Internal Revenue Service

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LEGEND

X =

Y =

Z =

State =

Dear :

This letter responds to a letter from X's authorized representatives dated January 13, 2012, submitted on behalf of X, requesting a ruling concerning the qualifying income exception to the publicly traded partnership rules of § 7704 of the Internal Revenue Code (the Code).

According to the information submitted and representations made, X is a limited partnership organized under the laws of State and publicly traded within the meaning of § 7704(b). Among other activities, X engages in the transportation and processing of natural gas within the United States through affiliated operating subsidiaries treated as partnerships and disregarded entities for federal income tax purposes. To facilitate its transportation and processing activities, X owns natural gas gathering pipelines, natural gas processing systems, and the natural gas pipeline rights-of-way associated with each pipeline.

X's customers are natural gas producers that use hydraulic fracturing to extract natural gas from geologic formations. Hydraulic fracturing involves the injection of fluids, primarily water mixed with a proppant, into an oil or gas well at high pressure to fracture geologic formations and open pathways for the oil or gas to flow. The fracturing process requires very large volumes of water.

To meet the water needs of X's customers, X and Z formed Y, a limited liability company taxed as a partnership for federal income tax purposes, under the laws of State. Y will develop, construct, own, and operate a water delivery pipeline system ("Pipeline") for the purpose of supplying fresh water to X's customers and other natural gas producers for use in the production of natural gas through hydraulic fracturing. The Pipeline will primarily run parallel to the trunk-line of X's natural gas gathering pipelines and share X's existing rights-of-way. Y will earn income from long-term pipeline capacity and supply agreements with X's customers. Y expects to enter into additional long-term pipeline capacity and supply agreements with other natural gas producers in the region. Under the agreements, natural gas producers will pay Y for the pipeline supply and transportation of fresh water to water impoundment ponds designated by the natural gas producers.

X further represents that the supply and transportation of fresh water to natural gas producers for use in hydraulic fracturing is integral to the exploration and production of natural gas from shale formations and the preservation and growth of X's existing activity of natural gas transportation. X, through Y, is uniquely situated to efficiently supply fresh water through a pipeline due to its existing rights-of-way and expertise in pipeline transportation. Y intends to provide the water supply solely to natural gas producers operating in proximity to X's natural gas gathering assets, many of whom are either current customers or prospective customers of X's natural gas gathering services.

Section 7704(a) provides generally that a publicly traded partnership shall 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) interest in that partnership are readily tradable on a secondary market (or substantial equivalent thereof).

Section 7704(c)(1) provides that § 7701(a) shall not apply to any publicly traded partnership for any taxable year if such partnership met the gross income requirements of § 7704(c)(2) for such 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) explains 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 such partnership for such taxable year is qualifying income.

Section 7704(d)(1)(E) provides that the term "qualifying income" means income or 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, or timber).

Based solely on the facts submitted and representations made, we conclude that X's distributive share of the gross income derived by Y from the supply and transportation of water to oil and gas producers for use in the exploration, development, and production of oil or natural gas is qualifying income within the meaning of § 7704(d)(1)(E).

Except as expressly provided herein, no opinion is expressed or implied concerning the 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. In addition, this office has not verified or determined whether any other commercial use may exist for the water delivery pipeline system developed, constructed, owned, and operated by Y. To the extent that other commercial uses may exist for the water delivery pipeline system, this letter ruling will not apply in determining whether X's distributive share of any gross income that may be derived from such other uses constitutes qualifying income under § 7704(d)(1)(E).

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 rulings, it is subject to verification on examination.

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.

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,

Bradford R. Poston
Senior Counsel, Branch 2
(Passthroughs & Special Industries)

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

cc: