

Internal Revenue Service

Number: **201927007**

Release Date: 7/5/2019

Index Numbers: 7704.00-00, 7704.03-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

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CC:PSI:B03

PLR-127713-18

Date:

April 9, 2019

LEGEND

X =

GP =

Operating
Partnership =

State =

a =

b =

c =

Dear :

This letter responds to a letter dated September 13, 2018, and subsequent correspondence, submitted on behalf of X by X's authorized representative, requesting a ruling under § 7704(d)(1)(E) of the Internal Revenue Code (Code).

FACTS

X, a State limited liability company and a publicly traded partnership, is in the business of owning and managing businesses in the upstream oil and gas sector. X

does not directly own the property on which the oil and gas exploration, development, and production services are performed. Of the members of X's group, Operating Partnership, a State limited liability company, is the main operating entity and is a partnership for federal tax purposes. X indirectly owns a% interest in Operating Partnership as a limited partner. X also owns b% of GP, the sole general partner of Operating Partnership. GP, a State limited liability company and a partnership for federal tax purposes, holds a c% interest in Operating Partnership.

Operating Partnership owns properties and has its operations in two states where it directly engages in upstream oil and gas exploration, development, and production, as well as the acquisition and development of producing oil and gas properties and developing non-producing oil and gas properties. Operating Partnership, however, does not employ any employees or independent contractors to manage or operate its upstream oil and gas exploration, development, and production business. Operating Partnership looks to GP to perform all the services. GP contracts with X and its subsidiaries to provide the workforce to actually conduct the exploration, development, production, and related support activities.

X, including through subsidiaries, provides all employees needed to the Operating Partnership in order for Operating Partnership to conduct the oil and gas exploration, development, and production activities. In addition, X provides employees to the Operating Partnership for all support and back-office activities needed to operate Operating Partnership's overall oil and gas business. X's employees perform the following activities on behalf of Operating Partnership: (1) geological services, including conducting geological surveys and interpreting data; (2) field services, including drilling an exploratory well, conducting drill stem and production flow tests, and monitoring drilling, production, and gathering; (3) purchasing supplies; (4) human resources, including staffing and payroll management; (5) accounting, including joint interest billing and managing division orders; (6) tax reporting; (7) investor relations; (8) financial services, including evaluations of the use of the capital markets and the debt markets, hedging strategy and execution; (9) legal services, including property acquisition agreements and title confirmation; and (10) information technology services. A majority of the employees are involved with field services.

X is reimbursed for its services via a management fee paid by Operating Partnership to GP, which is passed-through to X. The management fee paid by Operating Partnership to GP is earned lump-sum annually and paid quarterly. The management fee is in exchange for the work X does for Operating Partnership. In addition, X is directly reimbursed for some indirect costs, such as rent and general and administrative costs.

LAW AND ANALYSIS

Section 7704(a) provides that, except as provided in § 7704(c), a publicly traded partnership will be treated as a corporation.

Section 7704(c)(1) provides that § 7704(a) does not apply to a publicly traded partnership for any taxable year if such partnership meets the gross income requirements of § 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 § 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(c) 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 include both § 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)(1) provides that § 7704(d)(1)(E) activities include the exploration, development, mining or production, processing, refining, transportation, or marketing of any mineral or natural resource.

Section 1.7704-4(c)(2) defines exploration as an activity performed to ascertain the existence, location, extent or quality of any deposit of mineral or natural resource before the beginning of the development stage, including by drilling an exploratory or stratigraphic type test well, conducting drill stem and production flow tests, conducting geological or geophysical surveys, and interpreting data obtained from geological or geophysical surveys.

Section 1.7704-4(c)(3) defines development as an activity performed to make accessible minerals or natural resources, including by drilling wells to access deposits of minerals or natural resources.

Section 1.7704-4(c)(4) defines production as an activity performed to extract natural resources from the ground including by operating equipment to extract natural resources from wells.

Section 1.7704-4(c)(10)(i) provides that, if the partnership is in the trade or business of performing a § 7704(d)(1)(E) activity, qualifying income includes income received to reimburse the partnership for its costs in performing that § 7704(d)(1)(E) activity, whether imbedded in the rate the partnership charges or separately itemized. Reimbursable costs may include the cost of designing, constructing, installing, inspecting, maintaining, metering, monitoring, or relocating an asset used in that § 7704(d)(1)(E) activity, or providing office functions necessary to the operation of that § 7704(d)(1)(E) activity (such as staffing, purchasing supplies, billing, accounting, and financial reporting). For example, a pipeline operator that charges a customer for its cost to build, repair, or schedule flow on the pipelines that it operates will have qualifying income from such activity whether or not it itemizes those costs when it bills the customer.

CONCLUSION

Based solely on the facts submitted and representations made, we conclude that the income recognized by X from the receipt of the management fee constitutes qualifying income under § 7704(d)(1)(E). X is receiving the management fee income for directly engaging in § 7704(d)(1)(E) activities, including oil and gas exploration, development, and production, in addition to the associated back-office support functions necessary to the operation of the business.

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), whether X is 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 requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

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.

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,

Associate Chief Counsel
(Passthroughs and Special Industries)

By: _____
Caroline E. Hay
Assistant to the Branch Chief, Branch 3
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

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

cc: