

Internal Revenue Service

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Person To Contact:
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Telephone Number:

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Date:
August 5, 2015

Legend

X =

Y =

Z =

State =

Date =

n1 =

n2 =

Dear _____ :

This responds to your letter dated August 13, 2014, and subsequent correspondence, submitted on behalf of X, requesting a ruling under section 7704(d)(1)(E) of the Internal Revenue Code (Code).

FACTS

According to the information submitted, X is a limited partnership organized under the laws of State. Y is a publicly traded corporation formed in State. Y is an independent oil and gas company engaged in the acquisition, exploration and development of natural gas and oil products. Y developed midstream operations consisting of (1) gathering and

transportation system for its natural gas, NGL, and oil production and (2) water provision and delivery for hydraulic fracturing operations. Y conducts its water provision and delivery services through two wholly owned subsidiaries collectively known as Z. On Date, X completed an initial public offering (IPO) pursuant to which Y contributed its natural gas gathering and compression assets to X in exchange for limited partnership interests in X. X also received a right of first offer to purchase Y's water-related assets and associated fluids services business. X intends to exercise this right.

Z provides fluid delivery, handling, treatment, processing, and disposal services to Y pursuant to various Services Agreements. Z also has the right to provide these services to other oil and gas producers. These services are rendered in all three phases of the exploration and production of oil and gas: upstream of the well site, at the well site, and downstream of the well site.

As part of its upstream services, Z uses pumps operated by Z personnel to withdraw water from local rivers, streams, and other sources. The water is then transported through a system of above and below ground pipelines, water storage facilities including impoundments and above ground tanks and pumping stations, for use in hydraulic fracturing ("fracking").

Fracking stimulates production of natural gas and oil from dense subsurface rock formations. Fracking involves the injection of fluids, primarily water, sand, and chemicals under pressure through a cased and cemented wellbore into targeted subsurface formations to fracture the surrounding rock and stimulate production, requiring very large volumes of water.

At the well site, Z typically installs pipelines and high-speed pumps to connect the applicable impoundment to the wellsite. After the infrastructure is in place, Z supplies water to the well site and stores it in above-ground storage tanks (ASTs) with a capacity of n1 to n2 barrels of water. Personnel of Z must be present at the well site during all active fracking operations to ensure equipment is functioning properly and maintain proper flow rates. Maintaining proper flow rate is essential to the success of the drilling operation because water being removed from above-ground storage tanks may exceed the rate at which water is entering the tanks. Personnel must monitor hoses and pumps and make adjustments as necessary to ensure that the tanks do not overflow while transferring water at a rate that most efficiently compensates for the asymmetrical flow rates at which the tanks are filled and emptied. The provision of high-rate transfer services is specialized and requires skilled employees or contractors to coordinate closely with the fracking contractor and other onsite personnel.

Z, utilizing its personnel or by hiring independent contractors, also transports, stores, processes, treats, and disposes of waste fluids associated with the exploration and production of oil and gas through hydraulic fracturing. Flowback and produced water are picked up by tank trucks and transported to a water treatment or disposal facility.

Waste fluids are then processed to allow the resulting water to be discharged back into surface water sources, processed to allow the resulting water to be reused in fracking operations, or disposed of by injecting the fluids into secure underground formations, including salt water disposal wells.

X and Y make the following representations:

1. The services provided by Z require substantial assets and equipment that are dedicated exclusively to use in the exploration and production of oil and gas.
2. The services provided by Z require personnel with specialized knowledge, training, and experience.
3. The production of oil and gas using the hydraulic fracturing process would not be commercially viable without fluid handling services.

LAW & ANALYSIS

Section 7704(a) provides that, except as provided in section 7704(c), a publicly traded partnership will 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 the substantial equivalent thereof).

Section 7704(c)(1) provides that section 7704(a) does not apply to a publicly traded partnership for any taxable year if such partnership meets the gross income requirements of section 7704(c)(2) for the 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) provides, in relevant part, that a partnership meets the gross income requirements of section 7704(c)(2) for any taxable year if 90 percent or more of the gross income of the partnership for the taxable year consists of qualifying income.

Section 7704(d)(1)(E) provides 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 (including fertilizer, geothermal energy, and timber).

CONCLUSION

Based solely on the facts submitted and the representations made, we conclude that gross income derived by X from the delivery of water and the collection, treatment, and transport of flowback, produced water, and other fluids will constitute qualifying income for purposes of section 7704(d)(1)(E). This ruling is not applicable to any income derived by X from the delivery of water, including recycled produced water, to affiliates or third parties where X does not also collect and clean, recycle, or otherwise dispose of the delivered water after use.

Except as expressly provided herein, no opinion is expressed or implied concerning the federal 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 X meets the 90 percent gross income requirement of § 7704(c)(1) in any taxable year for which this ruling may apply.

The ruling contained in this letter is 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 ruling, it is subject to verification on examination.

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 letter 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 representatives.

Sincerely,

Laura C. Fields

Laura C. Fields
Senior Technician Reviewer, Branch 1
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

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