



As part of its Fluid Delivery Services, Partnership will provide freshwater and brine for use specifically in fracturing fluid, drilling mud, and casing cement. The freshwater Partnership will provide will initially consist of freshwater produced from water wells and will be stored in a fresh water pond or holding tank. The brine will consist of brine produced by Partnership during the course of its drilling and production waste recycling activities or via solution mining brine. X anticipates Partnership storing such brine on land leased or owned by Partnership or at one of Partnership's disposal facilities in specially designed storage tanks. Partnership will supply freshwater and brine to the Producers via trucks, tanks, and, in some cases related to freshwater supply, pumps and pipelines that Partnership will lay and run to the freshwater source. These pipelines will be owned, operated, maintained, and controlled by Partnership and dedicated specifically to the transportation of fluids to producers for use in the fracturing process. X anticipates Partnership pricing this fluid supply service business on a per-barrel basis, which may also include a transportation fee component.

As part of its Oilfield Waste Treatment and Disposal Services, Partnership will provide the Producers with treatment and disposal services for flowback, produced water, pit water, and other drilling and production wastes, so that such wastes can be recycled or be disposed of consistent with Federal, state, or local regulations concerning waste products from mining or production activities. Partnership will receive customers' produced water and hydraulic fracturing flowback water via truck or pipeline at Partnership's disposal facilities. Partnership's recycling activities will produce water and fluids that are cleaned and purified for reuse in the oil and natural gas production process. For example, brine will be separated from the contaminated water and fluids during the recycling process and sold as described above concerning Fluid Delivery Services. When recycling of contaminated water and fluids is not commercially available and desirable, Partnership will dispose of such products, including by use of landfills (including permitted special waste landfills that are authorized to accept certain hazardous waste materials), land farms, injection wells, salt caverns, evaporation ponds, and surface water sites. Partnership will generally charge a fee on a per-barrel basis for its disposal services.

Partnership may also provide transportation services with respect to its Oilfield Waste Treatment and Disposal Services via fluid hauling trucks (e.g. vacuum trucks, end-dump trailers, roll-off box trucks) or pipelines from the Producers' production facilities to Partnership's disposal and/or processing facilities. Partnership will charge a transportation component on an hourly or per barrel basis when it provides transportation services. While Partnership does not expect to regularly take legal possession of the loads that it transports, occasionally it will take legal possession of such loads in order to assume the liability of such load from the well producer or operator. Partnership earns extra fees from its customers when such liability is assumed.

As a part of its Equipment Washout Services, Partnership will wash out trucks, trailers, frac tanks, roll-off boxes, cutting boxes, and certain other types of containers or equipment used in oil and gas extraction and production. The washout services are expected to be performed at Partnership's disposal facilities with equipment (e.g., pressure washer) that must be specially ordered by Partnership, as it is specifically designed for use with heavy machinery used in the exploration and production of oil and natural gas. Partnership will also be responsible for disposing of the waste fluids washed out of its customer's equipment in accordance with Federal, state, or local regulations concerning waste products from mining or production activities. Partnership's fees from these services may be charged on an hourly or "per job" basis. Furthermore, Partnership will recycle drilling mud. The drilling mud will be collected by Partnership through the use of equipment, such as a centrifuge, to isolate the reusable drilling mud from the drilling equipment being cleaned. Partnership intends to collect this drilling mud and recycle and repurpose it for sale to Producers for use in drilling and fracturing operations.

Finally, Partnership will perform hydrocarbon recovery and remediation in connection with its suite of fluid and other oilfield waste handling and disposal services. Partnership will sell such reclaimed hydrocarbons on relevant markets to third party collection companies.

X makes the following representations:

1. Partnership will supervise, direct, and control personnel for its Fluid Delivery Services, Oilfield Waste Treatment and Disposal Service, and Equipment Washout Services. These activities require personnel with specialized knowledge, unique training, and experience, such as training in fluid pressure monitoring, spill prevention, and operating pumps critical to the operation of Partnership's disposal facilities.
2. The provision of fluids and water transfer services are essential to the completion of oil and natural gas drilling and fracturing operations.
3. Processing, treatment, and disposal of flowback fluids and produced water is required in order to comply with governmental regulations and industry standards.
4. Partnership's fluid management services require daily involvement and will be performed on an ongoing basis throughout the exploration and production life cycle of each producing property. Partnership's disposal facilities and related service equipment will be staffed and are equipped to allow for remote monitoring capabilities.
5. Partnership supplies fresh water exclusively to customers engaged in the exploration, development, mining or production, processing, refining, transportation, or marketing of any mineral or natural resource.

6. Partnership operates its disposal facilities within the same geographic areas as that in which Partnership supplies fresh water to customers.

#### 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(c)(4) provides that an activity constitutes mining or production if it is performed to extract minerals or natural resources from mines and wells, or to extract minerals or natural resources from the waste or residue of prior mining or production allowable under § 1.7704-4.

Section 1.7704-4(e) provides, in pertinent part, that § 1.7704-4 incorporates some of the interpretations under §§ 611 and 613 and the regulations thereunder as provided in § 1.7704-4.

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) (providing that mining includes the extraction of ores or minerals from the ground).

Section 1.7704-4(c)(8) provides that marketing is the bulk sale of minerals or natural resources, and products under § 1.7704-4(c)(4), (5), or (6). Marketing generally does not include retail sales (sales made in small quantities directly to end users), which includes the operation of gasoline service stations, home heating oil delivery services, and local natural gas delivery services.

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 Partnership from its Fluid Delivery Services, Oilfield Waste Treatment and Disposal Services, and Equipment Washout Services will constitute qualifying income within the meaning of § 7704(d)(1)(E). Furthermore, gross income derived by Partnership from the recovery and marketing of hydrocarbons and the mining and marketing of brine produced from solution mining 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 Partnership from the delivery and transfer of fluid, including recycled produced water, brine (but not including brine produced from solution mining), and drilling mud, where Partnership 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 Partnership meets 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 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 Partnership 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

cc: