individuals or entities are subject to taxation in the context of defining an eligible holder to the extent they are taxable on the items of income and gain allocated by the Partnership or would be taxable on the items of income and gain allocated by the Partnership if they had no offsetting deductions or credit.”

**UPDATE ON INSTITUTIONAL
OWNERSHIP IN THE MLP SPACE**

INSTITUTIONAL INVESTORS

- Mutual Funds
 - Legislative limitations
 - Timing of K-1s
 - State issues
- Tax Exempts (IRAs; KEOGHs)
 - UBTI
 - \$1,000 exclusion
- Closed End Fund (C Corporation)
 - Fiscal year end
 - Earnings and profits
 - Dividends (1099s) to shareholders
- Hedge Funds
 - Compliance issues

ACCOUNT NUMBERS AND UNITS BY ENTITY TYPE (2005)

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Entity Type	Total Accounts*	Percent	Total Units	Percent
Individual	1,222,624	51.71%	651,464,390	46.33%
Corporation	74,400	3.15%	124,836,299	8.88%
Partnership	27,123	1.15%	81,017,407	5.76%
Estate	14,265	0.60%	10,056,326	0.72%
Trust	393,687	16.65%	268,899,051	19.12%
Foreign Citizen	13,971	0.59%	24,975,018	1.78%
Other	36,381	1.54%	86,281,127	6.14%
Exempt Organization	16,898	0.71%	8,160,407	0.58%
IRA/SEP/KEOGH	525,593	22.23%	131,541,965	9.36%
Pension Plan	22,046	0.93%	15,316,198	1.09%
Qualified Ret. Plan	5,130	0.22%	1,143,207	0.08%
Clearing Entity	2,023	0.09%	869,240	0.06%
Roth IRA	<u>10,310</u>	<u>0.44%</u>	<u>1,516,696</u>	<u>0.11%</u>
	2,364,451	100.00%	1,406,077,331	100.00%

* Total Accounts are the accounts holding a position at some time during the tax year

ACCOUNT NUMBERS AND UNITS BY ENTITY TYPE (2006)

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Entity Type	Total Accounts*	Percent	Total Units	Percent
Individual	1,693,500	48.90%	951,008,811	42.91%
Corporation	117,663	3.40%	255,104,843	11.51%
Partnership	51,980	1.50%	173,817,743	7.84%
Estate	19,641	0.57%	32,978,224	1.49%
Trust	605,571	17.49%	443,881,139	20.03%
Foreign Citizen	31,514	0.91%	90,498,264	4.08%
Exempt Organization	25,275	0.73%	22,775,736	1.03%
IRA/SEP/KEOGH	850,349	24.56%	210,513,189	9.50%
Pension Plan	37,597	1.09%	26,965,180	1.22%
Qualified Ret. Plan	7,977	0.23%	2,139,247	0.10%
Clearing Entity	2,719	0.08%	3,938,867	0.18%
Roth IRA	<u>19,220</u>	<u>0.56%</u>	<u>2,430,945</u>	<u>0.11%</u>
	3,463,006	100.00%	2,216,052,187	100.00%

* Total Accounts are the accounts holding a position at some time during the tax year

TAX SHIELD

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Ratio of Taxable Income to Cash Distributed

- “We estimate that if you own the common units you purchase in this offering through the record date for distributions for the period ending December 31, 2009, you will be allocated, on a cumulative basis, an amount of federal taxable income for that period that will be 20% or less of the cash distributed to you with respect to that period.”

•EBITDA	\$3.10
<u>DD&A</u>	<u>\$2.70</u>
Taxable Income	\$0.40
Cash Distribution	\$2.00
Tax Shield	$1 - (\$0.40/\$2.00)$ = 80%

BIOGRAPHIES

ØChris Buckalew: 214.754.7912 (chris.buckalew@us.pwc.com)

Chris has twelve years in leading the practice unit for MLP Services and currently services more than 70 MLPs nationwide. He has assisted numerous partnerships in planning for asset distributions and exit strategies for partnership liquidations. He has also used this partnership expertise in the design and development of partnership accounting and reporting systems. These systems provide practical solutions to difficult tax reporting issues, including special allocations of pre-formation asset attributes, basis adjustment calculations, Section 704(c) curative income allocations and Schedule K-1 reporting for large partnerships.

ØTim Fenn: 713.758.2747 (tfenn@velaw.com)

Tim's principal area of practice is domestic and international business taxation, with a focus on partnerships and corporations. Much of his practice involves the taxation of MLPs and other clients in the energy industry. In addition, he advises individuals, private equity firms, investment banks, partnerships and corporations in various transactions, including mergers and acquisitions, capital market transactions and restructurings. Tim has successfully represented clients before the Internal Revenue Service, the U.S. Tax Court, the U.S. District Court for the Southern District of Texas, the U.S. Court of Appeals for the Sixth Circuit and the U.S. Court of Appeals for the Tenth Circuit.

ØBernard Morris: 416.777.6550 (morrisb@bennettjones.ca)

Bernard is involved with all aspects of Canadian and cross border tax issues pertaining to the structuring of business acquisitions, divestures, and financing. He has significant experience in advising on the utilization of tax effective flow-through entities, such as partnerships and commercial trusts in the context of private equity funds, and the use of investment funds to support domestic and international interests. His practice includes planning for inter-generational transfer of businesses.