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Proposed regulations – Qualifying income, minerals or natural resources-related activities of partnerships

May 5: The Treasury Department and IRS released for publication in the *Federal Register* proposed regulations (REG-132634-14) as guidance relating to qualifying income from activities of publicly traded partnerships with respect to minerals or natural resources. These proposed regulations also describe certain activities that are intrinsic to section 7704(d)(1)(E) activities.

Read the [proposed regulations](#)

Background

Because of a perception that the growth of certain publicly traded partnerships was eroding the corporate tax base, section 7704(a) was enacted in 1987 to provide that publicly traded partnerships generally will be treated as corporations.

An exception to the general rule was provided by section 7704(c). That exception applies if 90 percent or more of the partnership's gross income is "qualifying income."

For these purposes, "qualifying income" is defined generally as passive-type income—interest, dividends, and rent. Also, the definition of qualifying income includes income and gains derived from the exploration, development, mining or production, processing, refining, transportation, or marketing of minerals or natural resources under section 7704(d)(1)(E).

Prior regulations provide guidance on: (1) when a partnership is publicly traded; (2) transition rules for partnerships in existence prior to the effective date of section 7704; and (3) qualifying income from certain financial products. To date, there have not been regulations under section 7704(d)(1)(E). Instead, the IRS issued private letter rulings to address questions about section 7704(d)(1)(E).

The preamble to today's proposed regulations states that proposed regulations are being issued because requests for private letter rulings increased from five or fewer requests each year before 2008 to more than 30 requests received in 2013. Also, many of these ruling requests generally

concerned income from support services provided to businesses engaged in the section 7704(d)(1)(E) activities.

Proposed regulations

Today's proposed regulations provide guidance as to whether income from activities with respect to minerals or natural resources as defined in section 7704(d)(1) is qualifying income.

As noted in the preamble, these proposed regulations do not address the transportation or storage of certain fuel, activities with respect to industrial source carbon dioxide, alcohol fuel, or biodiesel fuel. The IRS and Treasury are requesting comments as to whether guidance is needed with respect to these activities and, if so, what specific issues need to be addressed

The proposed regulations use the term "qualifying activities" to describe activities relating to minerals or natural resources that generate qualifying income, including:

- The exploration, development, mining or production, processing, refining, transportation, or marketing activities—i.e., section 7704(d)(1)(E) activities
- Certain limited support activities that are intrinsic to section 7704(d)(1)(E) activities

The proposed regulations list the requirements under which an activity is a qualifying activity, and further define the terms listed as section 7704(d)(1)(E) activities, above. Certain activities are mentioned in the proposed regulations as non-qualifying activities, including:

- Timber processing, including pulp, paper, paper products, treated lumber, oriented strand board, plywood, and treated poles
- Olefins produced from assets not depreciated under MACRS class 13.3 (Petroleum Refining)
- The production and sale of methanol

Intrinsic activities

As noted in the proposed regulations, the IRS and Treasury recognize that certain limited support activities that are intrinsic to section 7704(d)(1)(E) activities also give rise to qualifying income because the income is derived from the section 7704(d)(1)(E) activity. The proposed regulations list three requirements that must be met for the support activity to be intrinsic:

- Specialized – The personnel performing the activity and any property used in the activity or sold to the customer performing the section 7704(d)(1)(E) activity must be "specialized" (e.g., personnel have received training unique to the mineral or natural resource). The preamble provides as an example of a non-intrinsic activity, catering services provided on a drilling site.
- Essential – The activity must be essential to the section 7704(d)(1)(E) activity, meaning that it must be necessary to physically complete the activity or to comply with federal, state or local law. The preamble provides as an example, water delivery and disposal services for water provided for use in fracking as an essential activity.
- Significant services – The preamble explains that a partnership provides "significant services" if its personnel have an ongoing or frequent presence at the site of the section 7704(d)(1)(E)

activity. The IRS and Treasury have specifically requested comments as to whether and how this requirement can be set forth in an objective standard.

- The proposed regulations also note that a qualifying activity may include extensive offsite services—for example, monitoring services may satisfy the significant services criterion.
- A list of certain activities that do not qualify as significant services is also provided, and include the design, construction, manufacture, repair, maintenance, lease, rent or temporary provision of assets.

Proposed effective date, transition rules

The proposed regulations are to be effective and apply for income of a partnership in a tax year beginning on or after the date that these rules are published as final regulations in the *Federal Register*.

A 10-year transition period is provided, which ends on the last day of the partnership's tax year that includes the date that is 10 years after the date of publication of the final regulations.

To apply the transition rule, the partnership must have a private letter ruling from the IRS that the income is from the activity is qualifying income, or that before May 6, 2015 (the publication date of these proposed regulations), the partnership was publicly traded, engaged in the qualifying activity, and this activity reasonably interpreted (e.g., a "will opinion" obtained from a competent tax advisor) the statute prior to the provisions in today's release.

Additionally, a publicly traded partnership that engages in an activity after May 6, 2015, but before the date the final regulations are published may treat income from that activity as qualifying during the transition period if the income from that activity is qualifying under the proposed regulations.

Comments and requests for a public hearing must be received by a date that is 90 days after May 6, 2015.

Contact Information

For more information on this Alert, please contact the authors [Robert Swiech](#), [Paul Kugler](#), [Deborah Fields](#) or one of our AI Tax Professionals:

[Jay Freedman](#)

New York

T: 212-954-3693

[Jeffrey Millen](#)

New York

T: 212-872-4490

[Michael Oates](#)

Roseland

T: 973-577-2408

[Emmanuel Tuffuor](#)

New York

T: 212-872-4475