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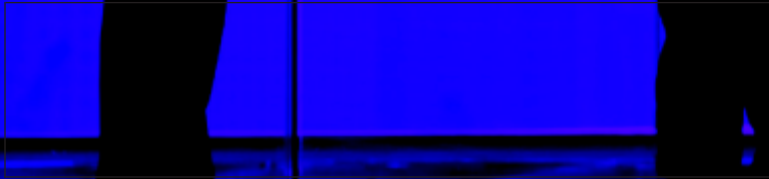
# TAX PLANNING INTERNATIONAL REVIEW

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## U.S. IRS Issues Proposed Regulations on Master Limited Partnership Income

The U.S. Internal Revenue Service (“IRS”) has published proposed regulations clarifying which activities generate “qualifying income” for a Master Limited Partnership (“MLP”). MLPs are partnerships whose ownership interests are traded on a securities exchange or secondary market. MLPs benefit from similar liquidity and access to markets as corporations, without being subject to an entity-level tax.

In 1987, in response to erosion of the corporate tax base due to the rapid growth of MLPs, Congress added section 7704 to the Internal Revenue Code, which generally treats MLPs as corporations. One exception to this treatment occurs if 90% or more of the MLP’s gross income is “qualifying income.” Qualifying income is generally passive income; however, under section 7704(d)(1)(E), qualifying income also includes income derived from the exploration, development, mining or production, processing, refining, transportation, or marketing of minerals or natural resources. The proposed regulations clarify which activities qualify under section 7704(d)(1)(E).

While the proposed regulations do not include activities in renewable energy as qualifying activities, Senator Chris Coons has announced that he will soon introduce legislation similar to the Master Limited Partnership Parity Act introduced in 2013. The legislation would extend the availability of MLPs to the renewable energy industry.

### The Proposed Regulations

Under the proposed regulations, qualifying activities include: (i) the exploration, development, mining or production, processing, refining, transportation, or marketing of minerals or natural resources (section 7704(d)(1)(E) activities); and (ii) certain support activities that are intrinsic to section 7704(d)(1)(E) activities (intrinsic activities).

The proposed regulations provide an exclusive list of operations that comprise each section 7704(d)(1)(E) activity. Only those operations listed in the proposed regulations, or as provided for in future published guidance, will qualify as a section 7704(d)(1)(E) activity; however, certain support services may qualify as intrinsic activities.

Recently, the IRS has been asked by paper and chemical companies to include their activities in MLPs as processing of natural resources. In response, the proposed regulations provide that processing and refining are generally activities that purify, separate or eliminate impurities, and that they do not include activities that cause a substantial physical or chemical change in the natural resource, or transform the natural resource into manufactured products. Thus, the production of plastics or similar petroleum derivatives does not qualify as processing petroleum, and the production of paper does not qualify as processing timber. Additionally, retail sales or distributions to retail sellers do not qualify under the proposed regulations.

Support services to the mineral or natural resource industry qualify as intrinsic activities if the particular activity: (i) is specialized to support a section 7704(d)(1)(E) activity; (ii) is essential to the completion of that activity; and (iii) requires the provision of significant services to support the activity.

To be specialized, the personnel performing the activity must have received training unique to the mineral or natural resource industry that is of limited

utility outside of section 7704(d)(1)(E) activities. If the activity includes the use of property, the property must be dedicated to section 7704(d)(1)(E) activities, must have limited use outside of those activities and cannot be easily converted to a use outside those activities. Alternatively, property used as an injectant in a section 7704(d)(1)(E) activity, such as water, lubricants and sand, qualifies but only if, as part of the activity, the partnership also collects and disposes of the injectant after use in accordance with applicable law. For example, a company transporting water for hydraulic fracturing will be a specialized activity, provided the company also collects and disposes of the flowback.

An activity is essential if it is required to physically complete the section 7704(d)(1)(E) activity (including in a cost-effective manner such as to make the activity economically viable), or required to comply with federal, state or local law. Legal, financial, consulting, accounting, insurance and other similar services are not essential.

An activity requires significant services to support the section 7704(d)(1)(E) activity if it is conducted on an ongoing or frequent basis by MLP personnel at the site of the section 7704(d)(1)(E) activities, and if those activities are necessary. Offsite activities (such as monitoring services) can qualify if performed on an ongoing or frequent basis, and if offered exclusively for those engaged in a section 7704(d)(1)(E) activity. The term “significant services” does not include the design, construction, manufacturing, repair, maintenance, lease, rent or temporary provision of property.

### Effective Date and Transition Rules

The rules are proposed to be effective for an MLP’s first taxable year that begins on or after the date final regulations are published. According to the proposed regulations, “no inference is intended” that activities undertaken prior to May 6, 2015 that are not qualifying under the proposed regulations were not qualifying when conducted.

The proposed regulations provide for a 10-year transition period ending on the last day of the partnership’s taxable year that includes the date that is 10 years after the date that these regulations are published as final regulations. During the transition period an MLP may treat income from an activity as qualifying income if: (i) the MLP received a private letter ruling from the IRS holding that income from the activity is qualifying income; (ii) the MLP engaged in the activity prior to May 6, 2015, treated the activity as giving rise to qualifying income, and it was qualifying income under the statute as reasonably interpreted prior to the issuance of the proposed regulations (a reasonable basis for the position is not enough); or (iii) after May 6, 2015, but before the regulations are published as final regulations, the MLP engages in the activity and the income from that activity is qualifying income under the proposed regulations.

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*Bloomberg BNA and Mayer Brown’s Energy Tax Confer-*

*ence: Maximizing Value will be held in Houston on September 21 and 22, featuring a panel session dealing specifically with IRS' recent proposed regulations impacting MLPs, recent consolidation of existing MLPs, the rise of alternative MLP-like structures and other trends. Additionally, a live webinar on July 23 will focus on the IRS' recent proposed regulations impacting MLPs.*

*Full details are available at <http://www.bna.com/energy-tax-conference/>.*