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June 4, 2015

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

Subject: Taxpayer Comments on Proposed REG-132634-14

To Whom It May Concern:

Suburban Propane Partners L.P. ("we," "us") appreciates the opportunity to submit comments on the proposed regulations under Section 7704(d)(1)(E) (the "Proposed Regulations").¹ We are supportive of the efforts to set forth in regulations the activities which produce qualifying income within the meaning of Section 7704(d)(1)(E) and write to address an activity which appears to have been overlooked in the Proposed Regulations: namely, retail sales of liquefied petroleum gas or propane. As set forth in detail below, the retail sale of propane has always been qualifying income under section 7704(d)(1)(E) as specified in the legislative history to Section 7704 and as recognized and confirmed by the Internal Revenue Service in 2007 by the Office of Chief Counsel.² We therefore request that the final regulations also specifically include a provision recognizing the retail sale of propane as qualifying income.

The preamble to the Proposed Regulations (the "Preamble") states that no regulations have been issued under Section 7704(d)(1)(E). Instead, questions about the specific application of Section 7704(d)(1)(E) have generally been addressed via private letter rulings, and that over time there has been a marked increase in seeking such rulings, particularly with respect to income from support services provided to businesses engaged in Section 7704(d)(1)(E) activities. The Proposed Regulations have been proffered in response to the increased interest in the application of Section 7704(d)(1)(E). We note, however, there have been no private letter ruling requests with respect to the retail sale and distribution of propane to end users because that matter has been settled since 1987. Although the Proposed Regulations change the conclusion for certain private letter rulings previously issued, we understand that there is no intent

¹ All references herein to Section are to the Internal Revenue Code of 1986, as amended.

² CCA 200749012 (Dec. 7, 2007) ("based on the legislative history of Section 7704(d)(1)(E), . . . we conclude that income derived from the distribution and marketing of propane to end users at the retail level constitutes qualifying income under Section 7704(d)(1)(E)").

to reverse conclusions that are clearly supported by the legislative history and other precedents. Because there are statements in the Proposed Regulations relating to marketing and local gas and delivery services which might be so construed, we are seeking confirmation that the qualifying income status for retail distribution and marketing of propane to end users is not affected or intended to be affected by the Proposed Regulations.

We set forth below the applicable legal analysis.

Statutory Analysis

Section 7704(a), enacted as part of the Omnibus Budget Reconciliation Act of 1987 (the "1987 Act"), generally treats publicly traded partnerships as corporations for federal income tax purposes. Section 7704(b) provides that the term "publicly traded partnership" means any partnership if (1) interests in that partnership are traded on an established securities market or (2) interests in that partnership are readily tradable on a secondary market.

Section 7704(c)(1) provides an exemption to this reclassification as a corporation to any publicly traded partnership that meets the gross income requirement of Section 7704(c)(2). A partnership will meet the gross income requirement of Section 7704(c)(2) if 90 percent or more of the gross income of the partnership for that taxable year consists of qualifying income.

As originally enacted in the 1987 Act, Section 7704(d)(1)(E) stated in relevant part that the term "qualifying income" includes "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 . . ." The Technical and Miscellaneous Revenue Act of 1988 (the "1988 Act") added the flush language of Section 7704(d)(1) which states that the phrase "mineral or natural resource" refers to any product that is eligible for depletion under Section 611; this includes coal, oil, and gas. The 1988 Act amendment was effective as if the provision had been included in the 1987 Act.

Proposed Regulations

The Proposed Regulations provide guidance on whether income from activities relating to natural resources and minerals constitute qualifying income under Section 7704(d)(1)(E).

Proposed Regulations Section 1.7704-4(a) provides:

For purposes of section 7704(d)(1)(E), qualifying income includes only income and gains from qualifying activities with respect to minerals or natural resources as defined in [Proposed Regulations Section 1.7704-4(b)]. For purposes of section 7704(d)(1)(E), qualifying activities include Section 7704(d)(1)(E) activities (as described in [Proposed Regulations Section 1.7704-4(c)]) and intrinsic activities (as described in [Proposed Regulations Section 1.7704-4(d)]).

Proposed Regulations Section 1.7704-4(c)(1) defines Section 7704(d)(1)(E) activities:

Definition. Section 7704(d)(1)(E) activities include the exploration, development, mining or production, processing, refining, transportation, or marketing of any mineral or natural resource as limited to those activities described in this paragraph (c) or as provided by the Commissioner by notice or in other forms of published guidance. No other activities qualify as section 7704(d)(1)(E) activities.

Proposed Regulations Section 1.7704-4(c)(7) defines “marketing” for purposes of Section 7704(d)(1)(E):

Marketing. An activity constitutes marketing if it is performed to facilitate sale of minerals or natural resources and products produced under [Proposed Regulations Section 1.7704-4(c)(4) or (5)], including blending additives into fuels. Marketing does not include activities and assets involved primarily in retail sales (sales made in small quantities directly to end users), which includes, but is not limited to, operation of gasoline service stations, home heating oil delivery services, and local gas delivery services.

The exclusion from qualifying income for retail sales derives from the legislative history, rather than the express statutory language. As explained in the Preamble:

The legislative history of section 7704 provides that marketing does not include activities and assets involved primarily in sales “to end users at the retail level.” S. REP. NO. 100-445, AT 424 (1988). Therefore, marketing does not include retail sales (sales made in small quantities directly to end users). For example, gas station operations are not including in marketing for purposes of section 7704(d)(1)(E). *Id.*

While this rule applies for certain products, the legislative history of Section 7704, as described below, represents congressional intent for classifying retail marketing of propane as a Section 7704(d)(1)(E) activity, as defined in Proposed Regulations Section 1.7704-4(c).

Legislative History

The legislative history establishes that, notwithstanding the general principle that marketing natural resources to end users at the retail level was not intended to be qualifying income under Section 7704(c), income from retail marketing of liquefied petroleum gas (primarily propane) was intended to be included as qualifying income under Section 7704(c).

The 1987 Act did not specifically define what constituted a passive activity with respect to a mineral or natural resource for purposes of Section 7704 and was silent on whether income from retail marketing constitutes qualifying income. However, the House Report 100-445, the conference report relating to the 1987 Act, provided:

Income and gains from certain activities with respect to minerals or natural resources are treated as passive-type income. Specifically, natural resources include fertilizer and geothermal energy, and timber, as well as oil, gas or products thereof. For this purpose, fertilizer, includes plant nutrients such as sulphur, phosphate, potash and nitrogen that are used for the production of crops and phosphate-based livestock feed. 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.³

Accordingly, although House Report 100-445 demonstrates that Congress intended that retail marketing of petroleum products generally does not constitute a passive-type activity that generates qualifying income under Section 7704, an explicit exception was made for retail sales of propane. Statements made by Congressman Rostenkowski, then Chairman of the House Ways and Means Committee, and Senator Bentsen, then Chairman of the Senate Finance Committee, establish that Congress clearly intended that retail marketing of liquefied petroleum gas, including propane, constitute an activity that generates qualifying income.

Congressman Rostenkowski stated to the House that:

Further, I would like to clarify for the record the scope of the provision in the bill treating certain publicly traded partnerships as corporations as it applies to a specific partnership. The partnership that I am concerned about primarily engages in the purchase, transportation, storage, distribution, and retail and wholesale marketing of liquefied petroleum gas—primarily propane—and other oil and gas products. These products are transported in trucks and railcars owned or leased by the partnership and by third party pipelines with which the partnership makes arrangement for transportation. It is my

³ H. Rep. No. 495, 100th Cong., 1st Sess. 947 (1987).

understanding that the income derived by the partnership from these activities would be included within the definition of...qualifying income.⁴

Congressman Rostenkowski made his statement on December 21, 1987, which was the date on which Conference Report 100-495 was agreed to in the House and Senate.

The next day, Senator Bentsen made a statement to the Senate nearly identical to Congressman Rostenkowski's statement to the House:

...income of a partnership from the purchase, transportation, storage, distributions, retail and wholesale marketing of liquefied petroleum gas, primarily propane, and other oil and gas products is [qualifying] income, even though such products are transported in trucks and railcars that are owned or leased by the partnership and transported by third-party pipelines with which the partnership contracts for transportation.⁵

That day, the bill was presented to and the 1987 Act was signed into law by the President.

Although House Report 100-495 indicated that retail marketing with regard to petroleum products generally did not constitute passive-type income for purposes of Section 7704(d)(1)(E), Congressman Rostenkowski's and Senator Bentsen's statements were clearly meant to qualify the general rule that retail marketing is not passive-type income. Congressman Rostenkowski's and Senator Bentsen's statements, made with respect to the final version of the bill that was signed into law, demonstrate a clear intention to treat income derived from the retail marketing of propane as qualifying income for purposes of Section 7704(d)(1)(E).

The next year, the Technical and Miscellaneous Revenue Act of 1988 (the "1988 Act") was enacted.⁶ The 1988 Act added language to Section 7704(d)(1)(E) clarifying what constituted a "natural resource" for purposes of Section 7704.⁷ The reports issued by the House and Senate that accompanied the 1988 Act clarified the scope of the rule for income from the transportation and marketing of oil and gas and explicitly recognized the exception that was provided for retail sales of propane.

The House Report provided:

⁴ 133 Congressional Record H. 11,967, 11,968 (December 21, 1987)(emphasis added).

⁵ 133 Congressional Record S. 37,957 (December 22, 1987) (emphasis added).

⁶ P.L. 100-647 (Nov. 10, 1988).

⁷ *Id.* ("Paragraph (1) of section 7704(d) of the 1986 Code is amended by adding at the end thereof the following new sentence: "For purposes of subparagraph (E), the term 'mineral or natural resource' means any product of a character with respect to which a deduction for depletion is allowable under section 611; except that such term shall not include any product described in subparagraph (A) or (B) of section 613(b)(7)")

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 refinery (whether by pipeline, truck, barge or rail) be treated as qualifying income. Income from any transportation of oil or gas 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.⁸

The House Report then qualified this paragraph with a footnote, citing Congressman Rostenkowski and Senator Bentsen's remarks as follows:

Income from transportation and marketing of liquefied petroleum gas in trucks and rail cars or by pipeline, however, may be treated as qualifying income. See statement of Mr. Rostenkowski, 133 Cong. Rec. H 11968 (December 21, 1987); see also statement of Senator Bentsen, 133 Cong. Rec. S 18651 (December 22, 1987) (substantially similar language).⁹

Similarly, Senate Report stated:

In the case of transportation activities with respect to oil and gas and products thereof, the Committee intends that, in general, income from bulk transportation of oil and gas and products thereof be treated as qualifying income. Transportation of oil and gas and products thereof that would constitute a bulk transfer (within the meaning of section 4081), as well as bulk transportation of oil and gas and products thereof by rail car, is considered bulk transportation for this purpose.

With respect to marketing of minerals and natural resources (e.g., oil and gas and products thereof), the Committee intends that qualifying

⁸ H.R. Rep. No. 1104, 100th Cong., 2d Sess. 11-17-18 (1988).

⁹ *Id.* at FN 1.

income be income from marketing at the level of exploration, development, processing or refining the mineral or natural resource. 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.¹⁰

The Senate Report also qualified these paragraphs with a footnote that cites Congressman Rostenkowski and Senator Bentsen's remarks:

Income 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. See Statement of Mr. Rostenkowski, 133 Cong. Rec. H 11,968 (December 21, 1987); see also Statement of Senator Bentsen, 133 Cong. Rec. S 18,651 (December 22, 1987) (substantially similar language).¹¹

The House and Senate conference reports cited Congressman Rostenkowski's and Senator Bentsen's statements with approval, demonstrating an acceptance of their remarks as authoritative on the treatment of income from the retail marketing of liquefied petroleum gas as qualifying income. Based on the Conference Reports, it is clear that Congress understood that the 1987 Act was meant to create a narrow exception from the general prohibition on retail marketing resulting in qualifying income for the retail marketing of liquefied petroleum gas, including propane. Congress understood that Congressman Rostenkowski and Senator Bentsen's remarks were meant to confirm such an exception, which both Conference Reports note as a caveat to the general rule that retail marketing to end users is not intended to be qualifying income.

In sum, neither the 1987 Act, which established the publicly traded partnership rules and the natural resources and minerals exception, nor the 1988 Act, which provided technical clarification on such rules, provide any guidance on whether income from retail marketing of oil, gas or products thereof constitutes qualifying income. Accordingly, the most significant guidance in this area comes from the legislative history of the 1987 Act and the 1988 Act. Based on the legislative history, Congress intended that retail marketing generally not result in qualifying income. However, based on the same legislative history, Congress also intended a narrow exception to the general rule for retail marketing of liquefied petroleum gas, including propane.

The Preamble, as described above, cites Senate Report 100-445 as support for its position that "marketing does not include activities and assets involved primarily in sales to 'end users at the retail level'" and that "marketing does not include retail sales (sales made in small quantities directly to end

¹⁰ S. Rep. No. 445, 100th Cong., 2d Sess. 424 (1988).

¹¹ *Id.* at FN 11.

users).” In general, Senate Report 100-445 does support these positions. However, the Preamble fails to mention the exception for retail sales of liquefied petroleum gas, including propane, which is also clearly set forth in Senate Report 100-445. Congressman Rostenkowski’s and Senator Bentsen’s statements on retail marketing (especially in their respective capacities as Chairman of the House Ways and Means Committee and the Senate Finance Committee) are an important component of the legislative history relating to retail marketing of natural resources, as cited in Senate Report 100-445, as well as House Report 1104, and, thus, it is critical to consider their remarks along with the rest of the legislative history.

Chief Counsel Memorandum Number 200749012

Consistent with the legislative history described above, the IRS issued Chief Counsel Memorandum 200749012,¹² which concluded “that income derived from the distribution and marketing of propane to end users at the retail level constitutes qualifying income under IRC Section 7704(d)(1)(E).” This conclusion, based on the statements of Congressman Rostenkowski and Senator Bentsen, is summarized in the memorandum as follows:

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...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.¹³

The reasoning of the Chief Counsel Memorandum underscores the conclusion that Congress, through “authoritative pronouncements,” intended “clearly” that retail marketing of propane constitute qualifying income under Section 7701(d)(1)(E).

¹² CCA 200749012 (Dec. 7, 2007).

¹³ *Id.* (emphasis added).

Contemporaneous Treatment of Retail Marketing of Propane

Moreover, at the time the 1987 Act was enacted, the propane industry recognized that retail sales of liquefied petroleum gas were qualifying income. Petrolane Partners, L.P. ("Petrolane"), a publicly traded partnership, had just been formed in March 1987 as a successor to the liquefied petroleum gas business of Petrolane Incorporated.¹⁴ In 1987, Petrolane conducted domestic liquefied petroleum gas retail operations in 42 states.¹⁵ For the year ended December 31, 1987, Petrolane distributed over 493 million gallons of liquefied petroleum gas to over 500,000 retail customers, of which approximately 63% of sales were to residential and commercial customers, approximately 18% were to engine fuel customers and approximately 19% were to agricultural customers and others.¹⁶ Petrolane was engaged in activities that were substantially identical to our current activities, including retail marketing of propane.¹⁷

In its 1987 Form 10-K, which was filed after the 1987 Act had been enacted, Petrolane stated that it was a "publicly traded partnership which is not subject to federal or state income tax."¹⁸ The Form 10-K also noted that Petrolane treated its income from current activities (including its substantial liquefied petroleum gas retail operations) as qualifying income for purposes of Section 7704:

The Revenue Act of 1987 (the "1987 Act") made changes to the federal taxation of income from publicly traded partnerships . . . Although the 1987 Act causes certain publicly traded partnerships existing on December 17, 1987 to be taxed as corporations beginning in 1997, [Petrolane] believes that its income from current activities falls within the exception for partnerships with certain types of qualifying income.¹⁹

Petrolane took the same position in its 1988 Form 10-K, which was filed after the enactment of the 1988 Act.²⁰ This position has been the industry norm for the past twenty-seven years.

Conclusion

¹⁴ Petrolane Partners, L.P., Form 10-K Annual Report for Fiscal Year ended December 31, 1987 at 1 (filed Mar. 30, 1988). Petrolane Incorporated had been marketing liquefied petroleum gas since the 1930s.

¹⁵ *Id.* at 2.

¹⁶ *Id.*

¹⁷ These activities include services to residents of rural areas where natural gas is not available and where propane is used for home heating, cooking, water heating and clothes drying.

¹⁸ *Id.* at 5.

¹⁹ *Id.*

²⁰ Petrolane Partners, L.P., Form 10-K Annual Report for Fiscal Year ended December 31, 1988 (filed Apr. 1, 1989).

The legislative history of the 1987 Act and 1988 Act clearly indicated that the retail marketing of propane was intended to be regarded as qualifying income under Section 7704. Furthermore, Chief Counsel Memorandum 200749012, after reviewing the legislative history, and the floor statements of Congressman Rostenkowski and Senator Bentsen in particular, confirmed the conclusion that Congress intended that the retail marketing of propane constitute qualifying income under Section 7704. Finally, the industry has adhered to this view since enactment of the PTP rules.

Because of this clear history that retail sales of propane were intended by Congress to constitute qualifying income, we respectfully request that the final regulations contain a clear statement confirming that retail and wholesale sales of propane are qualifying for purposes of Section 7704.

Sincerely,



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