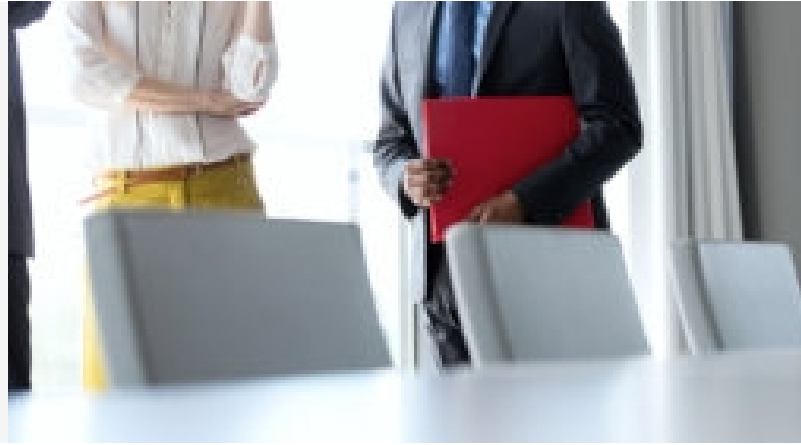


# FINAL MLP TAX REGULATIONS CAUGHT BETWEEN ADMINISTRATIONS

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The US Department of the Treasury has recently issued final regulations that affect the taxation of certain master limited partnership (“MLPs”). This briefing describes the background of, and some of the issues relating to, the new regulations and touches on the uncertainty about the status of the regulations in light of steps taken by the new presidential administration.

## MLPS TAXED AS PARTNERSHIPS

MLPs are typically partnerships that are involved with natural resources or related items and are publicly traded on an exchange. MLPs are often intended to be classified as partnerships for US federal income tax purposes. Unlike a corporation, which is subject to tax on its own income, as well as an additional layer of tax on its shareholders when it pays dividends, an MLP that is taxed as a partnership does not pay US income tax, and instead its partners pay any applicable tax.

Pursuant to section 7704 of the Internal Revenue Code (the “Code”), however, publicly traded partnerships generally are treated as corporations for US federal income tax purposes. There is an exception for a publicly traded partnership to be taxed as a partnership if 90% or more of the partnership’s gross income is “qualifying income.” Qualifying income includes “passive-type” income such as dividends and interest, but also includes income from the exploration, mining, production, processing, transportation or marketing of minerals or natural resources.

## TANKER MLPS – SPECIAL CONSIDERATIONS

Tanker MLPs (MLPs owning tankers that transport crude oil, LNG, LPG or other natural resources or certain byproducts) generally have qualifying income from “transportation” of natural resources. In the case of tanker MLPs that transport chemical byproducts of natural resources, the regulations define when the assets being transported qualify under these rules.

The consequence of a tanker MLP failing to satisfy the qualifying income test may be less significant than it would be for a US-based onshore MLP because tanker MLPs typically are organized outside the United States, and derive most of their income from non-US sources. However, the test is still relevant because a tanker MLP that is classified as a corporation would potentially be subject to the 2% “freight tax” on gross income from voyages to or from the United States, unless it can satisfy the exemption under section 883 of the Code. Furthermore, a tanker MLP that is taxed as a corporation may be classified as a “passive foreign investment company” (PFIC), which can have additional negative tax and reporting consequences to its US investors.

## NEW REGULATIONS

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Historically, an MLP would obtain comfort that it is classified as a partnership for US tax purposes by obtaining a private letter ruling (PLR) from the US Internal Revenue Service (IRS). In an effort to streamline this process and provide consistency, the Department of the Treasury released proposed regulations in 2015 and final regulations on January 19 2017.

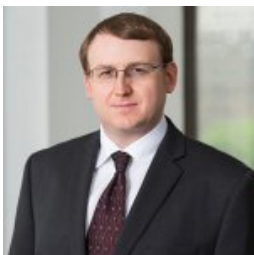
The proposed regulations attempted to delineate the often murky line between “processing and refining” of natural resources in which the resulting product is still treated as qualifying under the regulations, and “manufacturing,” which converts the product into a non-qualifying asset. For example, fuel oil and a plastic bag are both made from petroleum, but fuel oil is “processed” and therefore qualifies under the rules, whereas a plastic bag is “manufactured” and does not. More difficult to classify are olefins such as ethylene and propylene, which are petrochemicals derived from natural gas that are used in manufacturing plastic. Another questionable activity is conversion of coal to coke. Both olefins (obtained through steam cracking) and coal-based coke were excluded from the qualifying income test under the 2015 regulations. The final regulations reversed the course on olefins but not on coke. At least two MLPs have been potentially affected by the new rules: Westlake Chemical Partners LP, which processes olefins and would qualify under the new rules, and SunCoke Energy Partners LP, which processes (or “manufactures”) coal into coke and would fall outside the new rules.

## TRUMP FREEZE ON NEW REGULATIONS

The final regulations were released on January 19 2017, the last day of President Barack Obama’s term in office. They were scheduled to be published in the Federal Register, which contains all official government agency rules, on January 24, with retroactive effect to January 19. The following day, the new administration of President Donald Trump issued a memorandum freezing all new regulations and directing the Office of Federal Register to immediately withdraw from publication any new regulations scheduled to be published. On January 24, notwithstanding the memorandum, the final regulations were published in the Federal Register. It is not readily apparent why the regulations were published in contravention of the freeze; it is possible that there was simply not enough time to comply with the memorandum.

As a result, it would appear that the new regulations are now in effect, and can be withdrawn only pursuant to new regulations or other binding administrative guidance from the Trump Administration.

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