

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **201336016**
Release Date: 9/6/2013
Index Number: 7704.00-00, 7704.03-00

Third Party Communication: None
Date of Communication: Not Applicable
Person To Contact: _____, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B02
PLR-153103-12
Date:
May 07, 2013

Legend

X =

Y =

State =

Dear _____ :

This responds to your letter dated December 13, 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 corporation formed under the laws of State. X represents that it intends to form Y and contribute to Y all or a portion of its assets and business operations described below. X further intends for Y to become a publicly traded partnership within the meaning of § 7704(b).

According to X, the oil and gas industry has experienced a significant resurgence in drilling and development activity in recent years. This accelerated activity, coupled with new and unconventional drilling techniques, has created a great need for competent fluids management services and products. X represents that its business operations

are exclusively focused on fluids management for the oil and natural gas exploration, development, and production industry.

X provides extensive fluids management services and environmental solutions to the oil and gas industry by customizing cost-effective solutions focused on the completion and production stages of the fluids life cycle. X's services and products offerings include: (a) water transfer by pipe; (b) large above-ground fluids storage alternatives; (c) proppant, guar and other guar alternatives, and other completion, stimulation, production, and specialty chemicals or additives; (d) water conditioning for re-use; (e) flowback and well testing services; (f) fluids transportation and storage; and (g) logistics and distribution services to support its product and service offerings. These services and products offerings are discussed in greater detail below.

X's business is operated in two segments. X's fluids management operations are comprised of its water transfer, field fluids logistics, and flowback and well testing operations, X's fluids technologies operations are comprised of its well completion and stimulation products, fluids conditioning, and production and specialty chemicals operations.

X's Fluids Management Segment

According to X, water transfer services are critical for oil and gas producers because, water is often required for a successful fracturing operation. Additionally, flowback and produced water must be treated or disposed of appropriately. X's water transfer services include implementing systems of pumps, piping, manifolds, above-ground storage tanks, and filtration equipment tailored for customers' specific needs and the local climate and terrain. Specifically, X designs, installs, and monitors semi-permanent or temporary distribution pipelines, together with various manifolds and centrifugal pumps, to transfer fluids to or from multiple well pad locations, pits, tanks, water sources, treatment facilities and disposal sites. X also provides water filtration services to address large and small particles that may be present in water volumes before, during, or after fracturing operations.

With respect to above-ground storage tanks, X provides steel tanks, with a range of capacity, to meet its customers' various on-site fluids storage needs. These above-ground storage tanks are typically leased to the customer on a day-rate basis and integrated into a larger fluids management system.

With respect to X's water transfer services, X provides pipe and hose, pit lining, light towers, and generators for on-site fluids management and related support, typically in exchange for a rental fee. Customers are generally billed for the movement of water, based on the number of hours and the number of trucks required for the job, on the number of miles of piping that is required, or on a measured rate of flow (e.g., barrels per minute of fluids throughput). These fees often include the use of any associated

pumps, although customers alternatively may be billed for the use of pumps through a separate rental fee.

With respect to X's field fluid logistics services, X sells fluids and proppant, provides storage, transportation, transloading, and logistics services, provides pumping and recovery services via a fleet of trucks, and provides tanks to facilitate the delivery, storage, use and disposal of such fluids and proppant on or around the well site.

According to X, proppant is a critical component to many fracturing operations, as it functions to hold open fractures in the formation created by high-pressure pumping. X provides a variety of supply and storage services for various types of proppant (e.g., resin-coated, ceramic and traditional sand) including: (a) proppant storage through centralized silos, terminals, and railcars; (b) proppant transloading through regional rail transloading terminals; (c) proppant transportation, typically to the well site, through a fleet of specialized trucks; and (d) proppant inventory management services, which includes using a combination of these assets to ensure timely and adequate deliveries to well sites and other customer locations. X typically charges customers on a tonnage basis for sales and transloading of proppant, on a monthly fee basis for proppant storage, and on a mileage basis for proppant transportation.

According to X, it is essential that oil and gas producers have the necessary quantities and types of fluids to support the exploration, development, and production of oil and gas. It is also essential that flowback water and other oilfield fluids, including heavy crude oil, are hauled away from the well site. X supplies many drilling, completion and production fluids, including fresh water, on a per-barrel basis to well sites via its fleet of tank and water trucks. According to X, water is a necessary component of most fracturing fluid, which is generally comprised of water, proppant, and a small percentage of chemicals necessary for the efficient exploitation of a well. X's fluid offerings include trucking services for hauling water to well sites or between impoundments. X also uses its trucking and logistics assets to haul away flowback water, produced water and other oilfield fluids, including heavy crude oil, away from the well site. Trucking and logistics services are typically billed to X's customers on a per-barrel, per-mile, or per-hour basis.

According to X, fluids must be stored, transported and, in some cases, recovered at the well site to facilitate the drilling and completion of an oil and gas well. X's fluids services include well site storage through traditional and insulated "frac tanks". These so-called frac tanks, which are designed to hold fluids in advance of fracturing and to capture flowback water after pumping, are typically provided to customers through rental agreements with varying terms.

In addition, X uses a fleet of trucks and tanks to provide well site logistics services, including equipment hauling and support for field activities, such as rig service operations and overall fluids management. Pumping, recovery and disposal operations include pressure truck services to provide testing for facilities, well heads, and pipelines,

and vacuum truck services for the recovery and disposal of frac fluids and oilfield wastes. X typically provides these services on a fee-for-service basis, with an hourly rate for equipment deployed.

X also maintains a fleet of “hot oilers,” which are trucks that provide services to establish and maintain production of oil and gas wells. Hot oil services involve circulating heated fluid, such as fresh water or oil, into piping, tubing, casing, or tanks for the removal of paraffin and tar-based oils, or asphaltenes. According to X, paraffin, or paraffin hydrocarbon, is a waxy material present in most crude oils. Where paraffin is found in crude oil in a particular formation and kept at formation temperatures and pressures, it generally remains liquid and does not create an issue. However, paraffin will usually precipitate out of crude oil as it cools, causing it to build up in the wellbore or other tubing used to convey petroleum and create a blockage such that the flow of oil is substantially constrained. Asphaltenes occur in many crude oils as colloiddally suspended particles, which precipitate when the crude oil can no longer keep the particles dispersed. Many of the same issues occur with asphaltenes as with paraffins, though asphaltenes tend to occur at the bottom of the well adjacent to the producing formation wall. Producing wells requiring paraffin or asphaltene treatment generally use hot oil services on a recurring basis, sometimes as often as once a month, depending on the paraffin content of the local reservoir. As with X's other logistics offerings, these services are typically provided to oil and gas producers on a fee-for-service basis, with an hourly rate for equipment deployed.

X provides an extensive line of services and equipment to manage the flowback of fluids at the well site and conducts comprehensive well tests. Specifically, services include hydrocarbon and fluids separation, 24-hour well site surveillance, fluids measurement and analysis, field production support, production testing, well testing with real-time data reporting, and flaring operations. X also supplies sand separators and other flowback equipment designed to separate solids, oil, gas and water from the total fluids stream produced by a well. X's customers typically pay either a day rate for services or a rental fee for the operator's use of specific equipment. Well site surveillance services may be provided by subcontractors under X's control.

X's Fluids Technologies Segment

According to X, completion and stimulation products comprise the largest segment of X's fluids technologies business. These chemicals and additives are primarily used in hydraulic fracturing or other aspects of the well completion and stimulation process. X develops, manufactures, and supplies both a full suite of specialty oilfield products, including fracturing components such as guar and other guar derivatives, cross-linkers and breakers, stimulation chemicals, acids and additives, cementing chemicals and additives and a wide range of commodity chemicals.

A large portion of X's sales revenue from its specialty oilfield products is derived from the sale of guar, a plant derivative used as a thickening agent to increase the viscosity of fracturing fluid, and guar derivatives. X procures guar from third parties and delivers it to the customer at a distribution facility or at the well-site, usually as either a powder or mixed with mineral oil in the form of a slurry. In conjunction with its sales of guar and guar derivatives, X provides "cross-linkers" used to help the guar create the desired gel, "breakers" that break down thickened fracturing fluid and leave the sand and other proppant behind to keep the fractures "propped" open and to provide a conduit for the hydrocarbons to flow out of the wellbore, friction reducers, and chemical well stimulators, all of which comprise approximately % of typical fracturing fluid. The remainder of the fracturing fluid is comprised of approximately % water and % of proppant.

X's other oilfield products include polymers, clay stabilizers and potassium chloride substitutes used to stabilize certain types of shale formations, and surfactants, emulsifiers, foamers and defoamers which are each used to manage the reaction between oil in the formation and water in the fracturing fluid, as necessary. X's additives and products include thixotropic materials (substances that form a gel when still and liquefy when pressure is applied), density-reducing agents, anti-settling agents, and many other products designed for specific uses in oil and gas wells. In addition to its own proprietary specialty chemicals, X manufactures products to conform to customers' proprietary formulations.

X also provides a range of "commodity chemicals" to its customers, including alcohols, amines, betaines, fatty alcohols, acids, waxes, oils and petrolatum, solvents, and surfactants which can be mass produced on a large scale. In all cases, such products are sold to oilfield services companies for use in the exploration, development and production of oil and gas. X typically charges its customers for completion and stimulation products on a volumetric basis.

X also offers other services in conjunction with the supply of oilfield services and commodity chemical products. X maintains a dedicated transportation fleet and distribution facilities to facilitate delivery of its products. X also stores both dry and liquid chemicals and provides warehousing services. X also provides field services, laboratory services, and well site support to its oilfield services customers.

According to X, the manner in which the oilfield services industry manages produced and flowback water is evolving as technologies are developed that allow the water to be re-used in fracturing operations. Water that is produced during the flowback process or during production varies by region of the country and by the formation being produced, and contains bacteria, oil and grease, metals, high salinity levels, or hardness levels that must be mitigated in order for the water to be re-used in the fracturing process or recycled. Specifications for re-use in an oil or natural gas field vary by basin and are impacted by disposal costs or regulatory requirements in the region. X provides both

mechanical and chemical treatments for flowback and produced water so that it may be re-used for hydraulic fracturing purposes.

Treatment may take place on site using self-contained mobile treatment trailers that use proprietary technology involving a combined mechanical and chemical treatment process. X has also been acquiring additional equipment to further increase its portfolio of services. The process varies depending on customer need, but can subject the flowback or produced water to one or more of the following: solids and oil separation, electro oxidation, clarification and hard water treatment. X also frequently provides clear brine suitable for re-use in hydraulic fracturing in certain formations. Following treatment, bacteria and total suspended solids content may be reduced by over % and metals content may be reduced by % to % depending on the metals present. X typically charges customers for treated water on a day rate or per-barrel basis.

X also derives income by providing oilfield operators with production support through the development, manufacture, and sale of production and specialty chemicals and related services. X analyzes underperforming wells and engineers chemical solutions designed to stimulate production and reduce production costs. X operates full-service laboratories and field laboratories to provide analytical services, and provides multiple products to assist customers with their production needs. X also creates custom chemical blends to address various production-related issues. X's laboratories analyze produced water, gas, oil, solids, residuals, and bacteria based on samples from within a well and provide site specific, customized solutions for treating a well to help restore production. X's laboratories are also capable of analyzing well failures and recommending products for well stimulation.

X's product lines in its fluids technologies segment include production treating, specialty chemical supplies and well stimulation products. Such products include biocides, corrosion inhibitors, paraffin products, scale inhibitors, gas well enhancers, anti-sludge agents, emulsion breakers, and friction reducers. X owns a fleet of treater trucks that can inject these chemicals into a customer's producing oil or gas well as necessary. The fee for this service is typically billed separately from product sales and is dependent on the number of stops and mileage to the well site. Other chemical products are delivered to bulk storage facilities on the operator's site. The cost for this delivery service is typically included in the price of the products. X also designs and oversees the application of chemical products during well stimulation jobs and provides management services for delivery of products at the well site.

X has requested a ruling that the gross income that Y will derive from the fluids management and fluids technologies activities described above 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 Y will derive from the fluids management and fluids technologies activities described above 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 Y 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 Y is a partnership for federal tax purposes.

This ruling is directed only to the taxpayer requesting it. However, in the event of a technical termination of Y 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: