

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **201602004**
Release Date: 1/8/2016
Index Number: 7704.03-00

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B01
PLR-130994-14

Date:
September 25, 2015

Legend

X =

Y =

State =

Dear :

This responds to your letter dated August 14, 2014, and subsequent correspondence, submitted on behalf of X and Y, requesting a ruling under section 7704(d)(1)(E) of the Internal Revenue Code (the "Code").

Facts

According to the information submitted, X is a limited liability company organized under the laws of State. X intends to form a publicly traded partnership within the meaning of § 7704(b) by effecting an initial public offering of units in Y. Y is a limited partnership organized under the laws of State. Y will provide a full suite of fluid, solid, and oilfield waste handling, treatment, and disposal services to oil and natural gas producers engaged in the exploration, development, and production of oil and gas.

As part of its upstream services, Y will deliver fresh water and other solutions, including brine, to well sites for use in fracturing. The fresh water provided by Y will initially consist of rain water and other natural runoff and may also consist of recycled water. The brine provided by Y will initially consist of brine produced during the drilling and

formation of a salt cavern by injecting fresh water into a salt formation and retrieving the fully saturated brine that is returned through the cavern wellbore. Y may also provide recycled brine. Y will also deliver drilling mud and casing cement. The water and other fluids will be delivered by truck, tanks and, in some cases, temporary and permanent pipelines that will be owned, operated and maintained by Y. During the provision of these services, Y's employees will either remain present at both the fluid source and the well site to oversee the functioning of the pipelines and equipment or will monitor the fluid source and well site on an ongoing basis.

Y intends to provide inter-well site water transportation services including transporting fluids between producers' well sites on a single producing property, transporting fluids between frac tanks for a producer at a single well site, and transporting fluids for a producer between one or more well sites or a treatment plant. Y anticipates using pipelines for its water transfer services which will significantly reduce costs and produce less carbon emission. Where necessary to complete Y's fluid and waste handling services, Y will also lease specially designed frac tanks to oil and gas producers to provide temporary storage capacity for water, flowback, produced water, pit water, and other drilling and production wastes. Y's employees will either remain present at well sites to ensure water is pumped at a sufficient rate or will monitor the fluid source and well site on an ongoing basis.

Y will also process, treat, and dispose of waste solids and waste fluids associated with the exploration and production of oil and natural gas produced through drilling, fracturing and production. Y will develop, construct and manage water lines, gathering systems and special waste landfills in connection with the treatment and disposal of waste solids and waste fluids. The processed fluids will be cleaned and purified for reuse, or will be disposed of by injecting the fluids into secure underground formations or discharged into surface water sites. Reclaimed materials such as brine that are separated during the recycling process will be marketed for reuse in the oil and natural gas production process. Y will also earn income from the marketing of hydrocarbons recovered during the waste fluid treatment and disposal process. Y intends to sell these reclaimed hydrocarbons in relevant markets other than to end users at the retail level. The waste solids will be disposed of in special waste landfills. Y expects to conduct extensive monitoring of its disposal sites to comply with environmental and federal regulations. Y's employees will operate, maintain, and monitor the disposal and treatment facilities on a continuous basis.

As part of its downstream services, Y expects to earn income from washing out trucks, containment bins, tanks and other equipment used in the oil and natural gas extraction and production process ("washout activities"). This equipment must periodically be washed out to remove debris and preserve the full capacity of the equipment. Y's employees will perform washout activities at the well sites using equipment specifically designed for use with the heavy machinery used in the exploration and production of oil

and natural gas. Y will be responsible for disposing waste fluids washed out of the producer's equipment.

In conjunction with its washout activities and recycling and disposal services, Y will earn income from the recycling of drilling mud. Drilling mud will be collected by Y through the use of equipment, such as a centrifuge, to isolate the reusable drilling mud from the drilling equipment that is being cleaned. The collected mud will be recycled and repurposed for sale to producers for use in drilling and fracturing operations.

X and Y make the following representations with respect to Y's operations:

1. The services provided by Y will require substantial assets and equipment that are dedicated exclusively to use in the exploration and production of oil and gas and have limited utility outside of those areas.
2. The services provided by Y will 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 and 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) provides that, for purposes of § 7704(d)(1)(E), the term "mineral or natural resource" means any product of a character with respect to which a deduction for depletion is allowable under § 611; except that such term shall not include any product described in § 613(b)(7)(A) or (B).

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).

Section 611 provides, in part, that in the case of mines, oil and gas wells, other natural deposits, and timber, there shall be allowed as a deduction in computing taxable income a reasonable allowance for depletion. Section 613(b) lists certain of the mines, wells, and other natural deposits subject to depletion. Section 613(b)(4) identifies sodium chloride.

Section 613(c) provides that mining includes the extraction of ores or minerals from the ground.

Revenue Ruling 73-540, 1973-2 C.B. 203, provides that extracting sodium chloride by the use of water in the solution mining method from underground rock salt beds are extraction processes and are considered allowable mining processes within the meaning of § 613(c).

Conclusion

Based solely on the facts submitted and the representations made, we conclude that gross income derived by Y from the delivery of fluids, provision of inter-well water transfer services, and the processing, treatment and disposal of waste solids and waste fluids, including washout services, will constitute qualifying income for purposes of § 7704(d)(1)(E). Further, gross income derived by Y from the recovery, recycling, and marketing of brine, chemicals, and drilling mud to oil and gas producers and of hydrocarbons other than to end users at the retail level constitutes qualifying income within the meaning of § 7704(d)(1)(E). This ruling is not applicable to any income derived by Y from the delivery of water, brine, drilling mud, or other materials to affiliates or third parties where Y does not also collect and clean, recycle, or otherwise dispose of the delivered materials 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 Y will meet 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 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 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

cc: