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BLOG POST

MLP Qualifying Income - IRS May Reconsider Position on the "Processing or Refining" of NGLs into Olefins

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An IRS official indicated that the government may reconsider its position in the recently issued proposed regulations under Section 7704(d)(1)(E) of the Internal Revenue Code regarding the production of olefins derived from natural gas liquids (NGLs). According to press reports, Curtis G. Wilson, IRS associate chief counsel (passthroughs and special industries), stated that the government has been meeting with industry engineers to better understand how olefins are produced – "We thought we had an understanding. We might have been wrong," Mr. Wilson said at the American Bar Association 2015 Joint Fall CLE Meeting in Chicago on September 18, 2015. *See* Laura Davison, *Final Publicly Traded Partnership Rules Could Bless Olefins*, BNA Daily Tax RealTime (September 18, 2015) & David Stewart, *ABA Meeting: List in Proposed PTP Qualifying Income Regs is Not 'Final Word'*, Tax Analysts (September 21, 2015).

The proposed regulations provide that an activity is processing or refining only if the activity is done to "purify, separate or eliminate impurities." Moreover, the proposed regulations generally provide that an activity will not qualify as processing or refining if the activity causes a substantial physical or chemical change in a mineral or natural resource or transforms the mineral or natural resource into new or different mineral products or into manufactured products.

In determining what constitutes "processing or refining" the proposed regulations are more strict with respect to the processing or refining of natural gas as compared to crude oil. For example, the proposed regulations confirm that processing includes the fractionation or separation of natural gas into its constituents which are normally recovered in a gaseous phase (methane and ethane) and those which are normally recovered in a liquid phase (propane, butane, pentane and gas condensate). However, the proposed regulations provide that any further processing or refining of those components, such as processing of NGLs into olefins through the use of a steam cracker, is not a qualifying activity. On the other hand, the proposed regulations provide that the production of olefins from a crude oil feedstock is a qualifying activity if the olefins are produced at a refinery in connection with the production of fuel.

Treating the processing of NGLs into olefins as a qualifying activity would be consistent with prior private letter rulings issued by the IRS (PLRs 201241004 and 201340011) and also would be consistent with the proposed regulations' treatment of olefins produced in the crude oil refining process.

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If you have questions regarding the proposed regulations or MLP qualifying income in general, please reach out directly to one of the members of Bracewell's tax team.

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