

Tax Regulatory Developments – Proposed Regulations Interpreting § 7704(d)(1)(E)

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I. Regulatory Update: Proposed Regulations Under § 7704(d)(1)(E)

A. Background

1. IRS published proposed regulations on May 6, 2015 under IRC section 7704(d)(1)(E).
2. First time IRS has addressed this section via regulations.
3. Prior guidance issued in Private Letter Rulings (PLRs).
4. Since 2008, the number of PLR requests has greatly increased.
5. IRS declared an informal moratorium or “pause” on section 7704 PLRs in March 2014 to determine what standards should be used in determining whether an activity gives rise to qualified income.

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B. Proposed rules -

1. The term “qualifying activities” in the regulations describes activities relating to minerals or natural resources that generate qualifying income. Qualifying activities include:
 - a) The exploration, development, mining or production, processing , refining, transportation, or marketing of minerals or natural resources (section 77094(d)(1)(E) activities); and
 - b) Certain limited support activities that are intrinsic to section 7704 (d)(1)(E).

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B. Proposed rules (cont'd)

2. An activity is intrinsic to section 7704(d)(1)(E) only if it:
 - a) Is specialized to support the activity;
 - b) Is essential to the completion of the activity; and
 - c) Requires the provision of significant services to support the activity.

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C. Major issues include:

1. Exclusive lists of qualifying activities.
2. The definition of processing and refining and industry-specific rules.
3. The definition of mineral or natural resources.
4. Outstanding PLRs.

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D. Outlook

1. Deadline for written comments on the proposed regulations was August 4, 2015.
2. A public hearing has been scheduled for October 27, 2015.
3. Possible outcomes -
 - a) Proposed Regulations completely withdrawn;
 - b) Proposed Regulations finalized as is;
 - c) Proposed Regulations remain in proposed form; or
 - d) Parts of the Proposed Regulations are finalized and other parts are reproposeed.