

IRS Private Letter Rulings on Qualifying Income

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2014 Annual Meeting | July 17, 2014

I. Statutory Definition of Natural Resources “Qualifying Income”

Under section 7704(d)(1)(E), “qualifying income” means:

“income and gains derived from the exploration, development, mining or production, processing, refining, transportation (including pipelines transporting gas, oil, or products thereof), or the marketing of any mineral or natural resource (including fertilizer, geothermal energy, and timber), industrial source carbon dioxide, or the transportation or storage of any fuel described in subsection (b), (c), (d), or (e) of section 6426, or any alcohol fuel defined in section 6426(b)(4)(A) or any biodiesel fuel as defined in section 40A(d)(1),”

II. Section 7704(d)(1)(E) Legislative History

A. Revenue Act of 1987 (P.L. 100-203)

1. House Committee Report (H. Rept. 100-391):

“In the case of natural resources activities, special considerations apply. Thus, passive-type income from such activities is considerably broader, and includes income and gains from exploration, development, mining or production, refining, transportation, (including through pipelines transporting gas, oil, or products thereof), or marketing of, any mineral or natural resource, including geothermal energy and timber. For purposes of this provision, refining any natural resource is intended to include the production of fertilizer.”

II. Section 7704(d)(1)(E) Legislative History

A. Revenue Act of 1987 (P.L. 100-203)

2. Conference Committee Report (H. Rept. 100-495):

“Income and gains from certain activities with respect to minerals or natural resources are treated as passive type income. Specifically, natural resources include fertilizer, geothermal energy, and timber, as well as oil, gas or products thereof. For this purpose, oil, gas, or products thereof means gasoline, kerosene, number 2 fuel oil, refined lubricating oils, diesel fuel, methane, butane, propane, and similar products which are recovered from petroleum refineries or field facilities. Oil, gas, or products thereof are not intended to encompass oil or gas products that are produced by additional processing beyond that of petroleum refineries or field facilities, such as plastics or similar petroleum derivatives. Income of certain partnerships whose exclusive activities are transportation and marketing activities is not treated as passive-type income. For example, the income of a partnership whose exclusive activity is transporting refined petroleum products by pipeline is intended to be treated as passive-type income, but the income of a partnership whose exclusive activities are transporting refined petroleum products by truck, or retail marketing with respect to refined petroleum products (e.g., gas station operations) is not intended to be treated as passive-type income.”

II. Section 7704(d)(1)(E) Legislative History

B. Technical and Miscellaneous Revenue Act of 1988 (P.L. 100-647)

1. House Committee Report (H. Rept. 100-795):

“Natural Resources.—The bill clarifies the definition of income qualifying under the 90 percent requirement from certain activities with respect to a mineral or natural resource. Such qualifying income encompasses income from natural deposits listed in section 613(b) as well as oil and gas, fertilizer, geothermal energy property, and timber. Such qualifying income does not include, for example, income from fishing, farming (including the cultivation of fruits or nuts), or from hydroelectric, solar, wind, or nuclear power production.

The reference provided in the bill to depletable products is intended only to identify the minerals or natural resources and not to identify what income from them is treated as qualifying income. Consequently, whether income is taken into account in determining percentage depletion under section 613 is not necessarily relevant in determining whether such income is qualifying income under section 7704(d).

II. Section 7704(d)(1)(E) Legislative History

B. Technical and Miscellaneous Revenue Act of 1988 (P.L. 100-647)

1. House Committee Report (H. Rept. 100-795): (cont'd)

In the case of transportation activities with respect to oil and gas, the Committee intends that, in general, income from transportation of oil and gas to a bulk distribution center (whether by pipeline, truck, barge or rail) be treated as qualifying income. Income from any transportation of oil and gas by pipeline is treated as qualifying income. Except in the case of pipeline transport, however, transportation of oil or gas to a place from which it is dispensed or sold to retail customers is generally no intended to be treated as qualifying income. A retail customer does not include a person who acquires the oil or gas for refining or processing, nor does a retail customer include a utility providing power to customers, For example, income from transporting refined petroleum products by truck to retail customers is not qualifying income.¹⁰⁷

¹⁰⁷ Income from transportation and marketing of liquefied petroleum gas in trucks and rail cars or by pipeline, however, may be treated as qualifying income. See Statement of Mr. Rostenkowski, 133 Cong. Rec. H 11968 (December 21, 1987): see also Statement of Senator Bentsen, 133 Cong. Rec. S 18,651 (December 22, 1987) (substantially similar language).

II. Section 7704(d)(1)(E) Legislative History

B. Technical and Miscellaneous Revenue Act of 1988 (P.L. 100-647)

1. House Committee Report (H. Rept. 100-795): (cont'd)

Similarly, with respect to marketing of oil and gas, the Committee intends that qualifying income from marketing of oil and gas be income from marketing at the level of exploration, development, processing or refining oil and gas. By contrast, income from marketing oil and gas and products thereof to end users, or at the retail level, is not intended to be qualifying income. For example, income from retail marketing with respect refined petroleum products (e.g. gas station operations) is not intended to be treated as qualifying income.”

Statement of Mr. Rostenkowski, 133 Cong. Rec. H 11968 (December 21, 1987):

“Further, I would like to clarify for the record the scope of the provision in the bill treating certain publicly traded partnerships as corporations as it applies to a specific partnership. The partnership that I am concerned about primarily engages in the purchase, transportation, storage, distribution, and retail and wholesale marketing of liquefied petroleum gas—primarily propane—and other oil and gas products. These products are transported in trucks and rail cars owned or leased by the partnership and by third party pipelines with which the partnership makes arrangements for transportation. It is my understanding that the income derived by the partnership from these activities would be included within the definition of passive-type qualifying income.”

Statement of Senator Bentsen, 133 Cong. Rec. S 18,651 (December 22, 1987):

“Finally, I would like to clarify the definition of passive type income. Under the conference agreement, income of a partnership from the purchase, transportation, storage, distribution, and retail and wholesale marketing of liquefied petroleum gas—primarily propane—and other oil and gas products is passive-type income, even though such products are transported in trucks and rail cars that are owned or leased by the partnership and transported by third party pipelines with which the partnership contracts for transportation.”

II. Section 7704(d)(1)(E) Legislative History

B. Technical and Miscellaneous Revenue Act of 1988 (P.L. 100-647)

2. Senate Committee Report (S. Rept. 100-445):

“Natural Resources.—The bill clarifies the definition of income qualifying under the 90 percent requirement from certain activities with respect to a mineral or natural resource. For this purpose, a mineral or natural resource means any product of a character with respect to which a deduction for depletion is allowable under section 611, and also includes fertilizer. Such qualifying income does not include, for example, income from fishing, farming (including the cultivation of fruits or nuts), or from hydroelectric, solar, wind, or nuclear power production.

The reference in the bill to products for which a depletion deduction is allowed is intended only to identify the minerals or natural resources and not to identify what income from them is treated as qualifying income. Consequently, whether income is taken into account in determining percentage depletion under section 613 does not necessarily determine whether such income is qualifying income under section 7704(d).

II. Section 7704(d)(1)(E) Legislative History

B. Technical and Miscellaneous Revenue Act of 1988 (P.L. 100-647)

2. Senate Committee Report (S. Rept. 100-445): (cont'd)

In the case of transportation activities with respect to oil and gas and products thereof, the Committee intends that, in general, income from bulk transportation of oil and gas and products thereof be treated as qualifying income Transportation of oil and gas and products thereof that would constitute a bulk transfer (within the meaning of section 4081), as well as bulk transportation of oil and gas products thereof by rail car, is considered bulk transportation for this purpose.

With respect to marketing of minerals and natural resources (e.g. oil and gas and products thereof), the Committee intends that qualifying income be income from marketing at the level of exploration, development, processing or refining the mineral or natural resource. By contrast, income from marketing minerals and natural resources to end users at the retail level is not intended to be qualifying income. For example, income from retail marketing with respect to refined petroleum products (e.g. gas station operations) is not intended to be treated as qualifying income.”

II. Section 7704(d)(1)(E) Legislative History

B. Technical and Miscellaneous Revenue Act of 1988 (P.L. 100-647)

3. Conference Committee Report (H. Rept. 100-1104):

“The conference agreement follows the Senate amendments; except that (1) soil, sod, turf, water, mosses and (2) minerals from sea water, the air, or similar inexhaustible sources, shall not be treated as a mineral or natural resource.

In addition, the conference agreement follows the legislative history of the House bill with respect to income from certain transportation activities, with certain modifications. In the case of transportation activities with respect to oil and gas and products thereof, the conferees intend that, in general, income from transportation of oil and gas and products thereof to a bulk distribution center such as a terminal or a refinery (whether by pipeline, truck, barge or rail) be treated as qualifying income. Income from any transportation of oil or gas or products thereof by pipeline is treated as qualifying income. Except in the case of pipeline transport the transportation of oil or gas or products thereof to a place from which dispensed or sold to retail customers is generally not intended to be treated as qualifying income. Solely for this purpose, a retail customer does not include a person who acquires the oil or gas for refining or processing, or partially refined or processed products thereof for further refining or processing, nor does a retail customer include a utility providing power to customers. For example, income from transporting refined petroleum products by truck to retail customers is not qualifying income.

The conference agreement also clarifies that, in the case of income from marketing of fertilizer, bulk or truckload sales to farmers in amounts of 1 ton or more are not considered retail sales giving rise to non-qualifying income.”

II. Section 7704(d)(1)(E) Legislative History

C. Emergency Economic Stabilization Act of 2008 (P.L. 110-343)

- Joint Committee on Taxation (JCS-1-109):

“The provision provides that qualifying income of a publicly traded partnership includes income or gains from the transportation or storage of certain fuels. Specifically., the fuels are (1) any fuel described in section (b), (c), (d), or (e) of section 6426, namely alcohol fuel mixtures, biodiesel mixtures, alternative fuels (which includes liquefied petroleum gas, P Series Fuels, compressed or liquefied natural gas, liquefied hydrogen, liquid fuel derived from coal through the Fischer-Tropsch process, and liquid fuel derived from biomass), and alternative fuel mixtures; (2) neat alcohol other than alcohol derived from petroleum, natural gas, or coal, or having a proof of less than 190 (as defined in section 6426(b)(4)(A)), and (3) neat biodiesel (as defined in section 40A(d)(a)).”