NATIONAL ASSOCIATION OF PUBLICLY TRADED PARTNERSHIPS

2013 ANNUAL MEETING

REPORT OF THE REGULATORY COMMITTEE

TAX GUIDANCE AND ISSUES IN THE PAST YEAR

CONTENTS

REPORT OF THE REGULATORY COMMITTEE
TAX GUIDANCE AND ISSUES DURING 2012-2013

INTRODUCTION

Apart from the issuance of a large number of new private letter rulings on which activities meet the "qualifying income" definition under section 7704, the past year has been a quiet one in terms of regulatory guidance affecting MLPs. Most of guidance has been interesting but not critical.

At the time of last year's Annual Meeting, there was one set of proposed partnership tax regulations of interest to substantial interest to NAPTP members which remained outstanding from prior years: proposed regulations under Section 706 on determining partners' distributive shares when partnership interests change during the tax year, which were issued April 13, 2009. Several other proposed regulations of some interest to PTPs also remained to be finalized, including partnership merger guidance that had been in proposed form since 2007; regulations on noncompensatory options proposed in 2003; regulations under section 108(i) on deferred recognition by partnerships and S corporations of cancellation of debt income, proposed in 2010; and proposed regulations to eliminate the "de minimis partner" rule under section 704(b) published in 2012.

We were also awaiting proposed regulations providing guidance on the 3.8 percent net investment income tax (NIIT) that took place at the beginning of 2013. Although concerns about a specific provision relating to partnerships had been addressed verbally in a meeting with Treasury Department officials, we had not yet seen whether this and other questions raised by the application of the NIIT to MLP investors would be addressed in written guidance.

The section 706 and partnership merger regulations have not yet been finalized; however, proposed NIIT regulations came out in December. In addition, final regulations eliminating the "de minimis partner" rule under section 704 were issued in December, and new proposed regulations on noncompensatory partnership options were issued in February. On July 3, final regulations on deferred recognition of cancellation of indebtedness income under section 108(i) were published. Finally, as mentioned, some twenty PLRs on qualifying income have been issued since last year's report.

DEVELOPMENTS ON ISSUES FROM PREVIOUS YEARS

Net Investment Income Tax (NIIT)

One of the financing mechanisms included in the Affordable Care Act in 2010 was a new tax on investment income intended to help fund Medicare. The tax took effect on January 1, 2013. The provision, now I.R.C. section 1411, imposes a 3.8 percent tax on the "net investment income" (NII) of taxpayers with modified adjusted gross income of $250,000 (joint return) or $200,000 (single return). Modified AGI is AGI adjusted, when applicable, by certain types of income having to do with interests controlled in foreign corporations and passive foreign investment companies. The tax is imposed on the lesser of NII or the amount of modified AGI that exceeds the threshold. For example, a single taxpayer with $190,000 of MAGI of which $50,000 was NII would pay no tax, while a single taxpayer with $225,000 of MAGI and $50,000 of NII would pay tax on $25,000 and one with $260,000 MAGI and $50,000 of NII would pay tax on $50,000.

Immediately after the provision was enacted, there was concern as to how it would affect investors in MLPs, particularly whether distributions would be taxed. The language of the statute, however, shows that while MLP unitholders above the income thresholds will pay some additional tax under these provisions, they should not be disadvantaged vis a vis other investors. In fact, the NITT may increase the advantage of MLP unitholders over corporate shareholders.

On December 5, 2012, the IRS issued long-awaited proposed regulations providing guidance on this new tax. The regulations begin by stating in the preamble that the NIIT regime will generally follow the existing income tax rules in determining whether there is taxable income. If gain or loss is deferred or not recognized under the income tax rules, for instance, that will be true under the NIIT rules as well. There are exceptions, however, in order to prevent circumvention of the NIIT.

For MLP investors, the proposed regulations add detail to the basic mechanisms set out in the statute and provide clarification at least one point of ambiguity in the statutory that had concerned NAPTP.

NIIT Basics

"Net investment income" for purposes of this tax is defined as:

Gross income from "interest, dividends, annuities, royalties, and rents" that are not derived in the ordinary course or a trade or business; *plus*

1. Income derived from a trade or business which is

    a. A passive activity for the taxpayer (i.e., the taxpayer is a passive investor and not an active participant in the business)—the regulations specify that passive activity status will be defined at the partner level under the passive loss rules of section 469; or

    b. The trade or business of a trader in financial instruments or commodities; *plus*

2. Net gain from the disposition of property other than property held in a non-passive trade or business—the regulations specify that this includes taxable gain from distributions that exceed the taxpayer's adjusted basis, and that the amount of net gain added to NII may not be less than zero; *minus*

3. Deductions properly allocable to the investment income or gain.

What this means for MLP investors is that MLP distributions will continue to be tax-deferred, as they are under current law, as nothing in the bill changes their treatment as return of capital. Unitholders over the income thresholds would have the 3.8% tax added to the tax they pay on their share of partnership income—but it will be their net income, which is generally much less than the distributions. Corporate shareholders, by contrast, will pay the tax on their entire dividend if they are over the income thresholds.

The above applies only to passive investors, the public unitholders who play no role in the active management of the MLP. Active participants in an MLP (i.e., those for whom it is not a passive activity under section 469) who hold units will not be subject to this tax on their share of income, and their gain on disposition of units will be treated differently. These unitholders recognize gain only to the extent of the net gain (or loss) which they would take into account if all property of the partnership were sold for fair market value immediately before the disposition of the units.

Issue Related to Gain on Disposition of Units

In our initial review of the legislation, we spotted what appeared to be a technical glitch in the rule for active participants, which reads as follows:[1]

> (4) EXCEPTION FOR CERTAIN ACTIVE INTERESTS IN PARTNERSHIPS AND S CORPORATIONS.—In the case of a disposition of an interest in a partnership or S corporation—
>
> > (A) gain from such disposition shall be taken into account under clause (iii) of paragraph (1)(A) only to the extent of the net gain which would be so taken into account by the transferor if all property of the partnership or S corporation were sold for fair market value immediately before the disposition of such interest, and

[1] The text of the full provision is included in the material following this report.

(B) A rule similar to the rule of subparagraph (A) shall apply to a loss from such disposition.

While the heading of the provision clearly states an intent that the rule apply only to active participants, the text of the provision does not contain this limit. This appeared to raise the possibility that public unitholders would be required to measure gain when they sold their units by calculating the fair market value of all partnership property, information which they would not have. A subsequent explanation of the legislation issued by the Joint Committee on Taxation staff in March 2011 provided no clarification.

In March 2012, after the news circulated that the Treasury Department was working on regulations to implement the new tax and hoped to issue them in the near future, NAPTP representatives met with officials in the Treasury Department's Office of Tax Policy to discuss this issue. The Treasury staff walked them carefully through the cross references in the language to explain their interpretation that the language does cover only active interests. Clause (1)(A)(iii) of new section 1411, referred to in the language quoted above, is the clause that includes net gain in the definition of "net investment income." That clause, in turn, states that net gain is included in net investment income only if it is from the disposition of property "not described in paragraph (2)." Paragraph (2) states that the tax applies to a trade or business only if it is a passive activity for the taxpayer (or the taxpayer is in the trade or business of trading in financial instruments or commodities). Hence, the rule for calculating gain applies to the disposition of property (such as partnership units) only if the taxpayer's interest is not a passive one.

The Treasury staff agreed that the wording was confusing and reported that others had spoken with them about it as well. They indicated that the forthcoming regulations would include clarification of this legislative language, including possibly an example specific to PTPs.

The preamble to the regulations does confirm this understanding of paragraph 1411(c)(4) in language that is much more clear than that of the statute, stating in section 8 of the preamble (Federal Register. page 72626) that … "under the proposed regulations, the exception in section 1411(c)(4) is only applicable where the property is held in a trade or business not described in section 1411(c)(2)…[citations]… This means that the exception in section 1411(c)(4) does not apply where (1) there is no trade or business, (2) the trade or business is a passive activity (within the meaning of proposed § 1.1411–5(a)(1)) with respect to the transferor, or (3) where the partnership or the S corporation is in the trade or business of trading in financial instruments or commodities (within the meaning of proposed § 1.1411–5(a)(2))."

The actual regulatory language, proposed Reg. §1-1411(7)(a)(2), states:

"(2) *Interests to which exception applies*—(i) *In general.* The adjustment provided by this section applies only to dispositions of interests in partnerships or S corporations if—

(A) The partnership or S corporation is engaged in one or more trades or businesses (within the meaning of section 162), and at least one of its trades or businesses is not described in § 1.1411–5(a)(2) (trading in financial instruments or commodities); and

(B) With respect to the partnership or S corporation interest disposed of, the transferor is engaged in at least one trade or business that is not described in § 1.1411–5(a)(1) (passive activity with respect to the transferor)."

The regulations will be effective for tax years beginning after December 31, 2013, and the preamble states the IRS' intent to issue final regulations before that date. Taxpayers may rely on the proposed regulations until final ones become effective.

De Minimis Partner Rule

Under I.R.C. section 704, partnerships have substantial flexibility to use the partnership agreement to allocate among partners items of income, deduction, gain, loss, and credit. Section 704(b) limits this flexibility, however, by requiring that allocations under a partnership agreement have substantial economic effect. If they do not, allocations must be made according to the partner's interest in the partnership. Regulations under section 704 (Reg. §1.704-1(b) provides rules for determining whether allocations have an economic effect and whether that effect is substantial.

The de minimis partner rule, which was added in 2008, provides that in applying the criteria for substantiality of an allocation, a partnership need not consider the accounts of "de minimis" partners, those owning less than 10% of the partnership capital and profits and allocated less than 10% of each partnership item of income, gain, etc. On October 25, 2012, the IRS published proposed regulations eliminating the de minimis exception "to avoid unintended tax consequences"— taxpayers forming partnerships composed of partners with less than 10% interests and allocations to avoid the substantiality regulations.

The IRS issued final regulations on December 28, 2012 eliminating the de minimis partner rule for allocations becoming part of a partnership agreement after that date. Allocations that became part of a partnership agreement before December 28 and whose testing relied on the de minimis rule must be retested on the first day of the tax year beginning after December 28. The repeal of the de minimis rule should not be a problem for MLPs, even though they have large numbers of de minimis partners, as their partnership agreements are generally drafted so as to meet the substantial economic effect standards.

Final Regulations on Noncompensatory Options

On February 5, 2013, the Internal Revenue Service published a final version of regulations that had been in proposed form for ten years, since January 22, 2003. The regulations discuss tax consequences of issuing, transferring, and exercising noncompensatory partnership options; i.e., those not issued in connection with the performance of services. The regulations apply to call options, warrants, and conversion rights issued by a partnership which allow the holder to acquire an equity interest in the partnership (or cash measured by the value of the interest).

Like the proposed regulations, the final regulations:

- Generally provide that exercise of a noncompensatory option does not cause recognition of gain or loss to either the partnership or the option holder.
- Modify the regulations under section 704(b) regarding maintenance of partners' capital accounts and determination of partners' distributive shares of income.
- Provide that the holder of a call option, warrant, convertible debt, and convertible equity issued by a partnership may be treated as a partner under certain circumstances.

While the basic thrust of the final regulations is the same as that of the proposed ones, a number of clarifications and technical changes have been made, as described below.

Issuance, Exercise and Lapse of Noncompensatory Options

The final regulations, like the proposed ones, provide that noncompensatory options are not governed by section 721 (nonrecognition of gain or loss upon contribution of property to partnership in exchange for partnership interest) but by general tax principles. The final regulations also provide that section 721does not apply to the transfer of property to a partnership in exchange for a noncompensatory option, or to the satisfaction of a partnership obligation with a noncompensatory option. However, section 721 does apply to a contribution of property to a partnership in exchange for convertible equity in a partnership.

Under these principles, for the issuer of the option, *issuance* is not a taxable event; income or loss does not become fixed and determinable until the lapse, exercise, repurchase or other termination of the option. For the holder, the purchase is merely an investment in the option—a capital expenditure that is neither taxable nor deductible. However, if appreciated or depreciated property is used to acquire the option, then gain or loss is realized under section 1001. For issuance of convertible debt or equity, the conversion right embedded in the instrument is taken into account or tax purposes as part of the underlying instrument.

In general, the *exercise* of a noncompensatory option will be treated as a section 721 transaction and will not be taxable to the either holder or the partnership. In response to comments requesting clarification, the final regulations also provide that section 721 generally applies to the exercise of a noncompensatory option when the exercise price is satisfied with property or cash contributed to the partnership, regardless of whether the terms of the option require or permit a cash payment.

In response to comments requesting clarification of the proper treatment of accrued but unpaid interest on convertible debt, the final regulations clarify that section 721 does not apply to the transfer of a partnership interest to a noncompensatory option holder upon conversion of convertible debt in the partnership to the extent that the transfer is in satisfaction of the partnership's indebtedness for unpaid interest on the debt that accrued on or after the option holder began holding it. Additionally, the final regulations provide that section 721 does not apply to the extent that the exercise price is satisfied with the partnership's obligation to the option holder for unpaid rent, royalties, or interest that accrued on or after the beginning of the option holder's holding period.

In response to requests for clarification regarding options settled for cash, the final regulations provide that the settlement of a noncompensatory option in cash or property other than an interest in the issuing partnership is not a transaction to which section 721 applies.

The proposed regulations clarified that section 721 does not apply to the lapse of a noncompensatory option. Rather, consistent with general tax principles, the lapse generally results in the recognition of income by the partnership and of loss by the option holder. However, they did not do not address the character of the gain or loss recognized upon lapse, repurchase, sale, or exchange of the option. Section 1234(b) treats gain or loss from such transactions in securities as short-term gain or loss, but it is unclear whether it applies because it is unclear whether partnership interests are "securities" for purposes of this section. To address this, the IRS issued proposed regulations under section 1234(b), clarifying that partnership interest are securities for this purpose, concurrently with the final regulations.

The final regulations specify that if the holder of a noncompensatory option exercises it and then immediately redeems the partnership interest so acquired, general tax rules, including the disguised sale rules, will apply in determining whether this was in fact a cash settlement of the option. Similarly (though not identically) to the proposed regulations, the final regulations provide that, if the exercise price of a noncompensatory option exceeds the capital account received by the option holder on the exercise of the option, general tax principles will apply to determine the tax consequences of the transaction.

Accounting for Noncompensatory Options

The final regulations differ from the proposed ones in that they that they make the issuance by a partnership of a noncompensatory option (other than an option for a de minimis partnership interest) a permissible revaluation event under Treas. Reg. § 1.704–1(b)(2)(iv). Under the proposed regulations they were neither a permissible nor a mandatory revaluation event.

The proposed and final regulations provide rules to assist partnerships in accounting for any shifts in capital that result from the exercise of noncompensatory options. Generally the option holder will receive a partnership interest with a value greater or less than the aggregate value of the premium and the exercise price that the option holder contributes to the partnership, making the holder a contributor of property with built-in gain or loss under section 704(c). However, because the option privilege terminates upon contribution to the partnership, the partnership cannot allocate gain or loss from the option privilege to the option holder. Therefore, the proposed regulations allow partnerships to substitute built-in gain or loss in the partnership's assets for the built-in gain or loss in the option.

This is done by specifying that the option holder's capital account is equal to the consideration paid to the partnership to acquire the option and the fair market value of any other property contributed to the partnership upon exercise of the option. The partnership is then required to revalue its property immediately following the exercise of the option and to allocate the unrealized income, gain, loss, and deduction from this revaluation first to the option holder to the extent necessary to reflect the holder's right to share in partnership capital under the partnership agreement, and then to the historic partners in the same manner as if there had been a taxable disposition of the property for fair market value. The option holder will then, under section 704(c), recognize any income or loss attributable to that appreciation or depreciation as the underlying assets are sold, depreciated or amortized.

In response to comments, the final regulations clarify that

- When certain partnership properties are subject to special allocations to existing partners, the allocations must take into account the economic arrangement of the partners with respect to the property, and

- Allocations should be made on a pro rata basis from partnership property, subject to the requirement that the allocations take into account the economic arrangement of the partners.

The proposed and final regulations provide that the partnership should be allowed to shift capital between the historic partners and the option holder on exercise of a noncompensatory option even if the built in gain or loss in the option exceeds the appreciation and depreciation in partnership assets available to cover it. The regulations also require the partnership to make corrective allocations of gross income or loss to the partners in the year in which the option is exercised so as to take into account any shift in the partners' capital accounts that occurs as a result of the option exercise. If there are not sufficient partnership items in the year of exercise to conform the partnership's tax allocations to the capital shift, additional corrective allocations are required in succeeding years until the capital shift has been fully taken into account.

In addition, the final regulations:

- Require corrective allocations to be made so as to take into account any capital account reallocation upon exercise of a noncompensatory option. Partnership items may be correctively allocated to the exercising option holder only of items properly allocable to a partner that suffered a capital account reduction and only to the extent of the capital account reduction.

- Provide a mechanism for making corrective allocations using combinations of gross income and gain and gross loss and deduction in certain circumstances.

- Clarify that section 706 and its regulations and principles apply in determining the items of income, gain, loss, and deduction that may be subject to corrective allocation.

Finally, the proposed and final regulations require that any revaluation of partnership property (and subsequent adjustments in partners' capital accounts) that occurs while noncompensatory options are outstanding must take into account the fair market value of the outstanding options. The final regulations add the requirement that the adjustments must take into account the economic arrangement of the partners with respect to the property.

Characterization of the Option

These provisions address the circumstances under which the holder of a noncompensatory option to acquire a partnership interest should be treated as a partner for purposes of annual allocations of income and other items. The general rule under both the proposed and final regulations is that noncompensatory options will not be recognized as partnership equity, and the holder will not be treated as a partner with a right to share in partnership income until the option has been exercised. However, if the option holder's rights are substantially similar to those of a partner, then the holder will be characterized as a partner.

Under the proposed regulations, whether the option holder's rights are substantially similar to those of a partner will be determined under a facts and circumstances test. The final regulations retain the test with some modifications. Factors considered include:

- <u>Whether the option is reasonably certain to be exercised</u>. This is based on factors such the premium paid for the option, the term of the option, the predictability and stability of the value of the underlying partnership interest, and whether the partnership is expected to make distributions during the term of the option. The proposed regulations included as a factor whether the option premium and exercise price will become property of the partnership; the final regulations eliminate this factor. In addition, the final regulations provide two safe harbors for determining whether the option is reasonably certain to be exercised.

- <u>Whether the option holder has partner attributes</u>—i.e., shares in the partnership's economic benefit and detriment and has right to participate in management of the partnership. The final regulations add more detail, providing that this is based on all the facts and circumstances, including whether the option holder is provided with voting or managerial rights in the partnership. The final regulations also add that an option holder has partner attributes if, based on all the facts and circumstances, (1) the option holder is provided with rights similar to rights ordinarily afforded to a partner to participate in partnership profits or (2) the option holder ,undertakes obligations that are similar to obligations undertaken by a partner to bear partnership losses. The final regulations also provide that a noncompensatory option holder will not be considered to possess partner attributes solely because the option agreement significantly controls or restricts, or the holder has the right to control or restrict, a partnership decision that could substantially affect the value of the underlying partnership interest. Several other clarifications are added as well.

If the option holder is treated as a partner, then his distributive share of partnership income, gain, loss, deduction and credit must be determined, with the holder's interest in the partnership generally reflecting the economic differences between holding an option to purchase a partnership interest and holding the interest itself. The final regulations clarify that once a noncompensatory option is treated as a partnership interest, it may never again be treated as an option.

The final regulations make several other clarifications with regard to characterizing an option holder as a partner, including:

- Clarification of the provision that characterization rule applies only if there is a strong likelihood that the failure to treat the option holder as a partner would result in a substantial reduction in the present value of the partners' and the holder's aggregate tax liabilities by adding factors for making this determination,
- Clarification of the events that trigger testing under the characterization rule;
- Clarification that the timing of the characterization is as of the issuance of the option or immediately before any other event giving rise to the characterization; and
- Clarification that an option that is not treated as a partnership interest under the regulations may still be treated as one under general principles of law.

OID Rules

Finally, previously issued original issue discount regulations provide special rules for debt that is convertible into stock of the issuer. The proposed regulations amend these provisions to treat partnership interests as stock for purposes of these special rules. The final regulations follow the proposed regulations.

The final regulations apply to noncompensatory options that are issued on or after February 5, 2013.

Final Regulations under Section 108(i)

On August 13, 2010 the IRS published two sets of temporary regulations providing guidance on cancellation of indebtedness (COD) income under I.R.C. section 108(i), enacted in 2009, one set for corporations and the other for partnerships and subchapter S corporations. Under the general rules of the tax code, the cancellation or forgiveness of debt owed by a taxpayer is treated as taxable income received by the taxpayer. Section 108 provides various exceptions to this rule.

(With regard to the COD income of PTPs, the IRS last year issued Revenue Procedure 2012-28, which provides a safe harbor under which the IRS will not challenge a determination by a PTP that its COD income is qualifying income if the COD income is attributable to debt incurred in direct connection with the PTP's activities that generate qualifying income. The PTP may demonstrate that this is the case by any reasonable method. The revenue procedure suggests that one reasonable method would be to trace the proceeds of the debt generating the COD income to qualifying activities, using an approach similar to the one used for allocating interest expense under Reg. §1.163-8T. That regulation allocates interest expense in the same manner as the debt to which the interest relates).

Section 108(i) allows taxpayers to elect deferral of COD income realized from the reacquisition of an "applicable debt instrument" after December 31, 2008, and before January 1, 2011. An "applicable debt instrument" is one issued by a corporation or any person in the conduct of their trade or business. The income is taken into account over a five-year period beginning with the fourth or fifth tax year after the year of the reacquisition. The provision also provides for deferral of original issue discount expense arising from issuance of a debt instrument as part of the reacquisition. Under section 108(i)((5)(B)(iii) and a revenue procedure issued in August 2009 (Rev. Proc. 2009-37), the deferral election for partnerships is made at the partnership level rather than the partner level.

The temporary and proposed regulations provide five safe harbors for when a debt instrument is deemed to be issued in connection with the taxpayer's trade or business for purposes of section 108(i); if none of the safe harbors is met, a facts and circumstances test is applied. The safe harbors remain the same under the final regulations.

Both the proposed and final regulations:

- Provide guidance on allocation of the COD income, including how allocation is handled in tiered partnerships.
- Specify that a partner's basis is not adjusted under section 705 to account for his share of deferred items at the time of reacquisition but rather when the items are recognized.
- Provide guidance on calculating a partner's deferred section 752 amount under section 108(i)(6). This is the amount of the decrease in the partner's share of

partnership liability due to the discharge of partnership debt that is not treated as a current distribution to the partner. The proposed and final regulations require direct partners that have a deferred amount to respond to requests by the partnership for information to determine the deferred section 752 amount. The deferred amount is taken into account when the deferred COD income is recognized. The final regulations add an example to clarify how this provision works.

- Provide that a partner's capital account is adjusted for the partner's share of deferred items as if no election under 708(i) were made.
- Provide guidance under section 465 to prevent an election under section 108(i) from triggering recapture of losses under section 465(e).
- Provide guidance on deferral of original issue discount.
- Discuss various "acceleration events" which will trigger recognition of the deferred income, including a partnership's bankruptcy filing; liquidation; sale, exchange, gift, or transfer of substantially all the partnership's assets; or termination of business. Partner-level acceleration events include death or liquidation of the partner; the partner's sale, exchange, transfer, or gift of its separate interest; the partner's redemption of its separate interest; or the partner's abandonment of the interest.
- Specify events that will not constitute acceleration. These include the partnership's contribution of assets to another partnership in exchange for an interest in the transferee that is governed by section 721; a partner's contribution of its separate interest to another partnership in a section 721 transaction in exchange for an interest in the transferee partnership; like kind exchanges under section 1031; mergers and consolidations under section 708(b)(2)(A); an upper-tier partnership's distribution of its separate interest in a lower-tier partnership to its own partners; inter-company transfers; retirement of a debt instrument; and other transactions determined by the IRS to be non-acceleration events.
- Provide a cross reference to the foreign partner withholding rules under section 1446, as notice that withholding tax may be triggered when the deferred income is recognized.

The final regulations are effective July 3, 2013, the date of their publication in the *Federal Register.*

PRIVATE LETTER RULINGS

As was the case last year, the IRS has produced a steady stream of private letter rulings interpreting the qualifying income definition under section 7704(d) over the past year several months. Twenty-one qualifying-income PLRs have been issued since the last Annual Meeting; twelve so far in 2013. Frequent subjects of the PLRs are income from various oilfield services as qualifying income and various methods and degrees of processing petroleum products. Some

PLRs have blessed activities that had not been previously considered for MLPs, such as furnishing sand and water pipelines for fracking operations, production of olefins, and leasing of drilling platforms.

Although private letter rulings are specific to the taxpayer requesting them and cannot be cited as precedent, they can be a useful indication of the IRS' thinking in a particular area, as well as an indication of the types of activities being considered for PTPs. The rulings since the last annual meeting are summarized below in chronological order. Summaries of all qualifying-income PLRs can be found in the Members' section of the NAPTP website, under Federal Affairs, at http://www.naptp.org/Members/HistoricalRegulatory/PLRs/PLR_List.html.

PLR 201232008, issued April 9, 2012; released August 10, 2012: Loading, Injecting Additives, and Wholesale Distribution of Refined Products.

A PTP owns refined product terminals where it receives and stores petroleum products and loads them onto vehicles for transportation to the next point in the fuel supply chain. During the loading process the PTP injects fuel additives and blends biodiesel with gasoline. It receives fees for these additization activities, which also include receiving proprietary additives from various suppliers and blending them according to customers' requirements; obtaining generic additives and blending them into fuels for sales to its customers; and receiving biodiesel from customers, storing it in tanks, and injecting it into gasoline via pipelines. The PTP acts only as a wholesale distributor of refined products and does not engage in retail activity. The IRS ruled that these activities are qualifying income under section 7704(d)(1)(e).

PLR 201232020, issued April 27, 2012; released August 10, 2012: Income from Sale of Renewable Identification Numbers.

A PTP is engaged in operating a refined products pipeline business, a natural gas storage business, and refined petroleum and related products terminals. It serves as a distributor of petroleum products in areas that are served by its pipelines but does not engage in retail activities. The PTP blends ethanol into gasoline and biodiesel fuel at several terminals and sells blended gasoline and diesel fuel as a wholesale distributor. The PTP accumulates "renewable identification numbers" (RINs) as it blends biofuel into conventional fuel. Each 38 character RIN uniquely identifies the batch of renewable fuel and each gallon in that batch. It is transferred along with the fuel until the point when the renewable fuel is blended into conventional fuel or sold in the retail market, at which point it is separated from the fuel and becomes freely transferable. The RINs accumulated by the PTP exceed any obligation it has in connection with its renewable volume obligation under the Renewable Fuel Standard program, so from time to time, it sells its excess RINs to third parties through a broker involved in trading RINs or directly to a producer or importer of conventional fuels. The PTP requested a ruling that its income from the sale of the RINs is qualifying income under section 7704(d)(1)(e), on the basis that it is merely a second revenue stream from the processing and marketing of a natural resource. The IRS so ruled.

PLR 201233009, issued February 10, 2102; released August 17, 2012: Extraction, Transportation, Marketing, and Sales of Silica.

This PLR was heavily redacted when originally released so that it was impossible to tell the product involved. Fortunately, a subsequent ruling retroactively modifying this one has filled in the details (see PLR 201316005). A partnership will own and develop silica reserves. Its activities will include extraction, transportation, marketing, and sales of the silica in large quantities to industrial users, specifically oil field service companies, for injection as a proppant in the production of crude oil and natural gas. The IRS ruling states that the income derived from these activities is qualifying income under section 7704(d)(1)(E).

PLR 201233010, issued April 20, 2012; released August 17, 2012: Natural Gas Gathering, Processing and Anime Regeneration Services.

The taxpayer is an LLC which plans to form a PTP with a related party. The new PTP will engage in gathering and processing natural gas and operating natural gas processing facilities. The PTP will own and provide gathering services on two gathering systems. It will also own an interest in a natural gas processing plant, which chills natural gas streams in order recover NGLs, and related facilities including an NGL storage facility. The PTP will operate the plant and receive a fee for its management services, which will include maintaining all financial records and filing all necessary operational reports and notices required by government authorities. Finally, the PTP will own an amine regeneration unit and related equipment within a third-party natural gas processing plant. Amine gas treating is a group of processes that use chemical solutions to remove hydrogen sulfide and carbon dioxide from gases. The IRS ruled that income from all of these activities would be qualifying income under section 7704(d)(1)(E).

PLR 201234005, issued May 11, 2012; released August 24, 2012: Water Pipeline for Hydraulic Fracturing.

This PLR breaks new ground, as it involves a water pipeline. The PLR was requested by a PTP engaged, through its subsidiaries, in transportation (via gathering pipelines) and processing natural gas. Its customers are natural gas producers using hydraulic fracturing to extract natural gas from geological formations, a process requiring large volumes of water. The PTP and another party have formed an LLC taxed as a partnership which will build, own, and operate a water delivery pipeline system to supply water to its customers and other natural gas producers. The pipeline will run primarily parallel to the PTP's gathering pipelines and share their right-of-way. The LLC will earn income from long-term pipeline capacity and supply agreements with the PTP's current customers, and eventually with other natural gas producers, under which the water will be transported to water impound ponds that the producers designate.

The PTP represented to the IRS that the supply and transportation of fresh water to natural gas producers for use in hydraulic fracturing is integral to both the exploration and production of natural gas from shale formations and the preservation and growth of the PTP's existing natural gas transportation, and that the PTP (through the LLC) is uniquely situated to provide that water because of its existing rights of way and expertise. The water will be provided solely to natural gas producers.

The IRS ruled that the PTP's distributive share of the LLC's income from the supply and transportation of water to oil and gas producers for use in the exploration, development, and production of oil or natural gas is qualifying income within the meaning of § 7704(d)(1)(E). It warned, however, among other cautions, that it "ha[d] not verified or determined whether any other commercial use may exist for the water delivery pipeline system developed, constructed, owned, and operated by [the LLC]. To the extent that other commercial uses may exist for the water delivery pipeline system, this letter ruling will not apply in determining whether [the PTP's] distributive share of any gross income that may be derived from such other uses constitutes qualifying income under § 7704(d)(1)(E)."

PLR 201236005, issued June 5, 2012; released September 7, 2012: Processing of Petroleum Products via Dehydrogenation or Catalytic Cracking.

The specifics of this PLR have been heavily redacted, but there is still useful information. The taxpayer is a PTP engaged in the transportation, processing, storage, and distribution of natural gas, NGLs, crude oil, and refined products. The PTP is building a facility in which it will use dehydrogenation and catalytic cracking to convert a product (specifics have been reacted; we'll refer to it as Product A) into Product B (also redacted). The process was also expected to create by-products (specifics redacted). The facility would be operated through long-term agreements under which customer(s) (specifics redacted) will deliver Product A to the PTP (the customer(s) may buy feedstock from the PTP or from third parties) and receive back Product B in accordance with an agreed-upon yield ratio. In return, customers will pay a monthly, formula-based cash fee. The PTP will retain a product as additional compensation, and may retain any Product B produced above the yield ratio. The IRS ruled that the PTP's income from converting Product A into Product B will constitute qualifying income under §7704(d)(1)(E).

PLR 201241004, issued July 2, 2013; released October 12, 2012: Production, Transportation, and Storage of Olefins.

A PTP intends to acquire and operate a facility that processes the NGLs ethane and propane into olefins through a cracking process and sell the olefin to third parties as feedstock for production of chemical derivatives. The process involves use of a gas fired furnace to apply heat and pressure to the NGL molecules and remove their hydrogen atoms, producing olefins as a byproduct. The PTP also intends to acquire olefin pipelines and storage facilities and provide olefin transportation and storage services to third parties. The IRS ruled that the PTP's income from processing NGLs into olefins, as well as income from the transportation and storage of olefins, would be qualifying income under §7704(d)(1)(E).

PLR 201250003, issued September 6, 2012; released December 14, 2012: Offshore Oil and Gas Platform as Real Property.

This ruling expands the notion of what will be treated as "real property" to include offshore oil and gas platforms. In this case, the PTP was negotiating the lease of an offshore platform located in deep water offshore, with related machinery and equipment installed on the platform. The platform will consist of three sections designed to be permanently connected and act as a single structure: a vertical hull, a topside section of working decks connected to the hull, and a mooring system to attach the platform to the seabed. Machinery and equipment installed on the platform will be used to extract oil and gas from the lessee's undersea wells, separate oil and gas from the crude, and condition the oil and gas for export in gathering pipelines. Additional machinery on the platform will separate the extraction, separation and conditioning machinery, and the operation and maintenance of the platform. In addition, motor control equipment would control the machinery. The platform is intended to remain in the same location indefinitely, and no similar platform has ever been removed.

The lessee, an unrelated party, will have an initial exclusive use agreement, during which it will make monthly fixed payments to the partnership in addition to monthly fees based on the amounts of oil and gas processed and sent through the gathering pipelines. After the initial period, the lessee will have the right to use specified amounts of the platform's production handling capacity and pay fees based on amounts processed, with the right to reserve additional capacity in increments and pay a fee based on capacity reserved. After the exclusive use period, the partnership may lease the remaining capacity not used by the lessee. The lessee will be the operator of the platform with the exclusive right and obligation to operate and maintain it during the exclusive use period, Employees of the partnership will be on hand to make sure it does so. These employees will not perform any services for the lessee.

The partnership requested a ruling that income derived from leasing the facility will constitute rents from real property under § 856(d) and therefore constitutes qualifying income under §7704(d)(1)(C). After analysis of the statute and regulations, as well as several revenue rulings on real property and structural components, the IRS ruled that income earned under the lease would qualify as "rents from real property" under section 856(d) so long as rent attributable to the leasing of the machinery, as personal property which is leased under, or in connection with, the lease did not exceed 15 percent of the total rent for the tax year attributable to both the real and personal property under the lease. The IRS also concluded that the partnership's activities with respect to the platform would not cause the income to be treated as other than "rents from real property." The lease income would therefore constitute qualifying income under §7704(d)(1)(C).

PLR 201250014, issued August 15, 2012; released December 14, 2012: Marketing Refined Products.

This ruling was requested by a partnership that was planning to do an IPO and become publicly traded. The partnership is an independent wholesale distributor of refined petroleum products and natural gas, making bulk sales of these products to customers including dealers, distributors, and others (redacted in the document). It purchases refined products including gasoline, diesel fuel, and residual fuel oils, from refineries, trading organizations, and various producers, conducts operations at its terminals, and sells the products to its customers, which include dealer, distributors, and others..

The particular refined fuels for which the PLR was requested are redacted. Also redacted are the customers to whom the partnership sells natural gas after purchasing it from producers and trading companies. The IRS ruled that the partnership's income from the marketing of the undisclosed products was qualifying income under §7704(d)(1)(E).

PLR 201301010, issued September 28, 2012; released January 4, 2013: Sale of Blended and Processed Petroleum Products.

The PTP requesting this ruling refines and blends crude oil and other petroleum-based feedstocks into undisclosed refined products. It also blends, processes, packages, markets, and distributes undisclosed lubricants that are a blend of hydrocarbon-based feedstocks and small amounts of additives. The products are primarily sold to wholesalers and other fuel distributors and marketers, and certain products are sold in bulk to government, commercial, and industrial users in quantities and at prices that are not consistent with a retail sales transaction. The IRS ruled that income from these activities is qualifying income under section 7704(d)(1)(E).

PLR 201308004, issued November 5, 2012l released February 22, 2013: Production and Marketing of Fertilizer Products to Non-Agricultural Customers.

This PLR was requested by a PTP engaged in production and marketing of fertilizer products. The IRS ruled that the income derived by the PTP from the production and marketing of ammonia, urea, UAN fertilizer, nitric acid, and urea in solution for non-retail sale to customers operating in non-agricultural industries would be qualifying income under §7704(d)(1)(E) to the extent that these products would otherwise be marketable as fertilizer for agricultural purposes.

PLR 201313014, Issued December 11, 2012; Released March 29, 2013: Operation of Customer's Natural Gas Compressors.

In this PLR, a PTP had entered into an agreement with a natural gas gathering company to operate that company's natural gas compressors, including all tasks necessary to physically compress natural gas and move it through the processing equipment. The PTP was paid service fees for these services. The IRS ruled that income derived from the agreement was qualifying income under §7704(d)(1)(E).

PLR 201313015, issued December 18, 2012; released March 29, 2013: Income from Service Agreements of Subsidiary.

A PTP principally engaged in the transportation and storage of unspecified products had an indirect ownership interest in another company and was allocated a share of operating services fee income and related cost reimbursements earned by that company. The income was earned under various agreements for operation of specified assets owned by the service recipients, including both general and administrative services and direct operation and maintenance of specified assets. Services include taking delivery from customer, moving products through the assets, offloading products to customers, and various maintenance and administrative tasks. The IRS ruled that the income derived by the PTP from the service agreements would be qualifying income under§7704(d)(1)(E).

PLR 201314029, issued November 28, 2012; released April 4, 2013. Income Received Under Expansion Agreements.

The PLR was requested by a PTP engaged in the terminaling, storage, and transportation of crude oil, refined products, and LPG, with assets including storage tanks, marine docks, and pipeline. The PTPs' facilities serve as hubs connecting multiple modes of transportation of crude oil, refined products, and LPG, (pipelines, trucks, barges, tankers, and rail) from producing regions to refineries and on to their ultimate markets. Storage capacity is required at these hubs to facilitate efficient transportation and accommodate supply and demand imbalances. At times no pipeline exists between a prospective customer and the PTPs' facilities, and sometimes the assets at these facilities need to be expanded to meet the customer's needs. At such times the PTP and the customer may enter into an expansion agreement under which the needed facilities will be constructed. All expansion agreements require the customer to bear some of the construction costs; this is done in various ways.

The PTP represented to the IRS that the expansion agreements were integral to its terminaling, storage, and transportation activities: they were necessary to facilitate service relationship; that was their sole purpose; and they were only entered into if the PTP was also entering into a terminaling, storage, and transportation agreement with that same customer. The IRS ruled that the amounts the PTP received from terminaling, storage, and transportation customers for construction of terminaling, storage, and transportation facility improvements (or receipt of improvements from the customers) under expansion agreements was qualifying income under §7704(d)(1)(E).

PLR 201314038, issued December 12, 2012; released April 4, 2013: Processing Natural Gas into Dimethyl Ether (DME).

A corporation is planning to form a PTP which will build a facility to process natural gas into dimethyl ether (DME), a premium diesel fuel. DME is produced by a three step process in which natural gas is combined with steam at high heat to produce synthesis gas, the synthesis gas is converted into methanol via a catalyst, and the methanol is converted into DME via a second catalyst. The DME will be sold to third-party distributors, who will sell it to end users. The IRS ruled that the PTP's income from processing natural gas into DME and marketing the DME will constitute qualifying income under §7704(d)(1)(E).

PLR 201315008, issued January 4, 2013; released April 11, 2013: Treasury Locks, Interest Rate Swaps, Forward-start Interest Rate Swaps, and Interest Rate Caps.

A PTP engaged in terminaling and storage services for petroleum products and in natural gas services periodically issues debt securities to fund asset acquisitions and conduct its operations. To manage its interest rate risk, the PTP enters into treasury locks, interest rate swaps, forward-start interest rate swaps, and interest rate caps. In some cases these locks, swaps, and caps are integrated with the related debt instruments under Reg. 1.1275-6. The PTP requested a revenue ruling to apply only those cases when they cannot be so integrated. The IRS ruled that the PTP's income from the treasury lock, interest rate swap, forward-start interest rate swap, and interest rate cap Transactions is qualifying income within the meaning of §7704(d)(1) and §1.7704-3(a)(1).

PLR 201315015, issued January 3, 2013; released April 12, 2013. Processing Natural Gas into Gasoline and LPG.

The taxpayer requesting the ruling was a corporation which had formed a PTP. The corporation planned to convey to the PTP a facility that processed natural gas into gasoline and LPG through a three-step integrated process similar to the one described in PLR 201314038: natural gas is combined with steam at high heat to produce synthesis gas and the synthesis gas is then converted into methanol, hydrogen, and water via a copper-based catalyst. The methanol is then converted to dimethyl ether (DME) and water, which is passed over another catalyst to produce gasoline, LPG, and water. The gasoline and LPG are sold to third-party distributors, who in turn distribute them to end users. The IRS ruled that the PTP's income from processing natural gas into gasoline and LPG and marketing the gasoline and LPG would be qualifying income under §7704(d)(1)(E).

PLR 201316005, issued December 27, 2012; released April 19, 2013: Modifying Prior Silica Ruling.

This ruling retroactively modifies PLR 20123309 to correct the description of the way the PTP's IPO structure. In addition, it fills in details which had been redacted from the earlier ruling, so that we now know the ruling dealt with extraction, transportation, marketing, and sales of silica for use as a proppant in the extraction of crude oil and natural gas.

PLR 1322024, January 31, 2013; released May 31, 2013: Hydraulic Fracturing Services.

The taxpayer, an LLC treated as a partnership, plans to form a PTP that will, after its IPO, carry on its current oilfield services business. The taxpayer provides high-pressure hydraulic fracturing services to exploration and production (E&P) companies using mobile hydraulic fracturing units and associated heavy equipment that it owns and that are operated by its employees and independent contractors. The taxpayer represents these services to be integral to the production of oil and natural gas from wells drilled in shale and other tight formation reservoirs. The taxpayer has entered a contract with an independent exploration and production company to provide the company with hydraulic fracturing services for 24 months in return for various fees. The taxpayer represents this arrangement as typical of those that it (or the future PTP) will have with other E&P companies. The IRS ruled that the income the taxpayer will derive from hydraulic fracturing services is qualifying income under §7704(d)(1)(E).

PLR 201324002, issued February 21, 2013; released June 14, 2013: Processing Natural Gas into Gasoline, LPG, and Other Products.

This ruling is based on a process similar to those described in PLRs 201315015 and 20131438 below. The taxpayer plans to form a PTP and convey to it a facility that processes natural gas into methanol and synthesis gas, then processes those products into gasoline and LPG, in an integrated three-step process. Natural gas is combined with steam at high heat to produce synthesis gas and the synthesis gas is then converted into methanol, hydrogen, and water via a copper-based catalyst. The methanol is then converted to dimethyl ether (DME) and water, which is passed over another catalyst to produce gasoline, LPG, and water. The PTP will sell the gasoline, LPG, methanol, and synthesis gas to third-party distributors, who will then further distribute or process them. The IRS ruled that the PTP's income from processing and marketing of gasoline, LPG, methanol, and synthesis gas produced through the processing of natural gas would constitute qualifying income under §7704(d)(1)(E).

PLR201328005, issued April 2, 2013, released July 12, 2013: Pipeline Activities.

A PTP planned to earn income from relocating pipelines and related facilities that it used to transport minerals or natural resources to accommodate requests from third parties (e.g., to accommodate surface construction or subsurface development); the construction, installation, maintenance, and operation of, and transfer by customers to the PTP of, interconnects to pipelines used to transport minerals or natural resources; and the sale of condensate collected from pipelines used to transport minerals or natural resources. The PTP represented that these activities were integral to the pipeline transportation of minerals and natural resources. The IRS ruled that the PTP's income from these activities would constitute qualifying income under §7704(d)(1)(E).

ISSUES STILL OUTSTANDING

Two sets of proposed regulations of interest to PTPs have remained in proposed form for four and six years respectively. We are still awaiting final regulations.

Proposed Regulations on Determination of Distributive Share When Partnership Interest Changes (Section 706)

On April 13, 2009 the IRS issued proposed regulations under Code section 706, which deals with partnership and partner tax years. The proposed regulations deal with how partnerships should allocate tax items to partners who enter, leave, or otherwise change their interest in the partnership during the tax year—a subject which is obviously very relevant to

PTPs. The regulations have the potential to affect the monthly conventions generally used by PTPs to account for the numerous partners who buy and sell units during the year.

The primary purpose of the proposed regulations is to implement the "varying interests" rule of section 706(d)(1), which states that if a partner's interest in the partnership changes during the tax year, each partner's distributive share of any partnership item of income, gain, loss, or credit during the tax year is determined "by the use of any method prescribed by the Secretary which takes into account the varying interests of the partners in the partnership" during the tax year. The proposed regulations set forth prescribed methods.

The proposed regulations generally provide that partnerships should divide the tax year into segments based on the dates when partners' interests change. The partnership should determine the distributive shares of partnership items in each segment using the "interim closing of the books method"[2] and allocating items among partners in accordance with their respective partnership interests during the segment. If the partners agree, however, the partnership may use a proration method[3] rather than an interim closing of the books method. If the partnership uses the interim closing method, it may use either a daily convention (the books are deemed to close at the end of the day on which the change occurs) or a semi-monthly convention[4]. If the partnership uses the proration method the proposed regulations require a daily convention.

For PTPs, which have partners changing interests on a daily basis, these rules pose particular issues. The preamble to the regulations states that the IRS and Treasury are aware that some PTPs are using a monthly convention (any change occurring during a month is deemed to occur on one particular day of the month, usually the first day or the last day) or semi-monthly convention with the proration method. In light of this, the proposed regulations provide a special rule exempting existing PTPs from the proposed rule. Instead a safe harbor is provided under which PTPs, whether using the interim closing of the books method or a proration method, may use either the semi-monthly convention or a monthly convention that treats all transfers of publicly traded units during a month as occurring on the first day of the following month under a consistent method adopted by the partnership. Block transfers of units will not qualify for the safe harbor. Comments were requested on the application of conventions other than monthly or semi-monthly to PTPs.

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[2] The interim closing of the books method assumes for purposes of the allocations that the partnership's books were closed just before the change in partnership interests and allocates items based on ownership interests at the time the books were "closed."

[3]Under a proration allocation method, the items allocated among the partners are based on their pro rata share on each item for the entire tax year.

[4] The semi-monthly convention assumes that any ownership change that occurs on the 1st-15th days of the month, is deemed occur on the last day of the preceding month, while any for ownership change during the second half of the month is deemed to occur on the last day of the month)

The Association submitted comments prepared by its accounting firm representatives to the IRS on July 13, 2009. The Association's comments recommend, among other items, that the final regulations:

- Include a quarterly convention as an additional safe harbor convention that would allow PTPs making quarterly distributions to allocate tax items of a quarter to their unitholders who are the record holders on the date the quarterly distribution is declared.

- Allow PTPs using the proration method to prorate their annual aggregate tax items by the number of months (instead of by the number of days) during the year as a variation of the calendar day convention.

- Remove the block transfer exclusion and apply the safe harbor conventions (as provided in Prop. Reg. § 1.706-4(b)(3)) to transfers of all PTP units regardless of whether the units are publicly traded—or alternatively, apply the safe harbor conventions to transfers of all publicly traded PTP units (using an expanded definition) and limit the block transfer exclusion only to transfers of non-publicly traded PTP units.

- Provide that existing PTPs (as defined in Prop. Reg. § 1.706-4(f)) continue to be grandfathered from having to apply the conventions provided by the Proposed Regulations even if they have one or more "technical" terminations under section 708(b)(1)(B) on or after April 14, 2009.

The AICPA and the Tax Sections of both the American Bar Association and the New York State Bar Association have all submitted comments urging the IRS to allow greater flexibility in allocation methods in the final regulations. In addition, the ABA and NYSBA proposed that all partnerships, not just PTPs, be allowed to use a monthly convention.

The IRS Priority Guidance Plan for 2012-2013 includes issuing a final version of these regulations, so there is a chance we may see them this year. The Plan also calls for issuing new regulations under section 706(d) regarding the determination of a distributive share of any allocable cash basis items and certain other items when a partner's interest changes.

Proposed Regulations on Partnership Mergers and Notice 2009-70

Another set of proposed regulations which has been awaiting a final version for several years are the proposed regulations on the application of sections 704(c)(1)(b) and 737 to "asset-over" partnership mergers—those in which the terminating partnership is treated as having contributed all of its assets and liabilities to the continuing partnership in exchange for a partnership interest in the continuing partnership. These regulations, which have been described in detail in previous reports and can be found in the Members section of the NAPTP website, were issued in proposed form on August 21, 2007.[5] They are proposed to be effective for any distributions after January 19, 2005, of property contributed in an assets-over merger after May 3, 2004.

Additionally, on August 12 , 2009, the Internal Revenue Service issued Notice 2009-70 (2009-34 I.R.B. 255; also found on the NAPTP website), requesting comments on the proper application of rules relating to multiple layers of forward and reverse section 704(c) gains and losses to partnerships and tiered partnerships, particularly in the context of partnership mergers and divisions. The request for comment had its origin in the 2007 proposed regulations: according to the IRS, a number of the comments to those proposed regulations expressed concern about the proposed treatment of section 704(c) layers in connection with partnership mergers.

In addition, the Notice stated that the IRS and Treasury "have become aware that practitioners are taking positions based on different interpretations of the current tiered partnership rules," and that practitioners had suggested that these rules needed to be clarified and similar rules proposed for partnership mergers. It had therefore decided that further study of certain aspects of section 704(c) is needed before it can finalize the 2007 regulations.

On January 22, 2010, the New York State Bar Association Tax Section filed comments containing a number of specific recommendations. The NYSBA Tax Section's letter summarizing its recommendations, as well as the full report, is posted with the Annual Meeting material on the Association website.

There has been no indication from Treasury or the IRS as to when a final version of the 2007 regulations will be issued.

FORTHCOMING PARTNERSHIP GUIDANCE

The Priority Guidance Plan issued by the IRS and Treasury's Office of Tax Policy for 2012-2013 contains a number of partnership items, some of which may be of interest to PTPs. Three of the listed items—final regulations under section 706(d) regarding the determination of a distributive share when a partner's interest changes, final noncompensatory option regulations, and final regulations eliminating the de minimis partnership rule—have already completed and published. Other items on the priority list include:

1. More on COD income: regulations under §108(e)(7), which provides rules for recapturing gain when a creditor acquires stock of a debtor corporation and

[5] Links to the proposed regulations, Notice 2009-70, and the New York State Bar Association material referenced here can be found in the Annual Meeting material on the NAPTP website. A detailed description of the proposed regulations can be found online in the Annual Meeting material for previous years.

subsequently sells it. The regulations would provide similar rules for the case when the debtor is a partnership, as required by §108(e)(7)(E).

2. Regulations under §1.337(d)-3 relating to partnership transactions involving a corporate partner's stock or other equity interests. §1.337(d)-3 deals with corporations that avoid tax by exchanging an appreciated asset for its own stock *using* a partnership as an intermediary.

3. Final regulations under §469(h)(2) concerning limited partners and material participation. The proposed regulations, published on November 28, 2011, clarified that an interest in an entity such as an LLC or LLP can be considered a limited partnership interest (which under §469(h)(2) is presumed to be a limited partner interest) and establish a means by which the holder of such an interest can meet the material participation test..

4. Regulations concerning the fractions rule under §514(c)(9). This has to do with the UBTI rules for exempt organizations and should not affect PTPs.

5. Regulations under §§704, 734, 743, and 755 arising from the American Jobs Creation Act of 2004, P.L. 108-357, 118 Stat. 1418, regarding the disallowance of certain partnership loss transfers and no reduction of basis in stock held by a partnership in a corporate partner. Interim guidance was issued as Notice 2005-32. These provisions apply to partnerships without a §754 election in effect and to electing investment partnerships, and should not affect most PTPs.

6. Regulations under §707 relating to disguised sales of property.

7. Regulations under §§709 and 195 on organizational and start-up expenses of a partnership after a technical termination.

8. Regulations under §751(b), which treats a distribution to a partner of unrealized receivables or substantially appreciated inventory items in exchange for his interest in other partnership property as a sale between the partner and the partnership.

9. Regulations under §752 regarding the related person rules, which apply the rules regarding partnership liabilities to related parties as well as to partners.

Placement on the priority list does not necessarily guarantee that the listed guidance will appear during the period to which the list relates, but it provides an indication of what may be coming down the road from the IRS and Treasury.

Conclusion

While a number of proposed regulations of interest to PTPs have been finalized and guidance provided on the Net Investment Income Tax, the most interesting regulatory developments over the past year may be the numerous and varied private letter rulings relating to PTPs that have been released over the past year, as both existing and proposed PTPs explore additional activities which may fit under the qualifying income definition of section 7704(d). It is likely that this activity will continue in the coming year.