

## IRS Proposes Guidance for Determining MLP Qualifying Income

***Proposed regulations seek to provide rules for determining MLP qualifying income from certain activities and services performed with respect to minerals or natural resources.***

On May 5, 2015, the Internal Revenue Service (IRS) issued proposed regulations that would provide additional guidance for purposes of interpreting the rules under Internal Revenue Code (IRC) Section 7704(d)(1)(E) relating to the classification of income from certain activities with respect to minerals or natural resources as qualifying income. The proposed regulations were issued in response to increased interest in the application of IRC Section 7704(d)(1)(E) and will affect publicly traded partnerships (PTPs), master limited partnerships (MLPs) and their partners. The Department of the Treasury (Treasury) and the IRS have requested comments on all aspects of the proposed regulations. Before the proposed regulations are adopted as final regulations, Treasury and the IRS will consider any comments that are timely submitted to the IRS.

### Relevant Activities

The proposed regulations provide that certain activities and services relating to minerals or natural resources, which are known as Qualifying Activities, generate qualifying income within the meaning of IRC Section 7704(d)(1)(E). Qualifying Activities include both:

- Section 7704(d)(1)(E) Activities, which the proposed regulations define to include the exploration, development, mining or production, processing, refining, transportation or marketing of minerals or natural resources, and
- Intrinsic Activities, which the proposed regulations define to encompass certain limited support activities that are “intrinsic” to Section 7704(d)(1)(E) Activities.

Section 7704(d)(1)(E) Activities are intended to represent various stages of the extraction of minerals or natural resources from the earth and the eventual sale of products into the relevant markets. In turn, the stages of extraction include various types of activities performed with respect to minerals or natural resources, which are described in detail in the proposed regulations. Intrinsic Activities are intended to represent certain limited activities that support Section 7704(d)(1)(E) Activities and will generate qualifying income because such income is derived from the underlying Section 7704(d)(1)(E) Activity. An activity is an Intrinsic Activity, if all of the following apply:

- The activity is specialized to support a Section 7704(d)(1)(E) Activity.
- The activity is essential to the completion of a Section 7704(d)(1)(E) Activity.
- The activity requires the provision of significant services to support the Section 7704(d)(1)(E) Activity.

## 10-Year Transition Period

The proposed regulations will apply to income earned by a PTP or MLP in a taxable year that begins on or after the date that the regulations are published as final regulations in the Federal Register. The proposed regulations also provide for a 10-year transition period beginning on the date the regulations are published as final regulations in the Federal Register. The transition period will be relevant in three instances.

First, a PTP or MLP may treat income from an activity as qualifying income during the 10-year transition period, if the PTP or MLP is in receipt of a private letter ruling (PLR) from the IRS holding that its income constitutes qualifying income within the meaning of IRC Section 7704(d)(1)(E).

Second, a PTP or MLP may treat income from an activity as qualifying income during the 10-year transition period if, prior to the date on which the proposed regulations are published in the Federal Register (May 6, 2015), the PTP or MLP is (a) publicly traded, (b) engaged in the specific activity and (c) treated such activity as giving rise to qualifying income within the meaning of IRC Section 7704(d)(1)(E); provided that such income constitutes qualifying income under the current form of IRC Section 7704(d)(1)(E) as reasonably interpreted prior to the issuance of the proposed regulations.

Finally, a PTP or MLP may treat income from an activity as qualifying income during the 10-year transition period if the PTP or MLP is (a) publicly traded and (b) engages in such activity after the date on which the proposed regulations are published in the Federal Register (May 6, 2015) but prior to the date on which the regulations are published as final regulations in the Federal Register; provided that such income constitutes qualifying income under the proposed regulations.

## Conclusion

While still only in proposed form, the additional guidance relating to the classification of income from certain activities with respect to minerals or natural resources as qualifying income is likely to be material to many PTPs, MLPs and their partners. Even before the IRS promulgates the final regulations, taxpayers should consult their tax advisors and consider carefully the potential impact of these changes on planned or completed transactions and arrangements.

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