

Internal Revenue Service

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Date:
July 31, 2008

Legend:

X =

State =

Dear :

This letter responds to a letter dated May 22, 2008, 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.

Facts

You have represented that the facts are as follows. X is a limited partnership organized under the laws of State and is classified as a partnership for federal tax purposes. Further, X represents that it is a “publicly traded partnership” within the meaning of section 7704(b). X also represents that it is its intention that at least 90 percent of X’s gross income constitutes “qualifying income” under § 7704(d).

X, through various partnerships and disregarded entities, is engaged in the transportation, gathering, and storage of natural gas, and the sale of propane. X often enters into contracts with customers (“transportation and/or gathering agreements”) under which X agrees to transport and/or gather natural gas on behalf of its customers. The transportation and/or gathering involves the use of X’s natural gas transportation pipelines. The customers pay X for these transportation and/or gathering services.

Sometimes, when a customer wishes to enter into a transportation and/or gathering agreement, a pipeline extension must be constructed to connect the customer to X's existing transportation pipelines. In this situation, X and the customer will often enter into a separate contract under which the necessary pipeline extension will be constructed (an "interconnect agreement"). The interconnect agreements take several forms, but all provide that the customer will ultimately bear the pipeline extension construction costs. In some cases, the customer is responsible for constructing the pipeline extension and subsequently transfers ownership of the completed extension to X. In other cases, the customer will provide X with reimbursement payments to cover X's pipeline extension construction costs. In still other cases, the customer will neither construct the pipeline nor explicitly pay X for the construction of the pipeline, but will instead agree in the transportation and/or gathering agreement to pay a premium for X's transportation services; through payment of these premiums, the customer will eventually reimburse X for its pipeline extension construction costs.

X represents that the interconnect agreements are an integral part of the transportation of oil, gas, and/or products thereof. Specifically, X represents that each pipeline extension constructed pursuant to an interconnect agreement is necessary to facilitate a service relationship, and that each customer bears the costs of the pipeline extension in order to induce X to provide it with transportation and/or gathering services. X also represents that the sole purpose of the interconnect agreement is to facilitate the transportation and/or gathering agreement. Furthermore, X represents that it will only enter into an interconnect agreement if it is also entering into a transportation and/or gathering agreement with the same customer.

X seeks a ruling that the amounts it receives from pipeline transportation customers as reimbursement for construction of pipeline extensions (or receipt of such pipeline extensions from customers) for the transportation of oil, gas, or products thereof will constitute qualifying income under § 7704(d)(1)(E). However, X's request for a ruling that the reimbursement payments are "qualifying income" is not intended to apply to the portion, if any, of the reimbursement payments that exceeds the pipeline extension construction costs. That is, X is not seeking to have any "profit" from the construction of the pipeline extension included in its qualifying income for § 7704(d)(1)(E) purposes.

Law and Analysis:

Section 7704(a) provides 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) interests in that partnership are readily tradable on a secondary market (or the 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) 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).

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:

Based solely on the facts submitted and representations made, we conclude that the interconnect agreements are integral to the transportation and/or gathering of gas, oil, or products thereof. Therefore, the amounts X receives from pipeline transportation customers as reimbursement for construction of pipeline extensions (or receipt of such pipeline extensions from customers) for the transportation of gas, oil, or products thereof constitute qualifying income within the meaning of § 7704(d)(1)(E). However, this ruling does not extend to any amount of the reimbursement payments that exceeds the pipeline extension construction costs.

Except as specifically provided, no opinion is expressed or implied as to 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 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 that requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Pursuant to a power of attorney on file with this office, a copy of this letter is being sent to X's authorized representatives.

Sincerely,

Dianna K. Miosi

Dianna K. Miosi
Chief, Branch 1
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter

Copy for § 6110 purposes

cc: