

**Internal Revenue Service**

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Date:  
May 16, 2017

**LEGEND**

X =

State =

Date =

Dear :

This letter responds to a letter dated February 12, 2015, and subsequent correspondence, submitted on behalf of X by its authorized representatives, requesting a ruling under section 7704(d)(1)(E) of the Internal Revenue Code (Code).

**FACTS**

X is a limited partnership formed under State law on Date. X intends to be a publicly traded partnership, and will provide a broad range of services to working interest owners engaged in the exploration, development, and production of oil and natural gas (the Producers). Services to the Producers will include delivery, handling, treatment, recycling and disposal of petroleum-water mix produced as part of a Producers' oil and gas production (the Petroleum-Water Mix Services), and the transportation and storage of fluids for Producers' use in drilling and completing wells (the Fresh Water Distribution Services). X will provide the services through affiliated entities using employees of X or other contracted third parties.

In particular, as part of the Petroleum-Water Mix Services, X will collect the produced petroleum-water mix through X's combined liquids pipeline and transport the petroleum-water mix to X's central processing facility where the oil and petroleum-water mix will be separated, stored, and conditioned or treated before the petroleum-water mix is delivered to third parties contracted by X for either further treatment and recycling for

reuse in future drilling operations, or disposal in underground formations via injection wells in accordance with applicable state and Federal environmental regulations. Depending on the area of production, X may alternatively collect and transport the petroleum-water mix through pipelines or trucks directly to a salt water disposal well for disposal. In other areas, X may instead collect the petroleum-water mix through temporary pipelines and transport the petroleum-water mix to mobile on-site recycling skids where the petroleum-water mix will be cleaned and treated to remove hydrocarbons, toxic materials, particulates, and dissolved solids to meet specific water quality specifications. The solids will be continuously collected, removed, and disposed of in an approved solid waste facility. The treated water will be recycled at the site and returned to the Producer-owned tanks to be stored for reuse in the hydraulic fracturing process. X will receive a variable service fee for its Petroleum-Water Mix Services based on the volume of petroleum-water mix received to handle.

As part of the Fresh Water Distribution Services, X will provide fresh water (from recycling facilities and other sources) to Producers in the same geographic area as its Petroleum-Water Mix Services, using a combination of permanent buried pipelines, portable surface pipelines, fresh water storage facilities, and pumping stations. X will receive a monthly fee for its Fresh Water Distribution Services for each month that its services are provided.

X makes the following representations:

1. The services provided by X 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 X require personnel with specialized knowledge, training, and experience. Such personnel will operate, maintain, and monitor the assets and equipment on an ongoing basis.
3. The production of oil and gas using the hydraulic fracturing process would not be commercially viable without X's fluid handling services.
4. X will provide its Fresh Water Distribution Services exclusively to those engaged in section 7704(d)(1)(E) activities.

#### 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).

Section 1.7704-4(a) of the Income Tax Regulations provides that, for purposes of § 7704(d)(1)(E), qualifying income is income and gains from qualifying activities with respect to minerals or natural resources as defined in § 1.7704-4(b). Qualifying activities are section 7704(d)(1)(E) activities (as described in § 1.7704-4(c)) and intrinsic activities (as described in § 1.7704-4(d)).

Section 1.7704-4(d)(1) provides that an activity is an intrinsic activity only if the activity is specialized to support a section 7704(d)(1)(E) activity, is essential to the completion of the section 7704(d)(1)(E) activity, and requires the provision of significant services to support the section 7704(d)(1)(E) activity. Whether an activity is an intrinsic activity is determined on an activity-by-activity basis.

Section 1.7704-4(d)(2)(i) provides that an activity is a specialized activity if the partnership provides personnel (including employees of the partnership, an affiliate, subcontractor, or independent contractor performing work on behalf of the partnership) to support a section 7704(d)(1)(E) activity and those personnel have received training in order to support the section 7704(d)(1)(E) activity that is unique to the mineral or natural resource industry and of limited utility other than to perform or support a section 7704(d)(1)(E) activity.

In addition, to the extent that the activity involves the sale, provision, or use of specific property, § 1.7704-4(d)(2)(ii) requires that, in order for the activity to be a specialized activity, either (A) the property is primarily tangible property that is dedicated to, and has limited utility outside of, section 7704(d)(1)(E) activities and is not easily converted (as determined based on all the facts and circumstances, including the cost

to convert the property) to another use other than supporting or performing the section 7704(d)(1)(E) activities (except that the use of non-specialized property typically used incidentally in operating a business will not cause a partnership to fail § 1.7704-4(d)(2)(ii)(A)); or (B) If the property is used as an injectant to perform a section 7704(d)(1)(E) activity that is also commonly used outside of section 7704(d)(1)(E) activities (such as water and lubricants), the partnership provides the injectants exclusively to those engaged in section 7704(d)(1)(E) activities; the partnership is also in the trade or business of collecting, cleaning, recycling, or otherwise disposing of injectants after use in accordance with Federal, state, or local regulations concerning waste products from mining or production activities; and the partnership operates its injectant delivery and disposal services within the same geographic area.

Section 1.7704-4(d)(3)(i) provides that an activity is essential to the section 7704(d)(1)(E) activity if it is required to (A) physically complete a section 7704(d)(1)(E) activity (including in a cost-effective manner, such as by making the activity economically viable), or (B) comply with Federal, state, or local law regulating the section 7704(d)(1)(E) activity. Section 1.7704-4(d)(3)(ii) provides that legal, financial, consulting, accounting, insurance, and other similar services do not qualify as essential to a section 7704(d)(1)(E) activity.

Section 1.7704-4(d)(4)(i) provides that an activity requires significant services to support the section 7704(d)(1)(E) activity if those services must be conducted on an ongoing or frequent basis by the partnership's personnel at the site or sites of the section 7704(d)(1)(E) activities. Alternatively, those services may be conducted offsite if the services are performed on an ongoing or frequent basis and are offered to those engaged in one or more section 7704(d)(1)(E) activities. If the services are monitoring, those services must be offered exclusively to those engaged in one or more section 7704(d)(1)(E) activities. Whether services are conducted on an ongoing or frequent basis is determined based on all the facts and circumstances, including recognized best practices in the relevant industry.

Section 1.7704-4(d)(4)(ii) provides that personnel perform significant services only if those services are necessary for the partnership to perform an activity that is essential to the section 7704(d)(1)(E) activity, or to support the section 7704(d)(1)(E) activity. Personnel include employees of the partnership, an affiliate, subcontractor, or independent contractor performing work on behalf of the partnership. Section 1.7704-4(d)(4)(iii) provides that services are not significant services with respect to a section 7704(d)(1)(E) activity if the services principally involve the design, construction, manufacturing, repair, maintenance, lease, rent, or temporary provision of property.

## CONCLUSION

Based solely on the facts submitted and the representations made, we conclude that gross income derived by X from its Petroleum-Water Mix Services and Fresh Water

Distribution Services will constitute qualifying income within the meaning of § 7704(d)(1)(E). This ruling is not applicable to any income derived by X from the delivery and transfer of fluids, including recycled produced water, where X does not also collect and clean, recycle, or otherwise dispose of produced water and drilling production waste after use within the same geographic area.

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,

/s/

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

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