

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

Number: **201416003**  
Release Date: 4/18/2014  
Index Number: 7704.03-00

Third Party Communication: None  
Date of Communication: Not Applicable

Person To Contact:  
, ID No.

Telephone Number:

Refer Reply To:  
CC:PSI:B03  
PLR-127001-13  
Date:  
December 27, 2013

LEGEND

X =

State =

Dear :

This letter responds to a letter dated June 14, 2013, and subsequent correspondence, written on behalf of X 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 and publicly traded within the meaning of § 7704(b). Among other activities, X will provide essential fluid handling services to oil and natural gas producers engaged in the exploration, development, and production of oil and natural gas through affiliated operating limited partnerships, limited liability companies or disregarded entities. Specifically, X expects to generate income from (i) the supply of fresh water for use in the fracturing process, (ii) the transportation of fluids for use by producers in the exploration, development, and production of natural resources, (iii) the transportation of fracturing fluid to producers' well sites for use in exploration and production activities, and (iv) the transportation of flowback, produced water and other drilling and production wastes from producers' well sites to disposal facilities owned by third parties.

Fracturing is a technique by which fluids, primarily water mixed with a proppant, are pumped into an oil or natural gas well at high pressure to fracture geologic formations and open up pathways for the oil or natural gas to flow to the well and be

“produced” or extracted. The fracturing process requires very large volumes of water. Traditionally, water for fracturing fluid has been conveyed to well sites by truck. In some cases, temporary pipelines between a water source and well site are used. During the drilling and completion of a producing oil or natural gas well, before natural resource production begins in earnest, a significant portion (approximately 30 percent) of the fluids used in the process will be returned to the surface as waste streams (“flowback”). The flowback is often temporarily stored on the well site, but such stored flowback must ultimately be removed from the well site and disposed of consistent with applicable environmental regulations. In such circumstances, trucks, pipelines, or gathering systems have removed flowback, produced water, and other drilling and production wastes from drill sites.

X will earn income from supplying producers with fresh water for use in the fracturing process. X will supply the fresh water to producers via pumps and pipelines that X will lay and run to X's fresh water source. Such pipelines will consist of: (i) temporary pipelines (often flexible polyethylene, or plastic, pipe or various types of jointed pipe tubulars) that will be owned, operated, maintained, and controlled by X and dedicated specifically to the transportation of fresh water to producers for use in the fracturing process; and (ii) water delivery pipeline systems that will be developed, constructed, owned, operated, maintained, and controlled by X for the specific purpose of transporting fresh water to producers for use in the fracturing process. It is anticipated that the water delivery pipeline systems will, in many instances, run parallel to X's existing pipelines and share X's existing rights-of-way. In all cases, X expects to earn income from pipeline capacity and supply agreements whereby producers will pay X for the pipeline supply and transportation of fresh water to specific locations at the producers' well sites. In addition, X intends to provide the fresh water supply to producers operating in proximity to its existing crude oil and natural gas gathering assets. Many of these producers are either current customers or prospective customers of X's crude oil and natural gas gathering services.

X also expects to provide water transfer services. Such water transfer services will consist of the transportation of fluids for use by producers in the exploration, development, and production of natural resources. X anticipates that its water transfer services will encompass transportation activities including (i) transporting fluids between producers' well sites on a single producing property, (ii) transporting fluids between frac tanks for a producer at a single well site, and (iii) transporting fluids for a producer between one or more well sites and/or a treatment plant. In all cases, X's water transfer services will be charged on a per barrel, daily or hourly rate, or on a per-volume transported basis.

X will also earn income from the transportation of fracturing fluid for use in the producers' exploration and production activities. X will transport the fracturing fluid to the producers' well sites by pipeline, truck, or various other transportation equipment.

Finally, X will earn income from the transportation of flowback, produced water, and other drilling and production wastes from producers' well sites to disposal facilities owned by third parties. Initially, X will use gathering systems, either purchased from third parties or developed and constructed by X, for such transportation. In the future, X may expand its operations to include trucks or other equipment for such transportation. The exact mix of flowback, produced water, and other drilling and production wastes transported as well as X's method of operation with respect to such activities will differ depending on the geographic region in which X is operating.

### LAW AND ANALYSIS

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 such partnership are traded on an established securities market, or (2) interests in such partnership are readily tradable on a secondary market (or the substantial equivalent thereof).

Section 7704(c)(1) provides, in part, that § 7704(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) provides 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 consists of qualifying income.

Section 7704(d)(1)(E) defines "qualifying income" to include 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).

### CONCLUSION

Based solely on the facts submitted and representations made, we conclude that X's gross income from its fluid handling services as described in this letter is qualifying income within the meaning of § 7704(d)(1)(E).

Except as expressly provided herein, we express or imply no opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, we express or imply no opinion 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 X. 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 income that may be derived from such other uses constitutes qualifying income under § 7704(d)(1)(E).

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).

Under § 6110(k)(3) of the Code, the ruling may not be used or cited as precedent.

In accordance with a power of attorney on file with this office, we are sending a copy of this letter to your authorized representatives.

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,

Mary Beth Carchia  
Senior Technician Reviewer, Branch 3  
Office of the Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosures (2):

A copy of this letter  
A copy for § 6110 purposes

cc: