

**Internal Revenue Service**

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Washington, DC 20224

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Person To Contact:  
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Telephone Number:

Refer Reply To:  
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PLR-138320-12  
Date:  
January 31, 2013

Legend

X =

Y =

State =

Date1 =

Date2 =

a =

b =

c =

d =

e =

Dear \_\_\_\_\_ :

This responds to your letter dated August 31, 2012, 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.

## Facts

X is a limited liability company formed under the laws of State on Date1 and is treated as a partnership for federal income tax purposes. X represents that it intends to form a “publicly traded partnership” within the meaning of § 7704(b). After the initial public offering, the publicly traded partnership (itself or through affiliated operating limited partnerships, limited liability companies or disregarded entities) will carry on X’s current business as described below.

X is an oilfield service company that provides well stimulation services to the oil and gas industry. Specifically, X provides high-pressure hydraulic fracturing services to exploration and production companies in order to enhance the production of oil and natural gas from unconventional oil and natural gas basins (geologic formations such as shale and other tight formation reservoirs where natural flow is restricted). To provide these services, X uses mobile hydraulic fracturing units and associated heavy equipment that are owned by X and operated by X’s employees and independent contractors. This hydraulic fracturing equipment is specifically designed to pump specially formulated fluid (“fracturing fluid”) into a perforated well casing or tubing under high pressure.

The fracturing process is completed in multiple “stages,” or horizontal zones. Sand, bauxite, resin-coated sand or ceramic particles, each referred to as a proppant or propping agent, are suspended in the fracturing fluid and prop open the cracks created by the fracturing process in the underground formation. This causes the underground formation to crack or fracture, thereby allowing the hydrocarbons to flow more freely into the wellbore. X represents that these hydraulic fracturing services are integral to the production of oil and natural gas from wells drilled in shale and other tight formation reservoirs, because the production of such oil and natural gas would be significantly curtailed in the absence of such services.

X entered into a contract with Y to provide hydraulic fracturing services to Y in a specific geographic location. Y is an independent exploration and production company engaged in the acquisition, development and production of unconventional natural gas resources in the United States. The contract requires X to provide hydraulic fracturing services to Y over a 24-month period commencing on Date2. The contract requires X to provide an initial fleet of a pumps, and to perform a minimum of b stages per day for c days per month, resulting in a minimum of d fracturing stages per quarter. Under the contract, X’s fees for providing hydraulic fracturing services to Y consists of: 1) mobilization fees based on mileage from the location of X’s hydraulic fracturing fleet, charged at the initial stage of each job; 2) operating stage/well/day rates; 3) standby times rates and down-time rates in circumstances where Y does not provide X with the minimum d quarterly stages through no fault of X; 4) force majeure payment rates and payments in the event

a governmental body or regulatory agency issues a mandate that either makes it impossible for X to continue operations or causes an increase in X's rate; and 5) reimbursable costs with respect to hydraulic fracturing related material, equipment, work or services that are to be furnished by X at Y's request, plus e% for such cost of handling.

X represents that the contract with Y is illustrative of the contractual relationships that X expects to have with other exploration and production companies. The fee structure of these additional contracts is expected to be similar to the fees charged in the contract with Y. In certain instances, X may also source chemicals and proppants that are consumed during the fracturing process and charge its exploration and production customers a fee for providing such materials. Such charges for materials will generally reflect the cost of the materials plus a markup and will be based on the actual quantity of materials used in the fracturing process. Finally, X may charge its other exploration and production customers a handling fee for chemicals and proppants supplied by the customer.

X has requested a ruling that the gross income it derives from hydraulic fracturing services is qualifying income within the meaning of § 7704(d)(1)(E).

#### Law and Analysis

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

Section 7704(c)(1) provides that section 7701(a) shall not apply to any publicly traded partnership for any taxable year if such partnership met the gross income requirements of section 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 section 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) 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).

## Conclusion

Based solely on the facts submitted and representations made, we conclude that the gross income that X derives from providing hydraulic fracturing services will be 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, including whether X meets the 90 percent gross income requirement of § 7704(c)(1) in any taxable year for which this ruling may apply. In addition, no opinion is expressed or implied concerning whether any of the ownership structures discussed or referenced in this letter constitute partnerships for federal tax purposes.

This ruling is directed only to the taxpayer requesting it. However, in the event of a technical termination of X under § 708(b)(1)(B), the resulting partnership may continue to rely on this ruling in determining its qualifying income under § 7704(d)(1)(E). Section 6110(k)(3) of the Code provides that this ruling may not be used or cited as precedent.

Temporary or final regulations pertaining to one or more of the issues addressed in this ruling have not yet been adopted. Therefore, this ruling will be modified or revoked by the adoption of temporary or final regulations, to the extent the regulations are inconsistent with any conclusion in the letter ruling. See § 11.04 of Rev. Proc. 2012-1, 2012-1 I.R.B. 1, 50. However, when the criteria in § 11.06 of Rev. Proc. 2012-1, 2012-1 I.R.B. 1, 50 are satisfied, a ruling is not revoked or modified retroactively except in rare or unusual circumstances.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

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.

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

Sincerely,

Melissa C. Liquerman  
Branch Chief, Branch 2  
Office of the Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosures (2):

Copy of this letter

Copy for § 6110 purposes

cc: