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November 2, 1998

Legend

X =

Y =

PRS =

OLP =

a =

b =

c =

d =

e =

f =

g =

r =

s =

State =

This responds to a letter dated June 26, 1998, together with subsequent correspondence, submitted on behalf of PRS, requesting a ruling under § 7704(d) of the Internal Revenue Code that income and gains from PRS's activities relating to storing natural gas will constitute "qualifying income."

Facts

X is the common parent of a consolidated group of corporations. PRS is a limited partnership formed under the laws of State. PRS's sole general partner is Y, a State corporation and a member of X's consolidated group.

Y will own a a percent general partner interest PRS. The remaining b percent of the interests in PRS will be limited partnership interests. c percent of the limited partnership interests will be r units, some of which will be sold in an initial public offering and publicly traded, and d percent will be s units to be held by Y.

PRS's assets will consist primarily of limited partnership interests comprising e% of the interests in OLP, a limited partnership formed under the laws of State. Y will own a f% general partner interest in OLP. OLP will own and operate a federally regulated pipeline business engaged in the transportation of natural gas. In conjunction with the operation of the pipeline and the provision of natural gas pipeline transportation, OLP will own and operate g natural gas storage facilities. It is anticipated that OLP will acquire additional natural gas storage facilities in the future to be owned and operated in conjunction with its interstate pipeline business.

Natural gas will be stored in the gas storage facilities and the pipeline system incident to the provision of natural gas pipeline transportation by OLP and others. Persons who store natural gas in the gas storage facilities (or in the pipeline system) will be charged a separate, market-based (negotiated) fee or a cost of service rate, where applicable, for such storage. In nearly all instances, the natural gas stored will be moved through OLP's pipeline. Neither PRS nor OLP will own any natural gas.

Law and Analysis

Section 7704(a) generally treats publicly traded partnerships as corporations for federal tax purposes. 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 tradeable on a secondary market (or the substantial equivalent thereof).

Section 7704(c)(1) exempts from treatment as a corporation any publicly traded partnership for any taxable year if the partnership met the gross income requirement in § 7704(c)(2) for that taxable year and each preceding taxable year beginning after December 31, 1987, during which the partnership (or any predecessor) was in existence. 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 that taxable year consists of qualifying income. Section 7704(c)(2).

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 resources (including fertilizer, geothermal energy, and timber).

H.R. Rep. No. 495, 100th Cong., 1st Sess. 947 (1987), 1987-3 C.B. 193, 227, in discussing passive-type income, states as follows:

Income of certain partnerships whose exclusive activities are transportation and marketing activities is not treated as passive-type income. For example, the income of a partnership whose exclusive activity is transporting refined petroleum products by pipeline is intended to be treated as passive-type income, but the income of a partnership whose exclusive activities are transporting refined petroleum products by truck, or retail marketing with respect to refined petroleum products (e.g., gas station operations) is not intended to be treated as passive-type income.

The scope of passive-type income was later clarified in H.R.Rep. No. 1104, 100th Cong., 2d Sess. II-17 to II-18 (1988), 1988-3 C.B. 473, 507-508, which states as follows:

In the case of transportation activities with respect to oil and gas and products thereof, the conferees intend that, in general, income from transportation of oil and gas and products thereof to a bulk distribution center such as a terminal or a refinery (whether by pipeline, truck, barge, or rail) be treated as qualifying income. Income from any transportation of oil or gas or products thereof by pipeline is treated as qualifying income. Except in the case of pipeline transport, however, transportation of oil or gas or products thereof to a place from which it is dispensed or sold to retail customers is generally not intended to be treated as qualifying income. Solely for this purpose, a retail customer does not include a person who acquires the oil or gas for refining or processing, or partially refined or processed products thereof for further refining or processing, nor does a retail customer include a utility providing power to customers. For example, income from transporting refined petroleum products by truck to retail customers is not qualifying income (footnote omitted).

Conclusion

We conclude that income and gains from OLP's activities relating to storing natural gas in the gas storage facilities and the pipeline system will constitute "qualifying income" to PRS under § 7704(d)(1)(E).

Except as specifically set forth above, no opinion is expressed or implied as to the federal income tax consequences of the facts described above under any other provision of the Code. Specifically, no opinion is expressed concerning the classification of X, Y, PRS, or OLP for federal tax purposes, whether PRS will be 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(s) requesting it. 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,

David R. Haglund
Senior Technician Reviewer, Branch 1
Office of the Assistant Chief Counsel
(Passthroughs and Special Industries)

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

