

INSIGHTS

Final Regulations on MLP Qualifying Income Released and Published Despite Trump Moratorium

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On January 19, 2017, the Department of the Treasury and the Internal Revenue Service (IRS) issued final regulations ([Final Regulations](#)) regarding qualifying income under Internal Revenue Code (Code) section 7704(d)(1)(E). The Final Regulations were published on January 24, 2017 despite the Trump administration's prior announcement of a "freeze" on all unpublished regulations on January 20, 2017.

Under Code section 7704, 90% of a publicly traded partnership's income must be qualifying income in order for the partnership to maintain its pass-through status. Consistent with the proposed regulations issued in May 2015 ([Proposed Regulations](#)), the Final Regulations define qualifying income, for purposes of Code section 7704(d)(1)(E), as income from qualifying activities with respect to minerals and natural resources. Qualifying activities are (i) activities specifically enumerated in Code section 7704(d)(1)(E), including exploration, development, mining or production, processing, refining, transportation and marketing of minerals and natural resources (section 7704(d)(1)(E) activities) and (ii) activities that are intrinsic to section 7704(d)(1)(E) activities. The Final Regulations, however, provide significant changes to the Proposed Regulations with respect to the scope of such qualifying activities.

Section 7704(d)(1)(E) Activities

- **"Exclusive Lists" Removed.** The Final Regulations eliminate the concept of an exclusive list of section 7704(d)(1)(E) activities provided by the Proposed Regulations. Instead, the Final Regulations provide a general definition of each of the section 7704(d)(1)(E) activities followed by a non-exclusive list of examples of each.
- **Processing and Refining Activities.**
 - The Final Regulations expand the scope of activities qualifying as processing and refining by removing the requirements that (i) the taxpayer use a consistent Modified Accelerated Cost Recovery System (MACRS) class life for assets used in the activity and (ii) the processing and refining not cause a substantial physical or chemical change in the mineral or natural resource.

- The Final Regulations define the scope of qualifying refining and processing activities by category of natural resource (e.g., natural gas and crude oil, ores and minerals, and timber). Qualifying refining activity with respect to both natural gas and crude oil is defined by an expanded list of qualifying end-products. Such end-products include those typically produced at a petroleum refinery or natural gas processing plant, regardless of where they actually are produced by the taxpayer. The application of such expanded list to both natural gas processing and crude oil refining eliminates a preference in the Proposed Regulations for crude oil over natural gas, as well as a preference for fuel products over non-fuel products.
- **Liquefied Natural Gas (LNG) and Liquefied Petroleum Gas (LPG).** Consistent with the Proposed Regulations, the Final Regulations do not treat LNG and LPG as natural resources. The Final Regulations, however, explicitly provide that the liquefaction or regasification of natural gas are qualifying transportation activities, and the retail sale of LPG is a qualifying marketing activity.
- **Compression Services.** The Final Regulations expand the Proposed Regulations by treating the provision of compression services to a pipeline as a qualifying transportation activity.
- **Additional Activities.** The Final Regulations add a list of qualifying activities derived from a section 7704(d)(1)(E) activity. Such additional activities include:
 - the receipt of reimbursements for costs related to the performance of a section 7704(d)(1)(E) activity, as well as for the costs of providing office functions necessary for a section 7704(d)(1)(E) activity;
 - the sale of renewable identification numbers (RINs); and
 - the ownership of passive economic interests in minerals and natural resources including production royalties, minimum annual royalties, net profits interests, delay rentals, and lease-bonus payments.

Activities Intrinsic to Section 7704(d)(1)(E) Activities. The Final Regulations maintain the Proposed Regulations' requirements that a qualifying intrinsic activity (i) is specialized to support a section 7704(d)(1)(E) activity, (ii) is essential to the completion of a section 7704(d)(1)(E) activity, and (iii) requires the provision of significant services to support a section 7704(d)(1)(E) activity

- **Expansion of Injectants Exception.** Like the Proposed Regulations, the Final Regulations include an injectants exception, which allows the provision of injectants (e.g., water and lubricants) for use in oil and gas exploration to meet the specialization requirement even if such injectants are commonly used outside of section 7704(d)(1)(E) activities. The Final Regulations expand the exception by eliminating the Proposed Regulations' requirement that a taxpayer provide both injectant delivery and disposal services to the same well. Under the new approach, income from such activities will meet the specialization requirement so long as the taxpayer (i) provides injectants exclusively to those conducting section 7704(d)(1)(e) activities, (ii) engages in the trade or business of

collecting, cleaning, recycling, or otherwise disposing of injectants after use in accordance with applicable regulations, and (iii) operates its injectant delivery and disposal services within the same geographic area.

Transition Rules. The Final Regulations apply to income earned in taxable years beginning on or after January 19, 2017. The Final Regulations, however, provide a 10-year transition period ending in a partnership's taxable year that includes January 19, 2027. During the transition period, the partnership can continue to treat income as qualifying as long as (i) it received a ruling from the IRS that such income is qualifying; (ii) prior to May 6, 2015, the partnership was publicly traded, engaged in the activity, and treated the activity as giving rise to qualifying income, and that income was qualifying under the statute as reasonably interpreted prior to May 6, 2015; (iii) prior to May 6, 2015, the partnership was publicly traded and entered into a binding agreement for construction of assets to be used in such activity that would give rise to qualifying income under the statute as reasonably interpreted prior to May 6, 2015; or (iv) the partnership is publicly traded and engaged in the activity after May 6, 2015 but before January 19, 2017, and the income from that activity was qualifying income under the Proposed Regulations.

Moratorium on Unpublished Regulations

The day after the issuance of the Final Regulations, President Trump's Chief of Staff, Reince Priebus, released a [memorandum](#) indicating that any then unpublished regulations, including the Final Regulations, should be withdrawn and remain unpublished until reviewed and approved by the new administration. Surprisingly, despite the terms of the memorandum, the Final Regulations were published in the Federal Register on January 24, 2017 as initially scheduled and are currently in effect. While it is unclear why the Final Regulations were immediately published in light of the Priebus memorandum, the memorandum allows for an exception to withdrawal in emergency situations or other urgent circumstances relating to health, safety, financial, or national security matters, or otherwise, which may have been applied to the Final Regulations.