

**Internal Revenue Service**

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October 28, 2013

LEGEND

Company =

State =

Dear :

This responds to a letter dated May 28, 2013, and subsequent correspondence, submitted on behalf of Company, requesting a ruling concerning the qualifying income exception to the publicly traded partnership rules of § 7704 of the Internal Revenue Code (“Code”).

FACTS

Company is a limited partnership organized under the laws of State. Company is a “publicly traded partnership” within the meaning of § 7704(b) of the Code. Company, through affiliated limited partnerships or disregarded entities, represents that it will provide essential fluid handling and disposal services to oil and natural gas producers engaged in the exploration, development and production of oil and natural gas. This ruling request involves income Company derives from the supply of water in the fracturing process; the disposal of flowback, produced water, pit water, drilling mud and other drilling and production wastes; and hydrocarbon remediation.

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. Company will earn income from the supply of water used in the fracturing process. Company will provide transportation services for the water via trucks, tanks and pipelines. As the business grows, Company expects to source a

portion of its water from third parties. With respect to the water sourced from third parties, Company will repurpose an existing gas gathering system that it owns and convert that system into a water transportation system. Company will also provide inter-well site transportation services for which Company will charge on a per barrel, daily or hourly rate, or on a per-volume transported basis.

In addition, Company represents it will earn income from the disposal of flowback, produced water, pit water, drilling mud and other drilling and production wastes which result during the fracturing process in compliance with environmental regulations.

Company also represents that will earn income from hydrocarbon remediation services in connection with its fluid and other oilfield waste handling and disposal services. Company will remove skim oil and other similar hydrocarbons from the drilling waste at its facilities during the disposal process and to sell the reclaimed hydrocarbons in the relevant markets.

### 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 § 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) for any taxable year if 90 percent or more of the gross income of such partnership 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), industrial source carbon dioxide, or the transportation or storage of any fuel described in §§ 6426(b), (c), (d), or (e) or any alcohol fuel defined in § 6426(b)(4)(A) or any biodiesel fuel defined in § 40A(d)(1).

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, 100<sup>th</sup> 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, 100<sup>th</sup> Cong., 2d Sess. 424 (1988).

### CONCLUSION

Based solely on the facts submitted and representations made, we conclude that the income derived by Company from the supply of water in the fracturing process; the disposal of flowback, produced water, pit water, drilling mud and other drilling and production wastes; and hydrocarbon remediation is qualifying income within the meaning of § 7704(d)(1)(E).

Except as expressly provided herein, no opinion is expressed or implied concerning the federal tax consequences of any transaction or item discussed or referenced in this letter. In particular, no opinion is expressed as to whether Company meets the 90 percent gross income requirement of § 7704(c)(1) in any taxable year for which this ruling may apply.

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.

This ruling is directly only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent. However, in the event of a technical termination of Company 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).

Pursuant to the power of attorney on file with the office, a copy of this ruling will be sent to taxpayer's authorized representatives.

Sincerely,

Richard T. Probst  
Senior Technician Reviewer, Branch 3  
Office of the Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosures (2)

A copy of this letter  
A copy for § 6110 purposes