PUBLICLY TRADED PARTNERSHIPS AND CORPORATE SUBSIDIARIES

- A number of "traditional" MLPs, although probably a minority overall, do have corporate subsidiaries.

- The subsidiaries exist for a number of reasons, which include:
    - Otherwise qualifying operations that have varying levels of potentially non-qualifying income (e.g., terminals that hold mostly petroleum products but also some concrete).
    - Foreign operations – they can generate qualifying income, but the MLP structure does not work in other countries.
    - Acquisitions of and joint ventures with corporations engaged in qualifying income generating activities.
    - Activities which possess uncertainty at start-up over characterization of some types of income – those arguably but not definitely qualifying are placed in a subsidiary.
    - To hold small amounts of non-qualifying income within a business that is clearly within the bounds of §7704.
    - Co-issuance of debt financing.

- The subsidiaries pay corporate tax on their earnings, so double taxation occurs as to all dividend income to the MLP.
- MLPs rarely use internal debt capital in corporate subsidiaries outside the acquisition context.

- The income generated by these subsidiaries represents, for the most part, a small percentage of overall income.

- A corporate subsidiary earning non-qualifying income and paying dividends to an MLP is entirely within both the language and intent of section 7704.

- As the legislative history makes clear, section 7704 was enacted out of concern that the widespread use of MLPs would lead a loss of corporate income tax revenue. But corporate subsidiaries of PTPs pay corporate income tax and thus further the purpose of 7704..

- There is no legislative history indicating that Congress had any problem with MLPs receiving dividends from corporate subsidiaries engaged in non-qualifying activities. In fact, Treasury testimony in 1987 suggesting PTP treatment for entities engaged principally in developing timber, coal, oil and gas, and other natural resources acknowledged that the "downstream" operations such as milling, processing, refining, or marketing activities would remain in corporate form. If Congress had not meant to allow the use of corporate subsidiaries for this purpose, it would not have included dividends as qualifying income in section 7704 without restrictive language.

- The transition rules provided by Congress for PTPs with non-qualifying income, which allowed these "existing" MLPs to remain in existence after the transition period ended if they were able to change their income stream to meet the qualifying income test of 7704, also show that Congress contemplated the use of corporate subsidiaries for this purpose.

- The only restriction on corporate subsidiaries is in the IRS regulations governing the transition rules for the "existing" MLPs which allowed them to remain in existence through 1997 earning non-qualifying income as long as they did not engage in a "substantial new line of business" in which they had not been engaging when the law was passed. The regulations state that an activity of a corporate subsidiary may be treated as an activity of the MLP "if the effect of the arrangement is to permit the partnership to engage in an activity the income from which is not subject to a corporate-level tax and which would be a new line of business if conducted directly by the partnership" and sets forth safe harbor rules under which the activity of the corporate subsidiary could be attributed to the MLP for this purpose (Reg. §1.7704-2(e)). If the IRS and Treasury had thought that Congress did not approve of the use of corporate subsidiaries generally, it would have written this rule more broadly to apply to the qualifying income test for all PTPs, not just the "new line of business" test for the grandfathered ones.