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CC:PA:LPD:PR (REG-132634-14), Room 5203
Internal Revenue Service
P.O.Box 7604
Ben Franklin Station
Washington, DC 20044

Re: Comments on Proposed REG-132634-14, Qualifying Income from Activities of
Publicly Traded Partnerships With Respect to Minerals or Natural Resources

Dear Ladies and Gentlemen:

On behalf of AmeriGas Partners, L.P. (“*AmeriGas*”), we welcome the opportunity to submit the following comments in response to the request for comments made by the Department of the Treasury (the “*Treasury*”) and the Internal Revenue Service (the “*IRS*”) in the Notice of Proposed Rulemaking dated May 6, 2015, regarding Proposed Treasury Regulations Section 1.7704-4¹ (the “*Proposed Regulations*”) issued under Section 7704 of the Internal Revenue Code of 1986, as amended (the “*Code*”).²

The Proposed Regulations provide guidance on whether income from a publicly traded partnership’s exploration, development, mining, production, processing, refining, transportation, and marketing of minerals or natural resources constitutes qualifying income for purposes of Section 7704(d). We are encouraged by the IRS’s effort to clarify an area of law that has long been resolved by private letter rulings, however, we are concerned that the Proposed Regulations failed to specifically include distribution and marketing of propane to end users at the retail level (the activity hereinafter referred to as the “retail sale of propane”) as one of the exclusive list of activities that generate qualifying income, particularly in light of the fact that treating income derived from such activity is consistent with the legislative history of Section 7704 and the IRS’s own position laid out in CCA 200749012. Since the enactment of Section 7704, there have been numerous master limited partnerships (“*MLPs*”) (including AmeriGas) that have relied on the clear guidance from the legislative history of Section 7704, and recently, the IRS’s position that the retail sale of propane generates qualifying income and is a type of business that Congress

¹ REG-132634-14; 80 F.R. 25970-25977 (May 6, 2015).

² Unless otherwise indicated, all “Section” references herein are to the Code.

sought to exempt from corporate income tax. Therefore, we strongly recommend that the IRS take this opportunity to specifically include the retail sale of propane as one of the qualifying activities consistent with legislative intent.

This letter is divided into five parts. Part I provides a summary of our recommendation. Part II provides a description of AmeriGas's retail propane business. Part III discusses the treatment of MLPs engaged in the distribution and marketing of propane to end users at the retail level under current law and the ambiguities raised by the Proposed Regulations with respect to the treatment of such activity. Part IV analyzes the legislative history of Section 7704(d)(1)(E) and the IRS's published position with respect to income derived from the distribution and marketing of propane to end users at the retail level. Finally, Part V provides a detailed recommendation to expressly include distribution and marketing of propane to end users as one of the qualifying activities in the definition of "marketing" under Proposed Regulations Section 1.7704-4(c)(7) in accordance with the applicable legislative history and the established IRS position.

I. Summary of Recommendation

This letter recommends that, based on the legislative history of Section 7704(d)(1)(E), in particular, the floor statements of Congressman Dan Rostenkowski and Senator Lloyd Bentsen during the enactment of Section 7704, the final Regulations should provide that the definition of "marketing" in Section 7704(d)(1)(E) includes the distribution and sale of propane to end users at the retail level, *i.e.*, that such activity generates "qualifying income" for purposes of Section 7704(d). This recommendation is consistent with the IRS's established position, and will provide certainty to the marketplace and those MLPs already engaged in such activity.

II. AmeriGas's Retail Propane Distribution Business

AmeriGas is an MLP formed under Delaware law in 1994 and it operates the nation's largest retail propane distribution business. The common units of AmeriGas are traded on the New York Stock Exchange under the symbol "APU."

As a clean and versatile energy source, propane is used for a wide variety of applications. Residential and commercial customers use propane primarily for home heating, water heating and cooking purposes. Commercial users include hotels, restaurants, churches, warehouses, and retail stores. Industrial customers use propane to fire furnaces, as a cutting gas and in other process applications. Other industrial customers are large-scale heating accounts and local gas utility customers who use propane as a supplemental fuel to meet peak load deliverability requirements. As a motor fuel, propane is burned in internal combustion engines that power over-the-road vehicles, forklifts, commercial lawn mowers, and stationary engines. Agricultural uses include tobacco curing, chicken brooding and crop drying.

Many customers often rely on propane rather than other conventional fuel sources because propane is easily transported and stored. Similar fuels, such as natural gas, generally

require pipelines to reach end users – the construction of which is not feasible in rural areas. Further, propane shows promise as an environmentally friendly fuel source for commercial lawn mowers, energy efficient combined heat and power generation, and liquid injection systems designed to enhance mileage on diesel powered vehicles.

AmeriGas distributes nearly 1.4 billion gallons of propane annually to approximately 2 million residential, commercial/industrial, motor fuel, agricultural and wholesale customers in all 50 states. In its wholesale operations, AmeriGas principally sells propane to large industrial end-users and other propane distributors. Retail deliveries of propane are usually made to customers by trucks. Propane is pumped from the truck, which generally holds 2,400 to 3,000 gallons of propane, into a stationary storage tank on the customer's premises. AmeriGas also delivers propane in portable cylinders, including propane exchange cylinders. Some of these deliveries are made to the customer's location, where cylinders are either picked up or replenished in place. Through AmeriGas's propane exchange program, propane cylinders are available at nearly 49,000 retail locations throughout the United States. AmeriGas operates over 2,000 distribution locations and has nearly 8,400 dedicated employees.

III. Current Statute and the Proposed Regulations' Definition of "Marketing"

Section 7704(a) provides that, except as provided in Section 7704(c), a publicly traded partnership (which, for purposes of Section 7704, means any partnership if interests in such partnership are traded on an established securities market or are readily tradable on a secondary market (or the substantial equivalent thereof)) shall be treated as a corporation for U.S. federal income tax purposes.

Section 7704(c)(1) provides, however, that Section 7704(a) shall not apply to any such publicly traded partnership for any taxable year if such partnership meets the gross income requirements of Section 7704(c)(2) for such taxable year and each preceding taxable year beginning after December 31, 1987, during which the partnership (or any predecessor) was in existence.

Section 7704(c)(2) provides that a partnership meets the gross income requirements of Section 7704(c) for any taxable year if 90% or more of the gross income of such partnership for such taxable year consists of "qualifying income."

Section 7704(d)(1) defines "qualifying income" to include passive-type income (including, but not limited to, interest, dividends and rents), as well as "income and gains derived from the *exploration, development, mining or production, processing, refining, transportation (including pipelines transporting gas, oil or products thereof), or the marketing* of any minerals or natural resources (including fertilizer, geothermal energy, and timber)..."³ This is commonly referred to as the natural resource exception.

³ Section 7704(d)(1)(E) (emphasis added).

Prior to the issuance of the Proposed Regulations, there has been no statutory or regulatory definition provided to interpret the list of activities above. The Proposed Regulations provide the first set of regulatory guidance concerning Section 7704(d)(1)(E) and the definition of “qualifying income” with respect to activities related to minerals or natural resources. The Proposed Regulations provide that qualifying income includes only income and gains from qualifying activities with respect to minerals or natural resources as defined in the Proposed Regulations Section 1.7704-4(b).⁴ For purposes of Section 7704(d)(1)(E), the term “qualifying activities” includes “Section 7704(d)(1)(E) activities”⁵ and “intrinsic activities.” The preamble to the Proposed Regulations provides that such regulations contain an exclusive list of operations that comprise the Section 7704(d)(1)(E) activities for purposes of Section 7704.⁶

The Proposed Regulations define each of the listed Section 7704(d)(1)(E) activities in detail, but this comment letter only addresses the Proposed Regulations’ definition of “marketing.”⁷ Section 1.7704-4(c)(7) of the Proposed Regulations defines “marketing” as follows:

“(7) Marketing. An activity constitutes marketing if it is performed to facilitate sale of minerals or natural resources and products produced under paragraph (c)(4) or (5) of this section, including blending additives into fuels. Marketing does not include activities and assets involved primarily in retail sales (sales made in small quantities directly to end users), which includes, but is not limited to, operation of gasoline service stations, home heating oil delivery services, and local gas delivery services.”⁸

The preamble to the Proposed Regulations provides that marketing is defined “as the activities undertaken to facilitate sale of minerals or natural resources, or products produced from processing and refining,” but that according to the legislative history of Section 7704, “marketing does not include activities and assets involved primarily in sales ‘to end users at the retail level.’”⁹ The preamble to the Proposed Regulations then concludes “[t]herefore, marketing does not include retail sales (sales made in small quantities directly to end users). For example, gas station operations are not included in marketing for purposes of section 7704(d)(1)(E). Id. However, marketing includes bulk and wholesale sales made to end users. See, for example, H.R. Rep. 100-1104, at 18 (1988) (Conf. Rep.) (with respect to fertilizer) and incorporating in footnote 1, 133 Cong. Rec. 37957 (December 22, 1987) (*statement of Sen. Bentsen with respect*

⁴ Prop. Treas. Reg. § 1.7704-4(a).

⁵ Prop. Treas. Reg. § 1.7704-4(c).

⁶ 80 F.R. 25971; Prop. Treas. Reg. § 1.7704-4(c)(1).

⁷ While this letter only addresses the definition of “marketing,” we believe that transportation of propane to end users at the retail level should also be treated as a qualifying activity under “transportation” based on the same legislative history.

⁸ 80 F.R. 25976.

⁹ 80 F.R. 25973 quoting S. Rept. No. 445, 100th Cong., 2d. Sess. 424 (1988).

to propane).”¹⁰ Interestingly, the preamble and the Proposed Regulations fall short of including retail sales of propane as an exception to the new definition of “marketing” in the Proposed Regulations.

Despite the clear congressional intent, the drafters of the Proposed Regulations neglected to expressly provide an exception for the retail sale of propane. In fact, the text of the Proposed Regulations, by expressly excluding “local gas delivery services” from the definition of marketing, leaves a fair amount of ambiguity regarding retail sales of propane or other liquefied petroleum gas. One could interpret the Proposed Regulations as stating that even retail sales of liquefied petroleum gas (including propane) are not included in the definition of marketing. Such a result would contravene the legislative history of Section 7704 and the IRS’s previous position, both described in more detail in the next part.

IV. Legislative History of Section 7704 and Past IRS Position

In the absence of statutory and regulatory guidance as to the definitions of the activities enumerated in Section 7704(d)(1)(E), the legislative history of Section 7704 has often been looked to as a source of interpretation. For example, the IRS has relied on the floor statements of Congressman Rostenkowski and Senator Bentsen in issuing private letter rulings holding that storage of a natural resource generates qualifying income even though storage is not one of the enumerated activities.¹¹ As described in greater detail below, the IRS has looked to the same legislative history as authority that retail marketing of propane gives rise to qualifying income.¹²

Specifically with respect to “marketing,” it is noteworthy that the face of the statute does not limit the kind of income which would qualify as marketing income under Section 7704(d)(1)(E). Rather the Conference Report accompanying the Revenue Act of 1987 (the legislation that enacted Section 7704) provided the basis for limiting the scope of qualifying marketing income to exclude income from retail sales. The Conference Report provides, in relevant part, as follows:

Income of certain partnerships whose exclusive activities are transportation and marketing activities is not treated as passive-type income. For example, the income of a partnership whose exclusive activity is transporting refined petroleum products by pipeline is intended to be treated as passive-type income, but the income of a partnership whose exclusive activities are transporting refined petroleum products by truck, or retail marketing with respect to refined petroleum

¹⁰ *Id.* (emphasis added).

¹¹ PLR 9452013 (Sept. 26, 1994) (income from natural gas storage business treated as qualifying income); PLR 9904025 (Jan. 29, 1999) (income from natural gas storage business treated as qualifying income).

¹² See CCA 200749012 (Dec. 7, 2007).

products (e.g., gas station operations) is not intended to be treated as passive type income.¹³

When originally stated, it was assumed that these references were to the so-called “Exxon factor;” the fear that Exxon would convert to an MLP. But the general effect was to exclude activities and assets involved primarily in transportation and sale of gasoline to retail customers from the definition of marketing.

