Master Limited Partnership (MLP) Investment Primer

There are many factors to take into account when considering an MLP investment, but some of the most important for an investor are **(1) after tax returns, (2) tax reporting, (3) diversification, (4) credit risk, and (5) fees**. An MLP investment decision may depend on the account type (taxable vs. tax deferred) and what priority or importance is given to these five categories.

Common Investment Vehicles for MLP Exposure	Holding Type	Pros	Cons
Master Limited Partnership (MLP) Direct investment in an MLP.	Direct	• Partnership structure allows pass-through taxation to end investor. • Can generate tax-deferred income via return of capital distributions.	• Partnership structure issues Schedule K-1. • Can result in tax-deferred accounts owing unrelated business taxable income (UBTI) tax liability if income designated as UBTI exceeding $1,000.[1]
(C-Corp) Exchange Traded Fund / Mutual Fund / Closed End Fund (ETF/MF/CEF) Funds structured as corporations (C-Corps) under the U.S. tax code. Must accrue tax liability.	Funds	• Holdings level diversification. • Investment purity (allows for greater than 25% allocation to MLPs, conferring higher income potential).	• C-Corp structured funds must accrue tax liability/asset which is paid/ credited out of the fund, which may lead to tracking error vs. underlying index.
(RIC-Structured) Exchange Traded Fund / Mutual Fund / Closed End Fund Funds structured as regulated investment companies (RICs) under the U.S. tax code. Quasi pass-through tax treatment.	Funds	• Holdings level diversification. • Sector level diversification. • Greater capital appreciation potential.	• 25% cap on MLP holdings for RIC-structured funds, conferring lower income potential.
Exchange Traded Note (ETN) Debenture that generally seeks to track the performance of a stated index.	Debenture	• Holdings level diversification. • May have lower tracking error.	• ETN is a promissory note which exposes investors to credit risk of the issuing institution. • ETNs coupons taxed at ordinary income rates. • Have maturity dates like bonds, leading to potential reinvestment risk.

RIC-Structured MLP Funds

To avoid taxation at the fund level, RIC-structured MLP funds limit MLP exposure to under 25% of the fund, the maximum allowed by the IRS to qualify as a RIC. These funds often seek to allocate the remaining 75% or so to General Partners of MLPs and other energy infrastructure companies with high correlations to MLPs.

The most efficient investments from a diversification perspective are the funds and the ETN, which generally seek to track the performance of a basket of different MLP securities. Some funds may be actively managed while others passively track an Index, but all provide some form of diversification (company, geographic, business segment) that cannot be achieved with an individual MLP investment. An investor could achieve diversification by investing directly in several different MLPs, but this would create additional trading costs and result in individual K-1s for each security and likely complexity from additional state tax filings.

Diversification does not guarantee investment returns and does not eliminate risk of loss.

1. Not all income from an MLP is designated as UBTI. The UBTI from the MLP is typically found in the attached statements with the K-1. However, the tax deferred account needs to consider all UBTI income within the account, not just the potential UBTI from MLP investments.

MLP Investment Vehicle Comparison for Taxable Accounts

MLPs designate taxable income on a K-1 form rather than the typical 1099 form. For non-professionals, the K-1 forms can be complex and may require the hiring of a tax professional in order to complete their federal, state, and local taxes accurately. Additionally, investing in an MLP directly will result in a taxpayer being required to file in more states than just their state of residency. Investors should factor tax preparation costs into the total cost (both time and money) of their investment.Tax reporting is one area where RIC-structured funds, C-Corp funds, and ETN structures provide a clear benefit – the funds and ETN securities report their distributions on the simpler 1099 form.

Account Suitability
■ Taxable Account ■ Tax-Advantaged Accounts

Account Suitability	Credit Risk[2]	Tax Reporting	Tax Treatment of Fund	Tax Treatment of Distributions: Qualified Dividends	Tax Treatment of Distributions: Return of Capital
Master Limited Partnership (MLP) (Taxable Account) Direct investment in an MLP.	No	Federal and State K-1	N/A	No	Deferred liability to the extent of basis[3]
(C-Corp) Exchange Traded Fund / Mutual Fund / Closed End Fund (Taxable Account, Tax-Advantaged Accounts) Funds structured as corporations (C-Corps) under the tax code. Must accrue tax obligations.	No	1099 Reporting	Taxed at fund-level as C-Corp	100% Eligible	Deferred liability to the extent of basis[4]
(RIC-Structured) Exchange Traded Fund / Mutual Fund / Closed End Fund (Taxable Account, Tax-Advantaged Accounts) Funds structured as regulated investment companies (RICs) under the U.S. tax code. Quasi pass-through tax treatment.	No	1099 Reporting	Likely no fund-level tax liability	Eligible for non-MLP distributions	Deferred liability to the extent of basis[4]
Exchange Traded Note (ETN) (Taxable Account, Tax-Advantaged Accounts) Debenture that generally seeks to track the performance of a stated index or reference asset.	Yes	1099 Reporting[1]	No taxes on debenture	No - Treated as ordinary income	N/A

Taxable Accounts

In **taxable accounts,** the most efficient method for investing in MLPs may be to invest directly in the securities themselves. While this type of investment has other drawbacks, from a tax perspective it is more efficient due to the favorable tax treatment of individual MLPs.

Tax Deferred Accounts

In **tax deferred accounts** (e.g. IRA, 401k), the tax benefit of individual MLPs may disappear because this can result in the account owing an unrelated business taxable income (UBTI) if the income designated as UBTI in the K-1 exceeds $1,000. As a result of these considerations, the ETN structure is typically more efficient for these types of accounts than an investment in an ETF/MF/CEF or individual MLP.

1. The IRS may assert that Section 1260 applies to ETNs, which may convert some long-term capital gains to ordinary income and impose an interest charge. Tax exempt and tax deferred investors may then be exposed to UBTI similar to a direct MLP investment.
2. In the context of MLP fund investing, and not including the direct inherent credit risk of the underlying holdings with the fund, credit risk applies to investments through the ETN structure, because ETNs are structured as notes (debt instruments) and are essentially an obligation of the issuing institution. Unlike ETFs/MFs/CEFs, where individual MLP investments are segregated, an ETN investment exposes investors to the credit risk of the issuing institution, which could become problematic if the issuer's credit rating is downgraded or, in a more extreme case, if the issuer goes bankrupt. If the latter were to occur, investors in the ETN from that issuer could lose all or most of their investment.
3. Income, deductions, gains, and losses on the K-1 are taxed at the applicable rate for such items based on their tax character.
4. Basis and ROC are tracked at the fund level. A RIC investor could receive dividend income or ROC from the fund. A C-Corp investor could receive QDI or ROC from the fund.

Impact of Taxes on ETFs and ETNs

When considering an MLP ETF/MF/CEF vs. an ETN, investors must consider the different tax effects on both distributions and capital appreciation. **The ETF/MF/CEF category is more efficient for investors concerned with the taxation of distributions.** All examples below are illustrative and do not represent actual returns of any specific ETF or ETN. Please note: the discussion below does not constitute tax advice; please consult a tax professional before making an investment decision.

Tax Liability for Distributions in Year of Receipt

Tax Rates	MLP	C-Corp Fund	RIC-Structured Fund	Exchange Traded Note
Return of Capital Distributions	0%	0%	0%	N/A
Qualified Dividends	N/A	20%[1]	20% for non-MLP portion of holdings, if eligible	N/A
Ordinary Income	37%	N/A	37%	37%

1. An investor may not be able to take advantage of the 20% QDI rate due to limitations on holding period. The table above assumes no holding period limitations and lists QDI rates at the maximum of 20% for illustrative purposes.

Tax Liability for Potential Capital Gains Upon Sale

Tax Rates	MLP	C-Corp Fund	RIC-Structured Fund	Exchange Traded Note
Short-Term Capital Gains	37%	20%[1]	37%	37%
Long-Term Capital Gains	37% for recapture amount; 20% for remaining gain	20%[1]	20%	20%

Assumptions: Maximum individual marginal tax rate of 37% (which applies to Ordinary Income and Short-Term Capital Gains); Tax Rate of 20% on Long-Term Capital Gains and Qualified Dividend Income. The tables represent maximum federal rates and are for illustrative purposes only. Actual rates may differ depending on investor tax brackets and state/local taxes. Does not include 3.8% net investment income tax, which may be applicable.

Tax Treatment of Funds that Invest in MLPs

ETFs/MFs/CEFs structured as C-Corps apply an effective tax rate to the fund's price appreciation/depreciation. The effective federal and state tax rate is currently estimated to be 22.5% in this primer.

Tax Treatment of ETNs

In contrast, because ETNs are debt instruments structured as notes, distributions from ETNs are taxed at the ordinary income rate. However, from a price appreciation perspective, ETNs can be a more efficient investment because they are not subject to corporate tax.

Fees & How They Impact MLP Investments

All else being equal, investors tend to prefer investment options with the lowest fees. However, due to the unique tax structure and reporting requirements of MLPs, investors need to consider all the various costs of their investment.

Fees by Investment Type	MLPs	C-Corp Structured Funds	RIC-Structured Funds	Closed End Funds	Exchange Traded Notes
Active Management Fees	No	Yes	Yes	Yes	No
Passive Management Fees	No	Yes	Yes	Yes	Yes
Tax Preparation Fees	Yes - Schedule K-1 complexity and state filings + other costs of owning MLPs	No - Beyond standard equity reporting requirements	No - Beyond standard equity reporting requirements	No - Beyond standard equity reporting requirements	No - Beyond standard equity reporting requirements

To make this clear we will define two types of costs: (1) management fees and, (2) other costs:

With regard to management fees, the clear winner is an individual MLP investment, because this is simply a security and there are no management fees associated with a direct investment in a MLP security.

For investors considering various MLP Fund structures, management fees are typically higher for actively managed MFs and CEFs, while ETFs and ETNs that are passively managed and track an Index typically have lower management fees. This tends to hold true across asset classes other than MLPs as well, and is really a distinction between active and passive management.

When considering additional costs (other than management fees and taxes), investors should factor in the costs of their tax return preparation if it includes a K-1 and additional state filings. Investors in individual MLPs that hire a tax professional to complete their tax return should consider this an additional cost of investment.

Other costs to consider are trading costs, commissions, and the cost of maintaining a brokerage account to trade securities. These costs may depend on several variables including the broker used and the size of the investment.

Energy Limited Partnership Category	ETF	Mutual Fund	Closed-End Funds	ETN
Average Management Fee[1]	0.65%	1.02%	1.07%	0.86%

1. A fund or note's management fee may be just one component of a product's cost. Fees may also vary by share class. Please review the product's prospectus before making any investment decision. Other costs or fees, both inside and outside the fund structure, would increase your expenses. Source: Morningstar Direct. Mutual Fund Universe is derived from Morningstar's classification of oldest share class of funds categorized as Energy Limited Partnership Category. Avg as of June 10, 2026. Investment Type Search Criteria broken down as follows: Mutual Fund; 'Open End Funds'; CEF, 'Closed-End Funds'; ETF, 'Exchange Traded Funds'; ETN, 'Uncollateralized Debt Instrument.'

GLOSSARY OF TERMS

C Corporation (C-Corp)

This refers to any corporation that, under United States federal income tax law, is taxed separately from its owners. Typically, ETFs are classified as Regulated Investment Companies ("RICs") and can therefore avoid this additional tax. However, as a result of regulatory requirements surrounding MLP investing, in order for an ETF to hold more than 25% of its assets in MLPs, the ETF must be structured as a C-Corp rather than a RIC. This C-Corp structure reduces some of the tax efficiencies for the ETF and its investors.

Credit Risk

This refers to the risk that a borrower will default on any type of debt by failing to make the required payments. In the context of ETN investing, credit risk is applicable because ETNs are structured as unsecured debt instruments issued by an institution. Therefore, an investor in an ETN is exposed to the credit risk of the institution (e.g. a bank) issuing the ETN. This could become problematic if the institution has its credit rating downgraded or in a more extreme case if the institution goes bankrupt. Credit risk is also sometimes referred to as "counterparty risk."

Effective Tax Rate

The rate at which an individual or corporation is taxed. For an MLP ETF, structured as a C-corp and subject to taxation, the effective tax rate includes the federal and state income tax rate (based on each MLP's state apportionment). The effective tax rate can change over time as it reflects both the state and federal tax treatment of the underlying holdings.

Form 1099

A tax document used to report different types of taxable income other than wages, salaries and tips. Most investors who purchase stocks are familiar with this form as a means to report taxable income from dividends, interest, selling stocks, etc. on their tax return.

Schedule K-1

A tax document used to report the income, deductions, gains and losses, credits, etc. to a business's partners or S corporation's shareholders. Because they are structured as partnerships, individual MLPs provide a K-1 rather than a Form 1099 to each shareholder. The K-1 is typically more complex, and for the average investor may require the assistance of a tax adviser.

Return of Capital

A return of the shareholder's cost to purchase the investment. It is not taxable until the accumulated return of capital exceeds the original investment cost. Most MLP partnership distributions are classified as return of capital and are tax deferred to the extent of the owner's basis.