

EXTENSIONS OF REMARKS

AN AMENDMENT TO PROVIDE A PERMANENT EXTENSION OF THE TRANSITION RULE FOR CERTAIN PUBLICLY TRADED PARTNERSHIPS

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OF NEW YORK

IN THE HOUSE OF REPRESENTATIVES

Tuesday, May 23, 1995

Mr. HOUGHTON. Mr. Speaker, I am joined today by several of my colleagues, including Mr. KLECZKA, Mr. JACOBS, Mr. CRANE, Mrs. KENNELLY, Mr. SHAW, Mr. HERGER, Mr. BUNNING, Mr. MCCRERY, and Mr. NEAL, in introducing legislation to permanently extend the 10-year grandfather for publicly traded partnerships [PTP's]. This provision applies to those PTP's that were in existence at the time the Omnibus Budget Reconciliation Act of 1987 was passed.

Publicly traded partnerships, sometimes called master limited partnerships, were first created in the early 1980's. PTP's combined the traditional limited partnership form with the ability to have the partnership units freely traded on a stock exchange or over the counter.

In the 1987 act, Congress enacted section 7704 of the Internal Revenue Code. Section 7704 provides that PTP's generally will be taxed as corporations. Section 7704 does not apply, however, to PTP's where 90 percent or more of their income is qualifying income, such as from timber, oil and gas, and real estate. In addition, other PTP's in existence when section 7704 was enacted were grandfathered, but only for 10 years, through 1997. Our bill would extend this grandfather provision permanently.

APPROPRIATENESS OF THE 10-YEAR GRANDFATHER

We believe the 10-year limit on the grandfather for existing PTP's was inappropriate and unnecessary given the purpose for which section 7704 was enacted. According to the committee reports accompanying the 1987 act, section 7704 was intended to stop the "long-term erosion of the corporate tax base." Generally, the concern was that much of corporate America would convert to PTP's, thereby causing corporate tax revenues to decline. There appears to have been no serious debate in 1987 over whether limiting the duration of the grandfather was necessary to address these concerns.

There is no question that our purpose in enacting section 7704 was fully achieved by prospective application of that section. The movement toward use of PTP's had barely begun by 1987; there were only approximately 120 in existence at that time. It was the snowball effect of future conversions that we sought to prevent. Prospective application of section 7704 stopped that snowball effect dead in its tracks. Permanently grandfathering all existing PTP's would have had no effect on this goal whatsoever. Conversely, limiting the duration of the grandfather to 10 years was unnecessary to achieve our purpose.

Since prospective application of section 7704 achieved our purpose, we believe Con-

gress erred in 1987 by limiting the grandfather to 10 years. Unless we reverse that decision before it takes effect in 1998, those PTP's still in existence and their owners will face serious hardships with no corresponding benefit to the Government or the tax system. Our bill merely asks Congress to rethink its decision before any damage is done.

I can foresee that some people might view this proposal as special interest legislation. I strongly disagree. Had we chosen in 1987 to provide a permanent grandfather for existing PTP's, no one would have batted an eye. Instead, a permanent grandfather in 1987 would have been an appropriate decision for Congress to make based on the extent to which existing PTP's relied on the law that was in effect when they were created. The fact that the decision was initially made in 1987 should not stop us from revisiting the issue so long as the original decision has not yet taken effect.

We in Congress are called on to make decisions about appropriate transition relief in virtually every tax bill. Indeed, these types of decisions are ones that are particularly suited for the Members of Congress to make, since they generally involve the balancing of competing interests rather than technicalities of tax law.

Our proposal is different only because it is separate in time from the 1987 act. On the other hand, the proposal is generic in scope, applying to any PTP fitting the criteria. We believe that it is fair, before the 10-year grandfather expires, to determine whether that decision was the proper one or whether a permanent rule would be better.

Generally, Congress does not place time limits on grandfather provisions, other than what might be called project-specific provisions. The reasoning behind this policy is that if taxpayers were justified in relying on the law in effect at the time the taxpayer took action, then the taxpayers deserve relief from the change in the law, not just for a limited period but as long as the taxpayer's circumstances do not change.

REASONS FOR A PERMANENT GRANDFATHER

Some may wonder why these PTP's should be permanently grandfathered. After all, if they were taking advantage of so large a loophole that Congress had to shut it down, why should they benefit merely because they got in under the wire?

The truth is that these PTP's did not take advantage of an egregious loophole. PTP's are structured no differently from other types of limited partnerships. They merely combined that basic limited partnership structure with the ability for the units to be readily traded. The problem was thus not a loophole in the tax code that needed to be closed retroactively.

These PTP's relied on the law in effect before passage of the 1987 act, and that reliance was completely reasonable. The first proposal directed toward PTP's surfaced in 1984, but President Reagan chose not to forward it to Congress in his tax reform recommendations and we did not independently take up the idea in 1986. It was only when Treasury proposed section 7704 in mid-1987

as part of a list of acceptable revenue raisers that the proposal received any official endorsement. By that time, most of the affected PTP's were already in existence.

This raises what I believe is the most important issue in this debate: fairness to the PTP's and, more importantly, their owners. The process of converting from a corporation to a PTP is a costly and time-consuming one, easily taking over 1 year. The conversion process involved consultation with investment bankers, appraisals, planning by corporate finance, securities and tax lawyers, multiple filings with the SEC and State securities agencies, proxy statements and shareholder votes, etc. This process would not have been started or completed had there been any reasonable prospect that a change in the tax law would have applied retroactively or after a limited period of time.

To make matters worse, many of these same costs will be incurred once again if the 10-year grandfather is not made permanent. Grandfathered PTP's will be forced to convert to corporate form on January 1998. To do so, however, will require lengthy planning, and the same investment banking advice, appraisals, and attorney fees. The need for extensive, advance planning makes it essential that the matter be resolved this year.

More important is the effect that loss of the grandfather will have on PTP investors. It is a virtual certainty that the value of PTP units will be affected adversely if the grandfather expires. So it will be the investors that suffer most. And who are these investors? Most are average, middle-class taxpayers who have invested in PTP units because of their high yield, many before the 1987 act was passed.

We do not achieve any tax policy goal by retaining the 10-year grandfather. That goal was fully achieved by making section 7704 apply prospectively. Instead, all we would accomplish by retaining the 10-year grandfather would be harm to these PTP's and their investors. There is no doubt what our decision should be.

In conclusion I want to note the diversity of the PTP's that would benefit from permanent extension of the grandfather. The PTP's affected are involved in a wide variety of industries, from motels and restaurants to chemicals, financial advising, and macadamia nuts. Undoubtedly, these businesses operate in many of our districts. Of course, our districts are the homes to the individual investors in these PTP's. The most recent count indicates that there are well over 300,000 individual investors.

The 10-year grandfather hangs like a sword of Damocles over each one of these PTP's. We in Congress have the ability to remove that sword and there is no reason why we should not do so. We urge our colleagues to join with us to support this bill.

Thank you, Mr. Speaker.

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