However, at the time Section 7704 was enacted, Congress clearly evidenced an intent to include retail sales of liquefied petroleum gas in the definition of marketing, notwithstanding the general exclusion of retail sales. Specifically, Congressman Dan Rostenkowski, Chairman of the House Ways and Means Committee, stated:

I would like to clarify for the record the scope of the provision in the bill treating certain publicly traded partnerships as corporations as it applies to a specific partnership. The partnership that I am concerned about primarily engages in the purchase, transportation, storage, distribution, and retail and wholesale marketing of liquified [sic] petroleum gas – primarily propane – and other oil and gas products. These products are transported in trucks and rail cars that are owned or leased by the partnership and by third party pipelines with which the partnership makes arrangements for transportation. It is my understanding that the income derived by the partnership from these activities would be included within the definition of passive-type qualifying income.¹⁴

Furthermore, Senator Lloyd Bentsen, Chairman of the Senate Finance Committee stated:

Finally, I would like to clarify the definition of passive type income. Under the conference agreement, income of a partnership from the purchase, transportation, storage, distribution, and retail and wholesale marketing of liquified [sic] petroleum gas – primarily propane – and other oil and gas products is passive-type income, even though such products are transported in trucks and rail cars that are owned or leased by the partnership and transported by third party pipelines with which the partnership contracts for transportation.¹⁵

Both of the Bentsen and Rostenkowski statements with respect to retail sales of propane were acknowledged and confirmed in the legislative history of the Technical Corrections Act of 1988 (the “**1988 Act**”), in which the retail limitation as applied to transportation and marketing activities was clarified. The Conference Report on the 1988 Act notes that “income from transporting refined petroleum products by truck to retail customers is not qualifying income.”¹⁶

¹³ H.R. Rep. No. 495, 100th Cong., 1st Sess. 947 (1987), 1987-3 C.B. 946-947.

¹⁴ 133 Cong. Rec. H 11967, 11968 (December 21, 1987).

¹⁵ 133 Cong. Rec. S 18651-02, (December 22, 1987).

¹⁶ H.R. Rep. No. 1104, 100th Cong., 2d. Sess. 18 (1988)

However, a footnote to such statement in the Conference Report provides that “[i]ncome from transportation and marketing of liquefied petroleum gas in trucks and rail cars or by pipeline, however, may be treated as qualifying income.”¹⁷ The footnote refers to the statements of Congressman Rostenkowski and Senator Bentsen.¹⁸ The Senate Report also contains a similar footnote.¹⁹

The IRS, in Chief Counsel Advice 200749012 concluded that “income derived from the distribution and marketing of propane to end users at the retail level constitutes qualifying income under [Section] 7704(d)(1)(E).”²⁰ In reaching this conclusion, the IRS specifically cited the legislative history discussed above, and referred to the statements of Congressman Rostenkowski and Senator Bentsen.²¹ The IRS stated: “These two coordinated statements, issued by the chairmen of the House Ways and Means Committee (Congressman Rostenkowski) and the Senate Finance Committee (Senator Bentsen), respectively, *evidence a clear intention* to treat income derived from the retail marketing of propane as qualifying income,” and that “[i]t is clear from the committee reports that these joint statements were viewed as authoritative pronouncements concerning the scope of the legislation.”²²

V. Summary and Recommendation

Based on the preamble to the Proposed Regulations, which specifically cites the above-referenced legislative history to Section 7704, it is clear to us that the Treasury Department and the IRS continue to support the position that retail sales of liquefied petroleum gas, including propane, generate qualifying income for purposes of Section 7704(d)(1)(E). AmeriGas and other retail propane MLPs have consistently relied on this position in treating income derived from retail sales of propane as qualifying income.

Accordingly, to eliminate uncertainty in the market and to clarify the IRS’s accepted position, we respectfully recommend that the final Regulations explicitly provide that retail sales of liquefied petroleum gas, including propane, are included in the definition of marketing for purposes of Section 7704(d)(1)(E) and therefore generate qualifying income.

Thank you for the opportunity to comment on the Proposed Regulations. If you have any questions, please contact the undersigned at (713) 250-2165. We look forward to working with

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ S. Rept. No. 445, 100th Cong., 2d. Sess. 424 FN 11 (1988) (“Income from transportation and marketing of liquefied petroleum gas in trucks (as well as in railcars or by pipeline), however, may be treated as qualifying income. See Statement of Mr. Rostenkowski, 133 Cong. Rec. H 11,968 (December 21, 1987); see also Statement of Senator Bentsen, 133 Cong. Rec. S 18,651 (December 22, 1987) (substantially similar language)”).

²⁰ CCA 200749012.

²¹ *Id.*


²² *Id.* (emphasis added).

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you to ensure that the final Regulations under Section 7704(d)(1)(E) will be consistent with the Congressional intent of enacting Section 7704.

Respectfully submitted,

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