NATIONAL PROPANE GAS ASSOCIATION

July 31, 2015

Internal Revenue Service
Attn: CC:PA:LPD:PR (REG-132634-14)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Re: Qualifying Income From Activities of Publicly Traded Partnerships With Respect to Minerals or Natural Resources (REG-132634-14)

The National Propane Gas Association ("NPGA") welcomes the opportunity to comment on the Department of Treasury's ("Treasury") proposed regulations in section 1.7704-4 in response to the Department's May 6, 2015 Notice of Proposed Rulemaking that addresses qualifying income from publicly traded partnerships, hereafter referred to as master limited partnerships ("MLPs").

NPGA is the national trade association representing virtually every segment of the U.S. propane industry including businesses engaged in the retail marketing of propane gas and appliances, among other activities. We are pleased to submit these comments on behalf of our members, but particularly those that currently conduct business as MLPs.

We appreciate the desire of Treasury and the Internal Revenue Service ("IRS") to provide guidance with respect to the qualifying income requirements of Internal Revenue Code ("Code") section 7704 as they relate to certain natural resources. To date, guidance in this area generally has been limited to the plain reading of the statute and legislative history, and private letter rulings and other informal guidance. Significant recent developments in the production of oil and gas resources raise issues as to whether certain new activities give rise to qualifying income. While we understand the desire of Treasury and the IRS to address these new issues, we believe the government should also take the opportunity in the new regulations to solidify well-settled law with respect to activities that have been undertaken by propane MLPs since before the enactment of Code section 7704 and have been recognized as qualifying activities upon and since enactment in 1987.

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Background

Congress enacted Code section 7704 in 1987 to address the conversions of certain C corporations to MLP status following significant changes in tax law by the Tax Reform Act of 1986, including the inversion of the individual and corporate marginal income tax rates. Through Code section 7704, Congress limited the availability of partnership status for publicly traded entities to those entities with sufficient income from certain sources—largely, investment income and income from certain activities related to natural resources (commonly known as "passive-type income"). Income from retail activities related to natural resources generally was not qualifying income.[1] Congress provided a ten-year grandfather for entities that were partnerships as of the effective date of section 7704 but that did not have sufficient qualifying income after such date.

At least one propane company operated as an MLP before Congress enacted Code section 7704. Petrolane Partners, L.P. was formed in March 1987, prior to the enactment of section 7704, as a publicly traded partnership. Petrolane distributed propane to over 500,000 retail customers in 42 States. The chairmen of both Congressional tax-writing committees made it clear in floor statements that the legislation was not intended to affect Petrolane's status as a partnership despite its retail sales activity. On December 21, 1987, House Ways and Means Committee Chairman Dan Rostenkowski made the following floor statement in explaining the qualifying income requirement of new Code section 7704:

> 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 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 railcars owned or leased by the partnership and by third parties 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.[2]

The next day, Senate Finance Committee Chairman Lloyd Bentsen made an almost identical statement on the Senate floor:

> 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

[1] The disqualification of income from retail activities is pursuant to language found in the legislative history of Code section 7704 and subsequent technical amendment, as discussed below. No such prohibition appears in the statute itself.
[2] 133 Cong. Rec. H 11,968 (December 21, 1987).

> and transported by third party pipelines with which the partnership contracts for transportation.[3]

The following year, Congress passed the Technical and Miscellaneous Revenue Act of 1988, a bill that made several technical corrections to recent tax legislation, including to Code section 7704. The legislative history of the 1988 legislation made it clear that income from retail activities generally was not qualifying income. The House Ways and Means Committee report to H.R. 4333, the "Miscellaneous Revenue Act of 1988," in describing qualifying income from the transportation of natural resources, provided that "(f)or example, income from transporting petroleum products by truck to retail customers is not qualifying income." However, this statement was modified by a footnote that stated:

> 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 11,968 (December 21, 1987); see also Statement of Senator Bentsen, 133 Cong. Rec. S 18,651 (December 22, 1987) (substantially similar language).[4]

Similarly, the Senate Finance Committee report to S. 2238, the "Technical Corrections Act of 1988," generally provided that the bulk transfer of natural resources would be qualifying transportation income and that income from "retail marketing with respect to refined petroleum products (e.g., gas station operations) is not intended to be treated as qualifying income." However, as in the House report, these statements were modified by a footnote that stated:

> Income from transportation and marketing of liquefied petroleum gas in trucks (as well as in rail cars or by pipeline), however, may be treated as qualifying income. See Statement of Mr. Rostenkowski, 133 Cong. Rec. H 11,968 (December 21, 1987); see also Statement of Senator Bentsen, 133 Cong. Rec. S 18,651 (December 22, 1987) (substantially similar language).[5]

The conference report reconciling H.R. 4333 and S. 2238 largely adopted the language of the House report, including the footnote regarding propane partnerships.[6]

The IRS has also had an opportunity to consider whether a publicly traded propane company serving retail customers could be treated as a partnership. Chief Counsel Advice 200749012[7] dealt with a publicly traded partnership whose business principally consisted of transporting and selling propane purchased from third parties to the taxpayer's distribution locations and then to tanks on customers' premises and to portable propane tanks. The distribution to residential customers generally involved a large number of low volume deliveries

[3] 133 Cong. Rec. S 18,651 (December 22, 1987).
[4] H.R. Report 100-795, 100th Cong., 2d Sess. (July 26, 1988), p. 401.
[5] S. Report 100-445, 100th Cong., 2d Sess. (August 1, 1988), p. 425.
[6] H.R. Report 100-1104, 100th Cong., 2d Sess. (October 21, 1988), pp. 17-18.
[7] December 7, 2007.

by bulk delivery trucks. The taxpayer also delivered propane to industrial and commercial customers.

The IRS reviewed the 1987 and 1988 legislative histories of Code section 7704, focusing on the general disqualification of income derived from retail sales. The Service also reviewed the floor statements of the two tax-writing committee chairmen in 1987 regarding propane deliveries and the incorporation of those statements into the 1988 legislative history. The IRS concluded that the joint statements "were viewed as authoritative pronouncements concerning the scope of the legislation," and that Congress intended that the retail activities of the propane MLP were of the types that give rise to qualifying income for purposes of Code section 7704.

Relying on this, and similar analyses, several publicly traded propane companies with consumer retail deliveries have since been treated as partnerships. The legislative history of section 7704, as illustrated by the IRS' analysis in Chief Counsel Advice 200749012, clearly indicates that these companies qualified for partnership status. Thus, these propane companies generally went forward with their partnership transactions without first obtaining a private letter ruling.

Proposed regulations

Code section 7704(d)(1)(E) lists activities with respect to natural resources that give rise to qualifying income.[8] The legislative history to section 7704 provides a more comprehensive meaning for these activities, including a general prohibition on retail activities (except for retail activities related to propane). The proposed regulations incorporate many of the definitions and distinctions found in the legislative history, including the general prohibition against retail activities. For example, proposed regulations section 1.7704-4(c)(6) provides that:

> Transportation is the movement of minerals or natural resources and products …including by pipeline, barge, rail, or truck, except for transportation (not including pipeline transportation) to a place that sells or dispenses to retail customers.

Similarly, proposed regulations section 1.7704-4(c)(7) provides that:

> Marketing does not include activities and assets primarily in retail sales (sales made in small quantities directly to end users), which includes, but is not limited to, operation of gasoline service stations, home heating oil delivery services, and local gas delivery services.

Although the proposed regulations incorporate the general retail prohibitions from the legislative history of section 7704, they do not explicitly contain the propane retail exception found in the 1987 and 1988 legislative histories and analyzed in Chief Counsel Advice 200749012. However, the section of the preamble to the proposed regulations that discusses marketing activity references the floor statement of Chairman Bentsen regarding propane-related

[8] These activities are exploration, development, mining or production, processing, refining, transportation and marketing.

activities and implies that the current status of propane MLPs would be unchanged by the proposed regulations.

Suggested modification to proposed regulations

The final regulations under section 7704(d)(1)(E) should more fully incorporate the entire legislative history related to the section by explicitly including the language of the floor statements of Chairmen Rostenkowski and Bentsen regarding propane partnerships. To include the prohibitions against certain retail activities found exclusively in the legislative history, but not include the language related to propane partnerships also found in the same legislative history, will create uncertainty that has not existed since the enactment of section 7704.

Publicly traded propane companies have relied on this legislative history to operate as partnerships. Also, the IRS has concurred with this treatment as evidenced by Chief Counsel Advice 200749012. Nothing has happened since the legislative history was drafted that should change this analysis. Finally, if the intent of regulations is to clarify the scope of qualifying income from natural resources, excluding the legislative history relating to propane partnerships could have the opposite, and presumably unintended, effect.

Before the issuance of the proposed regulations, the availability of partnership status for propane companies was clear and consistent with legislative history. However, partnership status could be in doubt if the final regulations go forward with the current proposed regulation language regarding retail activity, but without the propane language. The current language could be read to deny partnership status to currently operating propane partnerships, contrary to congressional intent. The reference in the preamble of the proposed regulations to the floor statement of Chairman Bentsen presumably would disappear with the proposed regulations, and its applicability to the final regulations would be unclear. Similarly, without a clear indication otherwise, there could be questions as to whether the position of Chief Counsel Advice 200749012 was superseded by the final regulations.

For these reasons, we respectfully request that the body of the final regulations include the language from the floor statements and legislative history relating to propane partnerships. In addition, the final regulations should include an example that clarifies that the retail transportation and marketing activities described in the floor statements gives rise to qualifying income under Code section 7704.

Thank you for your attention to this important matter. Please do not hesitate to contact the undersigned if you have any questions or comments regarding this submission.

Sincerely,

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cc:

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