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Date:

**LEGEND**

X =

Y =

State1 =

State2 =

Dear :

This responds to a letter dated August 29, 2013, and subsequent correspondence, submitted on behalf of X by X's authorized representative, requesting a ruling under § 7704(d)(1)(E) of the Internal Revenue Code.

**FACTS**

X is a limited liability company organized under the laws of State1. X formed Y under the laws of State2 and intends to cause Y to become a publicly traded partnership within the meaning of § 7704(b) by effecting an initial public offering of units. X represents that Y will earn income by providing fluid management and disposal services to customers engaged in the exploration for, and the development and production of, oil and natural gas.

Y's fluid management services business will consist of fluids hauling, storage, and disposal services (both freshwater and brine), and specialized chemical services. With respect to its freshwater services, Y will remove freshwater from its sources using submersible pumps, transferring the water to storage containers before later trucking the water to a producer's site. Also as part of its fluid services, Y will provide storage

tanks and mixers for well-site use and will transport chemicals to a producer's site and monitor the flow rate of the chemicals into the storage tanks and mixers.

In order to supply brine to its customers, Y will design, construct, operate, and maintain a number of brine stations, which will be comprised of a salt cavern, a fresh water source, storage tanks, and pumps. As part of this process, Y will mine sodium chloride (salt) by drilling a cavern in a natural salt formation, and then pumping freshwater into the salt cavern to dissolve and absorb the salt, thereby producing brine. After the brine is extracted from the cavern, Y may sell the brine at the site of the cavern or transport the brine to an oil and natural gas producer's site.

Y will also transport flowback fluids generated by fracturing operations and produced water to disposal wells. Y's disposal services will include the design, construction, operation, and maintenance of saltwater disposal wells, and the transfer of waste from drilling operations to those wells by truck and pipeline for proper disposal. Y will earn income from agreements with exploration and production companies that obligate Y to transfer fixed quantities of associated waste from a drilling operation to a salt water disposal well for proper disposal, and may also provide disposal services to other oil and gas producers when Y has excess well capacity. Y may also earn income from selling the filtered hydrocarbons that are collected as part of the disposal process.

X makes the following representations:

1. Y will provide personnel for its fluid management and disposal services. Y's personnel will have specialized training, tools, and equipment for the performance of these operations.
2. The equipment used in and the personnel training associated with the fluid management and disposal services have no utility outside of oil and gas exploration. Under legal and environmental restrictions, the saltwater disposal wells are restricted to storing and disposing of waste associated with exploration and production activities, and are thus not easily converted to other use.
3. The production of oil and gas using the hydraulic fracturing process would not be commercially viable without fluid management services.
4. Processing and treatment of flowback fluids and produced water is required prior to injection into a disposal well in order to comply with governmental regulations and industry standards.
5. Y's personnel will design, permit, install, and operate Y's business and oversee day-to-day operations. Those individuals who will oversee the saltwater disposal wells will be present daily. Y will also remotely monitor operating conditions of its disposal wells.

## LAW AND ANALYSIS

Section 7704(a) provides that, except as provided in § 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 § 7704(a) does not apply to a publicly traded partnership for any taxable year if such partnership meets the gross income requirements of § 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 § 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).

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 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 representations made, we conclude that the gross income to be derived by Y from its fluid management and disposal services constitutes qualifying income within the meaning of § 7704(d)(1)(E). In addition, income derived by Y from selling the filtered hydrocarbons that are collected as part of the disposal process constitutes qualifying income within the meaning of § 7704(d)(1)(E) so long as the sales are not to end users at the retail level. This ruling is not applicable to any income derived by Y from the delivery of freshwater or chemicals where Y does not also collect and clean, recycle, or otherwise dispose of the delivered water or other chemicals 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 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 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 it 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 representative.

Sincerely,

Holly Porter  
Branch Chief, Branch 3  
Office of Associate Chief Counsel  
(Passthroughs & Special Industries)

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

cc: