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**LEGEND**

X =

State =

Dear :

This letter 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 (Code).

**FACTS**

X is a limited partnership organized under the laws of State. X is engaged in the gathering, processing, and transportation of natural gas, the gathering and transportation of crude oil and refined petroleum products, and the gathering, transportation, fractionation, storage, and marketing of natural gas liquids (NGLs).

X owns and operates several pipelines regulated by the Federal Energy Regulatory Commission as well as other lateral pipelines for the transportation of natural gas, NGLs, and crude oil. X's pipelines interconnect with other larger pipelines as well as refineries and processing facilities. X also owns and operates extensive gathering systems that have multiple delivery interconnects with producer wells.

In addition, X owns and operates a number of processing and fractionation facilities either entirely or partially through joint ventures with related and unrelated parties that are also engaged in the exploration, production, processing, and/or transportation of natural gas and/or crude oil. The processing facilities remove water vapor, solids, and other contaminants from NGLs to form a stream of marketable natural

gas consisting primarily of methane, and another stream of raw NGL mix (Mixed NGLs). The fractionation facilities separate the Mixed NGLs into their component parts (ethane, propane, iso-butane, normal butane, and natural gasoline). X's processing and fractionation services may be provided through a variety of commercial arrangements, but are typically reimbursed under fee or percent-of-proceeds arrangements that are based on the volume and NGL content.

In an effort to facilitate and grow X's transportation and processing activities, X derives income from the construction of interconnect points with its transportation and gathering systems, and the development of new or modification of existing transportation and processing facilities. For example, if no transportation is available between a customer's wellhead or existing pipeline, or if X has insufficient processing capabilities to provide the desired processing services, X and its customer may enter into separate but related contracts for the modification of existing or construction of new transportation and processing assets. The payments compensate X for the design, materials, construction or assembly of property, as well as the inspection and oversight of work performed by third parties. Although X is generally responsible for constructing (or causing the construction of) these assets, X typically engages a third party to perform the construction work. X may be compensated on a (i) fixed cost basis, (ii) reimbursement basis, or (iii) cost plus basis, or X may be reimbursed for the actual cost of construction. Alternatively, X may recoup the cost of construction through transportation and processing revenue by requiring the customer to commit to transporting or processing a minimum volume of product at a set fee per volume for a fixed period under an arrangement where the customer pays for committed transportation and/or processing volumes regardless of whether the volumes are actually transported or processed.

X also earns income from the receipt of management fees and reimbursement income for operating transportation or processing assets owned by third parties or through joint ventures to which X is a party. In each case, X (or one of its subsidiaries) performs all of the activities necessary for the function of the asset including (i) contracting with customers for the use of the transportation asset or facility, (ii) taking delivery of the natural gas from various gathering systems or common carrier pipelines, (iii) performing the tasks necessary to transport or process the natural gas, (iv) metering the quantities of natural gas, (v) monitoring the specifications of natural gas, and (vi) performing the tasks necessary to offload the natural gas for receipt by the customer. X is responsible for all ownership functions such as employing, directly or through an affiliate, all personnel who physically control the transportation asset or processing facility, handling all commercial transactions and conducting routine maintenance, as well as identifying and purchasing all supplies necessary to operate each facility. X is also responsible for billing, accounting, financial reporting, and treasury functions for each of the transportation assets and processing facilities. X is generally reimbursed for all costs incurred to operate and maintain the transportation and processing facilities and receives an additional fee (either fixed or calculated on a

cost-plus basis), though intercompany agreements may be cost-reimbursement only or cost plus a percentage of capital expenditures.

X requests a ruling that gross income recognized by X in the form of fees, cost reimbursements, and cost-sharing payments related to interconnect and expansion activities and X's operation of transportation or processing assets generate qualifying income under § 7704(d)(1)(E).

### **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(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 1.7704-4(c) of the Income Tax Regulations provides that section 7704(d)(1)(E) activities include the exploration, development, mining or production, processing, refining, transportation, or marketing of any mineral or natural resource.

Section 1.7704-4(c)(5) provides that an activity constitutes processing if it is performed to convert raw mined or harvested products or raw well effluent to substances that can be readily transported or stored, as described in §1.7704-4(c)(5). Section 1.7704-4(c)(5)(i) provides that an activity constitutes processing of natural gas if it is performed to (A) purify natural gas, including by removal of oil or condensate, water, or non-hydrocarbon gases (such as carbon dioxide, hydrogen sulfide, nitrogen, and helium), and (B) separate natural gas into its constituents which are normally recovered in a gaseous phase (methane and ethane) and those which are normally recovered in a liquid phase (propane, butane, pentane, and heavier streams).

Section 1.7704-4(c)(7)(i) provides that an activity constitutes transportation if it is performed to move minerals or natural resources, and products under § 1.7704-4(c)(4), (5), or (6), including by pipeline, marine vessel, rail, or truck. Except as provided in § 1.7704-4(c)(7)(ii), transportation does not include the movement of minerals or natural resources, and products produced under § 1.7704-4(c)(4), (5), or (6), directly to retail customers or to a place that sells or dispenses to retail customers. Retail customers do not include a person who acquires oil or gas for refining or processing, or a utility. Transportation includes moving or carrying (whether by owner or operator) products via pipelines, gathering systems, and custody transfer stations and providing storage services.

Section 1.7704-4(c)(10)(i) provides that, if the partnership is in the trade or business of performing a section 7704(d)(1)(E) activity, qualifying income includes income received to reimburse the partnership for its costs in performing that section 7704(d)(1)(E) activity, whether imbedded in the rate the partnership charges or separately itemized. Reimbursable costs may include the cost of designing, constructing, installing, inspecting, maintaining, metering, monitoring, or relocating an asset used in that section 7704(d)(1)(E) activity, or providing office functions necessary to the operation of that section 7704(d)(1)(E) activity (such as staffing, purchasing supplies, billing, accounting, and financial reporting). For example, a pipeline operator that charges a customer for its cost to build, repair, or schedule flow on the pipelines that it operates will have qualifying income from such activity whether or not it itemizes those costs when it bills the customer.

## CONCLUSION

Based solely on the facts submitted and representations made, we conclude that the gross income derived by X from the construction of interconnect points with its transportation systems and from expanding transportation assets and processing facilities for natural gas, NGLs, and crude oil for use in X's performance of § 7704(d)(1)(E) activities constitutes qualifying income under § 7704(d)(1)(E). We also conclude that the income derived by X from the receipt of management fees and reimbursement income for operating transportation or processing assets owned by third parties, or through joint ventures to which X is a party constitutes qualifying income under § 7704(d)(1)(E).

Except as specifically provided, we express or imply no opinion as to 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), whether X is a publicly traded partnership within the meaning of § 7704(b), or whether any other type of income not addressed in this ruling is qualifying income under § 7704(d).

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent. 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).

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

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 ruling request, it is subject to verification on examination.

Sincerely,

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

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