I'm looking for MLP exposure. What investment vehicle should I use?

What type of account?

TAXABLE

NON-TAXABLE
Tax Deferred (e.g. IRA, 401k) & Tax Exempt (e.g. foundations, charities)

Individual MLPs – Not recommended for tax deferred accounts because this can result in the account owing an “unrelated business taxable income” (UBTI) if the income designated as UBTI from the MLP exceeds $1,000.*

Exchange Traded Fund (ETF) / Mutual Fund (MF) / Closed End Fund (CEF) – Funds structured as Corporations (“C-Corps”) allow for investment in tax-deferred accounts.

Exchange Traded Note (ETN) – May allow for investment in tax deferred accounts. **

RIC-Structured MLP ETF/Mutual Fund – Funds structured as regulated investment Companies (“RICs”) allow for investment in tax-deferred accounts.

SEE TABLES:

Table 1: MLP investment vehicle comparison for taxable accounts

Table 2: Illustrative after-tax return of MLP ETF vs. ETN

* 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.

** The IRS may assert that Section 1260 applies to ETNs, causing tax exempt and tax deferred investors to have UBTI as if it directly invested in MLPs.
### TABLE 1: MLP INVESTMENT VEHICLE COMPARISON FOR TAXABLE ACCOUNTS

<table>
<thead>
<tr>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct MLP Investment</td>
<td>No¹</td>
<td>No</td>
<td>Yes, requires the issuance of both federal and state K-1s to investors</td>
<td>All distributions received that are not pro-rata share of income are return of capital to the extent of tax basis in the MLP. Return of capital distributions reduce tax basis in the investment. The income, deductions, gains and losses on the K-1 are taxed at the applicable rate for such items based on their tax character - this will vary from preferential rates (e.g. long-term capital gains) of 23.8% up to ordinary income tax rates.</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>ETF</td>
<td>Yes</td>
<td>No</td>
<td>No, 1099 reporting only</td>
<td>Distributions that are return of capital are not taxable to the extent of basis; regular dividends are generally taxed at the ordinary federal tax rate (currently 40.8%). Dividends may be eligible for qualified dividend tax rates (currently up to 23.8%).</td>
<td>Yes. Taxed as a C-Corp</td>
<td>No³</td>
</tr>
<tr>
<td>Mutual Fund</td>
<td>Yes</td>
<td>No</td>
<td>No, 1099 reporting only</td>
<td>Distributions that are return of capital are not taxable to the extent of basis; regular dividends are generally taxed at the ordinary federal tax rate (currently 40.8%). Dividend may be eligible for qualified dividend tax rates (currently up to 23.8%).</td>
<td>Yes. Taxed as a C-Corp</td>
<td>Yes</td>
</tr>
<tr>
<td>Closed End Fund</td>
<td>Yes</td>
<td>No</td>
<td>No, 1099 reporting only</td>
<td>Distributions that are return of capital are not taxable to the extent of basis; regular dividends are generally taxed at the ordinary federal tax rate (currently 40.8%). Dividend may be eligible for qualified dividend tax rates (currently up to 23.8%).</td>
<td>Yes. Taxed as a C-Corp</td>
<td>Yes</td>
</tr>
<tr>
<td>ETN</td>
<td>Yes</td>
<td>Yes. An ETN is a promissory note which exposes investors to credit risk of the issuing institution</td>
<td>No, 1099 reporting only</td>
<td>Treated as ordinary income and taxed at marginal tax rate (top rate is currently 40.8%)</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>RIC-Structured Fund</td>
<td>Yes⁴</td>
<td>No</td>
<td>No, 1099 reporting only</td>
<td>Distributions that are return of capital are not taxable to the extent of basis; regular dividends are generally taxed at the ordinary federal tax rate (currently 40.8%). Dividends may be eligible for qualified dividend tax rates (currently up to 23.8%).</td>
<td>No</td>
<td>Sometimes</td>
</tr>
</tbody>
</table>

Sources: Global X Funds, Morningstar, Bloomberg 2018.

¹Diversification can be achieved through investments in multiple MLPs. Diversification does not guarantee investment returns and does not eliminate risk of loss.

²All tax rates used are for federal income tax purposes only and includes the 3.8% Medicare surcharge imposed under IRC Section 1411, as of 11/5/18.

³Generally, most ETFs are passively managed.

⁴RIC-structured funds limit MLP exposure to 25% of fund assets. The fund may hold other securities such as the general partners of MLPs, energy infrastructure companies or utility companies.
TABLE 2: ILLUSTRATIVE AFTER-TAX RETURN OF MLP C-CORP ETF VS. ETN

<table>
<thead>
<tr>
<th>Example</th>
<th>MLP Yield</th>
<th>MLP Price Appreciation</th>
<th>Total Return</th>
<th>ETF After Tax Return</th>
<th>ETN After Tax Return</th>
</tr>
</thead>
<tbody>
<tr>
<td>Example 1</td>
<td>6.0%</td>
<td>0.0%</td>
<td>6.0%</td>
<td>4.6%</td>
<td>3.8%</td>
</tr>
<tr>
<td>Example 2</td>
<td>6.0%</td>
<td>6.0%</td>
<td>12.0%</td>
<td>8.1%</td>
<td>8.1%</td>
</tr>
<tr>
<td>Example 3</td>
<td>6.0%</td>
<td>12.0%</td>
<td>18.0%</td>
<td>11.6%</td>
<td>12.7%</td>
</tr>
<tr>
<td>Example 4</td>
<td>6.0%</td>
<td>-6.0%</td>
<td>0.0%</td>
<td>1.1%</td>
<td>-2.4%</td>
</tr>
</tbody>
</table>

After Tax Return assumes position is sold after one year.

Discussion

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 (K-1 vs. 1099), (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. Each type of investment will have different characteristics in the context of these five categories, and understanding these differences will help investors make a more informed investment decision in the MLP space.

Taxation – 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 (K-1s, multiple investments required to achieve diversification), from a tax perspective it is more efficient due to the favorable tax treatment of individual MLPs. 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. Distributions from an ETF/MF/CEF investing in MLPs will typically be considered a return of capital and investors will reduce their cost in the investment by the amount of the return of capital. 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. 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 estimated to be 23.5% in this primer.

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.

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.
Tax Reporting
Tax reporting for individual MLPs is the cause of much investor frustration. 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. If this is the case, investors should factor this cost into the total cost (both time and money) of their investment.¹ Tax reporting is one area where the ETF/MF/CEF and the ETN structures provide a clear benefit – the ETF/MF/CEF and ETN securities report their distributions on the simpler 1099 form.

More Efficient: ETF/MF/CEF, ETN, RIC-structured MLP funds  
Less Efficient: Individual MLPs

Diversification²
The most efficient investments from a diversification perspective are the ETF/MF/CEF and the ETN, which all invest in 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.

More Efficient: ETF/MF/CEF, ETN, RIC-structured MLP funds  
Less Efficient: Individual MLPs

Credit Risk
Credit risk refers to the risk that a lender will default on any type of debt by failing to make a payment. 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 ETF/MF/CEF 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.

More Efficient: ETF/MF/CEF Individual MLPs³, RIC-structured MLP funds  
Less Efficient: ETN (has credit risk)

¹Investors who already use a tax professional may not incur additional costs through direct MLP investment.
²Diversification does not guarantee investment returns and does not eliminate risk of loss.
³Only the indirect credit risk inherent in equity securities.
Fees
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. 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. 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.

More Efficient: Individual MLPs (if K-1 reporting costs are low) or low-cost passively managed ETFs, ETNs, or RIC-structured MLP funds

Less Efficient: Individual MLPs (if K-1 reporting costs are high) or high-cost actively managed MF/CEF, MLPs

Please note: the discussion above does not constitute tax advice; please consult a tax professional before making an investment decision.

GLOSSARY OF TERMS

C Corporation (C-Corp) – 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 are exempt from this additional taxation. 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 – 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, the effective tax rate is used to describe the federal and state income tax rate (taking into account each MLP’s state apportionment) of the ETF that invests directly in MLPs (and therefore is structured as a C-Corp and subject to taxation). 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 generated from dividends, interest, selling stocks, etc. on their tax return.

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.

Marginal Tax Rate – the amount of tax paid on an additional dollar of income, which increases along with an individual’s income. An investor’s marginal tax rate is an important consideration for MLP investing because distributions from ETNs (including MLP ETNs) are considered to be interest and are taxed at the individual’s marginal tax rate.

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.
Investing involves risk, including the possible loss of principal. International investments may involve risk of capital loss from unfavorable fluctuation in currency values, from differences in generally accepted accounting principles, or from economic or political instability in other nations. Investments in securities of MLPs involve risk that differ from investments in common stock including risks related to limited control and limited rights to vote on matters affecting the MLP. MLP common units and other equity securities can be affected by macro-economic and other factors affecting the stock market in general, expectations of interest rates, investor sentiment towards MLPs or the energy sector, changes in a particular issuer’s financial condition, or unfavorable or unanticipated poor performance of a particular issuer (in the case of MLPs, generally measured in terms of distributable cash flow). The Global X MLP ETF (NYSE Arca: MLPA) and the Global X MLP & Energy Infrastructure ETF (NYSE Arca: MLPX) invests in the energy industry, which entails significant risk and volatility. The Funds are non-diversified which represents a heightened risk to investors. Furthermore, the Funds invest in small and mid-capitalization companies, which pose greater risks than large companies. The potential tax benefits from investing in MLPs depend on them being treated as partnerships for federal income tax purposes. If the MLP is deemed to be a corporation then its income would be subject to federal taxation at the entity level, reducing the amount of cash available for distribution to the fund which could result in a reduction of the fund’s value.

MLPA has a different and more complex tax structure than traditional ETFs and investors should consider carefully the significant tax implications of an investment in the Fund. MLPA is taxed as a regular corporation for federal income tax purposes, which differs from most investment companies. Due to its investment in MLPs, the fund will be obligated to pay applicable federal and state corporate income taxes on its taxable income, as opposed to most other investment companies. The fund expects that a portion of the distributions it receives from MLPs may be treated as tax-deferred return of capital. The amount of taxes currently paid by the fund will vary depending on the amount of income and gains derived from MLP interests and such taxes will reduce an investor’s return. The fund will accrue deferred income taxes for any future tax liability associated certain MLP interests. Upon the sale of an MLP security, the fund may be liable for previously deferred taxes which may increase expenses and lower the fund’s NAV.

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