

Tax Alert

May 6, 2015

IRS Comes Out With Long-Awaited Proposed Regulations Clarifying the Scope of Assets and Activities That Qualify for MLP Treatment

On May 5, 2015, the IRS issued proposed regulations that provide guidance on whether income from activities with respect to minerals or natural resources is qualifying income for publicly traded partnerships (MLPs). The proposed regulations come after a long pause in the IRS's issuance of rulings in this area while the IRS studied the issues. Prior to the proposed regulations, the authority in the minerals and natural resources MLP area was limited to the statute, legislative history and a body of private letter rulings that could not be relied upon by anyone as binding legal precedent other than the taxpayer that received the ruling.

Under the proposed regulations, qualifying income includes only income and gains from "qualifying activities" with respect to minerals or natural resources. For this purpose, "qualifying activities" include exploration, development, mining or production, processing, refining, transportation and marketing of minerals or natural resources, as well as certain active support activities that are "intrinsic" to the exclusive list of activities described above.

The IRS stated in connection with the proposed regulations that "[t]hese proposed regulations are largely consistent with the rulings the IRS has issued in the past, with some exceptions. Where the new guidance interprets the law more narrowly than in the past," the IRS added, "Treasury and IRS believe the regulations more accurately reflect Congressional intent." For example, consistent with the past rulings, the proposed regulations expressly list hydraulic fracturing and water transportation—but only when coupled with flowback recycling and disposal services—as activities which may generate qualifying income.

On the other hand, the proposed regulations deviate from prior rulings in two notable areas. First, the proposed regulations provide that the conversion of methane into methanol and synthesis gas is not a qualifying activity. Second, the proposed regulations also provide that the processing of timber into pulp is not a qualifying activity, in contrast to prior ruling practice.

The proposed regulations generally include a 10-year transition period for an MLP to continue to treat income from an activity as qualifying income if the MLP had previously received a private letter ruling from the IRS or if the MLP treated such income as qualifying income prior to May 5, 2015, based on a reasonable interpretation of the statute and legislative history, taking into consideration IRS pronouncements in this area. MLPs that engage in an activity after May 6, 2015, may rely on the proposed regulations until final regulations are published.

The IRS has requested public comments, which are due by August 4, 2015

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