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March 01, 2012

LEGEND

X =

Y =

State =

a =

b =

Dear :

This letter responds to a letter from X's authorized representatives dated September 8, 2011, submitted on behalf of X, requesting a ruling concerning the qualifying income exception to the publicly traded partnership rules of § 7704 of the Internal Revenue Code (the Code).

X is a corporation organized under the laws of State. X intends to form Y under the laws of State and cause Y to become a publicly traded partnership within the meaning of § 7704(b). Y will earn income for providing services to customers engaged in the exploration for, and the development and production of, oil and natural gas.

Specifically, Y will earn income from the removal, treatment, recycling, and disposal of waste products generated by the fracturing process and residual wastes that accumulate in crude oil tank bottoms.

Fracturing is a technique by which fluids are pumped into an oil or gas well at high pressure to fracture geologic formations and open up pathways for the oil or gas to flow up for extraction. Y will earn fees from the removal, treatment, recycling, and disposal of flowback generated in the fracturing process, naturally occurring produced water, drilling muds, contaminated soils, and other residual waste products. Y will treat the flowback and produced water at offsite treatment facilities and onsite through the use of a closed-loop system. The closed-loop system removes solid wastes and heavy brine from the fluids allowing oil and gas producers to reuse the fluids in the fracturing process. Employees of Y will remain onsite to oversee the treatment process and periodically transport solid wastes to offsite treatment facilities. Y will not provide closed-loop systems to oil and gas producers to operate independently or for third party waste disposal providers to operate. Y will also remove and treat fluids used to wash and remove debris from containers, trucks, and equipment used by the oil and gas producers.

In addition to its waste removal, treatment, recycling, and disposal services, Y will earn income from the production and marketing of hydrocarbon products recovered from oil field wastes handled by Y. Y will collect crude oil skimmed from oil field wastes during the waste treatment process and sell the salvaged crude oil to oil refiners who do not themselves consume the crude oil in their own operations. X represents that Y will treat any income derived from the sale of crude oil to third party end users as nonqualifying income. Y will also produce an asphalt alternative consisting of a percent drilling and production wastes and b percent binder. Y will sell the asphalt alternative to government entities and commercial users for road construction and paving.

Section 7704(a) provides that a publicly traded partnership shall be treated as a corporation.

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) interest in that partnership are readily tradable on a secondary market (or substantial equivalent thereof).

Section 7704(c)(1) provides that § 7701(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) explains that a partnership meets the gross income requirements of § 7704(c)(2) 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) provides that the term “qualifying income” means income or 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, or timber).

The Conference Report accompanying the Omnibus Budget Reconciliation Act of 1987, in discussing the type of qualifying income described in § 7704(d)(1)(E), provides the following:

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 oil 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. 943 (1987), 1987-3 C.B. 226-227.

The Senate Report accompanying the Technical and Miscellaneous Revenue Act of 1988 provides the following:

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., 2d Sess. 424 (1988).

Based solely on the facts presented and representations made, we conclude that Y's gross income from the removal, treatment, recycling, and disposal of fracturing flowback, produced water, and other residual waste products generated by oil and gas wells during the fracturing process is qualifying income within the meaning of § 7704(d)(1)(E). We further conclude that the income derived from the marketing and distribution of salvaged crude oil and asphalt alternative produced by Y, excluding income earned from marketing minerals and natural resources to end users at the retail level, will also constitute qualifying income within the meaning of § 7704(d)(1)(E).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. In particular, no opinion is expressed as to whether Y meets the 90 percent gross income requirement in § 7704(c)(1).

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Melissa C. Liquerman
Branch Chief, Branch 2
(Passthroughs & Special Industries)

Enclosures (2)
Copy of this letter
Copy for § 6110 purposes