

# They're Here... Master Limited Partnership Qualifying Income Regulations Have Finally Arrived

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The Treasury Department and the IRS today issued long-awaited final regulations under Section 7704 of the Internal Revenue Code that provide qualifying income guidance with respect to the natural resource activities of publicly traded partnerships or “MLPs.”

Proposed qualifying income regulations released in May 2015 to provide natural resource-related guidance drew significant industry and investor comment, and some amount of criticism. Although we are continuing to digest these much anticipated final regulations issued today, we offer a few initial observations. Stay tuned.

## No More Exclusive List

The final regulations removed the proposed “exclusive list” of Section 7704(d)(1)(E) activities. Commenters noted that an exclusive list ignored the potential for technological changes that would leave the regulations inflexible to adapt to new technologies and processes. The final regulations provide a general definition of each of the eight listed activities, followed by a non-exclusive list of examples of each. However, the IRS and Treasury Department do not intend that the regulations be interpreted or applied in an expansive manner.

## Olefins Generate Qualifying Income

The final regulations generally define processing of natural gas and crude oil as the purification and separation into its component parts and, importantly, the refining of natural gas and crude oil as the further physical or chemical conversion or separation of the components parts. There is no longer a disparate treatment of olefins produced from crude oil and olefins produced from natural gas. Activities are treated as refining to the extent they give rise to listed products adopted from a U.S. Energy Information Administration (EIA) list of products produced in a crude oil refinery. Thus,

refining of natural gas liquids into olefins such as ethylene, propylene and butylene is an approved activity. Following the structure of the regulations, the transportation, storage or marketing of olefins is also an approved activity.

## **Liquefaction and Regasification of Natural Gas Generates Qualifying Income**

Neither LNG nor LPG are minerals or natural resources, however, liquefaction and regasification of natural gas is an approved transportation activity. The final regulations specifically provide that retail sales of LPG are qualifying.

## **Reimbursement of Costs**

Reimbursement of construction costs and allowable “back office” functions (such as staffing, billing, accounting and financial reporting) incurred in connection with performing a Section 7704(d)(1)(E) activity is qualifying. Management fees for administrative activities when the MLP is not otherwise performing the Section 7704(d)(1)(E) activity (e.g. operating the pipeline) is only qualifying if the intrinsic activity requirements are met.

## **Basin by Basin Approach for Oil Field Service Providers, and Clarification that an MLP’s Subcontractors are Treated as “Partnership Personnel”**

The final regulations adopt a “basin by basin” approach for water delivery services as opposed to the “well by well” approach taken in the proposed regulations. Thus, so long as the MLP provides fresh water to oil and gas producers and provides disposal services in the same geographic area, the MLP’s income from such activities can be qualifying. The final regulations also provide that the intrinsic activity requirements can be met if the MLP uses subcontractors, so long as the subcontractors are being compensated by the MLP.

## **Methanol Sales**

Income from the sale of methanol is not qualifying. This remains unchanged from the proposed regulations.

## **Coking of Coal**

Coking of coal is not a qualifying activity.

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