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Memorandum

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to: Harmon Dow
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subject: Retail Sales of Propane and Qualifying Income under § 7704(d)(1)(E)

This Chief Counsel Advice responds to your request for assistance dated July 18, 2007. This advice may not be used or cited as precedent.

LEGEND

X =
State =
Year 1 =

ISSUES

Whether income derived from the distribution and marketing of propane to end users at the retail level constitutes “qualifying income” under § 7704(d)(1)(E) of the Internal Revenue Code.

CONCLUSIONS

Based upon the legislative history of § 7704(d)(1)(E), in particular, the floor statements of Congressman Dan Rostenkowski and Senator Lloyd Bentsen during the enactment of § 7704, we conclude that income derived from the distribution and marketing of propane to end users at the retail level constitutes qualifying income under § 7704(d)(1)(E).

FACTS

X is a publicly traded partnership (“PTP”) organized under the laws of State. Since its formation in Year 1, X has been engaged in the retail and wholesale supply, marketing, and distribution of propane. X’s business consists principally of transporting and selling propane purchased from third parties to the X’s propane distribution locations and then to tanks on customers’ premises and to portable propane tanks. The distribution of propane to residential customers generally involves large numbers of small volume deliveries averaging approximately 200 gallons each. Retail deliveries of propane are typically transported from retail propane distribution locations to customers by bulk delivery trucks, which are generally fitted with a 3000 gallon tank. Propane storage tanks located on customers’ premises are then filled from these bulk delivery trucks. Residential customers typically rent their storage tanks from X.¹

X also delivers propane to industrial and commercial customers using portable tanks and various delivery trucks. In addition, X may lease tanks to independent distributors.

In addition to the retail distribution and marketing of propane, X is involved in other activities including: common carrier services; wholesale marketing of propane appliances; wholesale propane marketing and distribution; the sale of refined fuels; the retail sale of propane appliances and related parts and fittings; the renting of bulk propane tanks to customers; and other retail propane related services. These additional activities comprise less than 10% of X’s total revenues each year.

LAW AND ANALYSIS

Section 7704(a) provides that except as provided in § 7704(c), a publicly traded partnership will be treated as a corporation.

¹ The Service previously received a request (from a taxpayer unrelated to X) for a ruling that income from the rental of propane storage tanks would be considered “qualifying income” under section 7704(d). After being told that the Service would rule adversely on this issue, the taxpayer withdrew its ruling request. The Service continues to view the income from storage tank rentals as nonqualifying.

Section 7704(b) provides that the term "publicly traded partnership" means any partnership if (1) interests in such partnership are traded on an established securities market or (2) interests in such partnership are readily tradable on a secondary market (or the substantial equivalent thereof).

Section 7704(c)(1) provides that § 7704(a) shall not apply to any publicly traded partnership for any taxable year if such partnership met the gross income requirements of § 7704(c)(2) for such taxable year and each preceding taxable year beginning after December 31, 1987, during which the partnership (or any predecessor) was in existence.

Section 7704(c)(2) provides that a partnership meets the gross income requirements of § 7704(c) for any taxable year if 90 percent or more of the gross income of such partnership for such taxable year is qualifying income.

Section 7704(d)(1)(E) defines "qualifying income" to include income and gains derived from the exploration, development, mining or production, processing, refining, transportation (including pipelines transporting gas, oil, or products thereof), or the marketing of any mineral or natural resource (including fertilizer, geothermal energy, and timber). The Conference Report accompanying the Revenue Act of 1987 (which enacted § 7704), in discussing the type of qualifying income described in § 7704(d)(1)(E), states as follows:

Income and gains from certain activities with respect to minerals or natural resources are treated as passive-type income. Specifically, natural resources include fertilizer, geothermal energy, and timber, as well as oil, gas or products thereof. For this purpose, oil, gas, or products thereof means gasoline, kerosene, number 2 fuel oil, refined lubricating oils, diesel fuel, methane, butane, propane, and similar products which are recovered from petroleum refineries or field facilities. Oil, gas, or products thereof are not intended to encompass oil or gas products that are produced by additional processing beyond that of petroleum refineries or field facilities, such as plastics or similar petroleum derivatives. Income of certain partnerships whose exclusive activities are transportation and marketing activities is not treated as passive-type income. For example, the income of a partnership whose exclusive activity is transporting refined petroleum products by pipeline is intended to be treated as passive-type income, but the income of a partnership whose exclusive activities are transporting refined petroleum products by truck, or retail marketing with respect to refined petroleum products (e.g., gas station operations) is not intended to be treated as passive type income.

H.R. Rep. No. 495, 100th Cong., 1st Sess. 947 (1987), 1987-3 C.B. 946-947.

The next year, Congress clarified the scope of the rule for income from the transportation and marketing of oil and gas. The Conference Report for the Technical and Miscellaneous Revenue Act of 1988 (the "1988 Act") provides:

In addition, the conference agreement follows the legislative history of the House bill with respect to income from certain transportation activities, with certain modifications. In the case of transportation activities with respect to oil and gas and products thereof, the conferees intend that, in general, income from transportation of oil and gas and products thereof to a bulk distribution center such as a terminal or a refinery (whether by pipeline, truck, barge or rail) be treated as qualifying income. Income from any transportation of oil or gas or products thereof by pipeline is treated as qualifying income. Except in the case of pipeline transport the transportation of oil or gas or products thereof to a place from which dispensed or sold to retail customers is generally not intended to be treated as qualifying income. Solely for this purpose, a retail customer does not include a person who acquires the oil or gas for refining or processing, or partially refined or processed products thereof for further refining or processing, nor does a retail customer include a utility providing power to customers. For example, income from transporting refined petroleum products by truck to retail customers is not qualifying income.

The conference agreement also clarifies that, in the case of income from marketing of fertilizer, bulk or truckload sales to farmers in amounts of 1 ton or more are not considered retail sales giving rise to non-qualifying income.

H.R.Rep. No. 1104, 100th Cong., 2d Sess. II-17-18 (1988), 1988-3 C.B. 507-508.

The Senate Report accompanying the 1988 Act states:

With respect to marketing of minerals and natural resources (e.g., oil and gas and products thereof), the Committee intends that qualifying income be income from marketing at the level of exploration, development, processing or refining oil and gas. By contrast, income from marketing minerals and natural resources to end users at the retail level is not intended to be qualifying income. For example, income from retail marketing with respect to refined petroleum products (e.g., gas station operations) is not intended to be treated as qualifying income. S.Rep. No. 445, 100th Cong., 2nd Sess. 424 (1988).

However, the Congressional Record indicates an intent to create a narrow exception with respect to income from the distribution and marketing of propane to end users. Congressman Dan Rostenkowski, Chairman of the House Ways and Means Committee, stated:

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 that I am concerned about primarily engages in the purchase, transportation, storage, distribution, and retail and wholesale marketing of liquified petroleum gas-primarily propane- and other oil and gas

products. These products are transported in trucks and rail cars that are owned or leased by the partnership and by third party pipelines 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.

133 Cong. Rec. H 11967, 11968 (December 21, 1987).

Senator Lloyd Bentsen, Chairman of the Senate Finance Committee, issued a similar statement:

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 liquified 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 and transported by third party pipelines with which the partnership contracts for transportation.

133 Cong. Rec. S18651-02, (December 22, 1987)

These two coordinated statements, issued by the chairmen of the House Ways and Means Committee (Congressman Rostenkowski) and the Senate Finance Committee (Senator Bentsen), respectively, evidence a clear intention to treat income derived from the retail marketing of propane as qualifying income.

It is notable, moreover, that both the Senate and Conference Reports to the 1988 Act specifically cite the statements of Congressman Rostenkowski and Senator Bentsen. S. Rep. No. 445, 100th Cong., 2d Sess 424 (1988); H.R. Rep. No. 1104, 100th Cong., 2d Sess. 17-8 (1988). Specifically, after concluding that income from “transporting refined petroleum products by truck to retail customers is not qualifying income,” the Conference Report provides the following caveat in a footnote, citing the statements of Senator Bentsen and Congressman Rostenkowski: “[i]ncome from transportation and marketing of liquefied petroleum gas in trucks (as well as in railcars or by pipeline), however, may be treated as qualifying income.” It is clear from the committee reports that these joint statements were viewed as authoritative pronouncements concerning the scope of the legislation.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

It could be argued that the citation in the committee reports is of little significance because the footnote says only that income from the transportation and marketing of liquefied petroleum gas “may” constitute qualifying income; it doesn’t provide that it “will” constitute qualifying income. According to this argument, the circumstances under

which such income ‘may’ constitute qualifying income must still be determined by reference to the rest of the legislative history, which clearly provides that income derived from sales to end users at the retail level is not qualifying income. However, read in the context of the Conference Report, the drafters’ use of the term ‘may’ is better interpreted as a grant of permission (i.e., as synonymous with “is allowed to” or “is permitted to”). Indeed, it is unclear what purpose the footnote serves if no special rules were intended to apply to liquefied petroleum gas.

It could also be argued that the statements of Congressman Rostenkowski and Senator Bentsen do not specifically address the treatment of income derived from sales of propane to “end users at the retail level.” Both statements, however, do note that income derived from the “purchase, transportation, storage, distribution, and *retail* and wholesale marketing” of propane constitute qualifying income (emphasis added). Although neither legislator specifically used the term “end user at the retail level”, the context clearly evidences an intention to treat all income derived from sales of propane – no matter where earned in the production and distribution chain – as qualifying income. In fact, the commonly understood definition of the term ‘retail’ is a sale to an end user or ultimate consumer. Thus, the omission is neither surprising nor of substantive import.

Based upon the legislative history of § 7704(d)(1)(E), specifically, the floor statements of Congressman Rostenkowski and Senator Bentsen, we conclude that income derived from the distribution and marketing of propane to end users at the retail level constitutes qualifying income under § 7704(d)(1)(E).

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Please call _____ if you have any further questions.

By: _____

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