

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

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Legend

Company:

Parent:

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Date 1:

Dear \_\_\_\_\_ :

This responds to a letter dated February 29, 2008, submitted on behalf of Company, requesting that the income derived from certain financial transactions (treasury locks and interest rate swaps) is qualifying income within the meaning of § 7704(d)(1) of the Internal Revenue Code.

Company, formed on Date 1, is a State limited partnership which is publicly traded. Its partners consist of Parent and its subsidiaries owning a% including the GP interest, with the remaining partnership interests being owned by Company's senior managers (b% LPs), an unrelated third party (c% LP) and members of the public (d% LPs). Company has not elected to be taxed as an association for federal tax purposes.

Company is principally engaged in the acquisition, exploitation and development of oil and natural gas properties and the acquisition, ownership and operation of related assets. Company conducts its business through two limited liability company subsidiaries that are disregarded entities for federal income tax purposes.

To obtain funds for asset acquisitions and general working capital, Company periodically issues debt securities. The interest rate payable on these securities is a function of the prevailing interest rate on a U.S. Treasury bond of the same maturity as Company's proposed debt issue, and of Company's credit rating. In the time period between Company's decision to issue debt and its actual issuance (the exposure period), Company runs the risk of an interest rate increase on U.S. Treasuries, which would increase its cost of debt capital. To minimize this risk, Company may enter into treasury locks, by which an unrelated party agrees to purchase U.S. Treasury bonds from Company at a price certain and with an interest rate equal to the rate in effect on the date of agreement. If the prevailing rate on Treasury bonds increases during the exposure period (or the time between the agreement date and the settlement date), Company then can purchase Treasuries at a lower market price for sale to the counterparty, thus realizing a gain that offsets Company's increased cost of debt capital. If, however, the prevailing Treasury rate decreases during the exposure period, Company realizes a loss upon settlement of the treasury lock, thus offsetting the lower cost of issuing its debt. (No Treasury bonds are actually purchased and delivered; the parties settle on a net basis.)

Company's capital structure may include both fixed and floating rate debt. If Company determines that market conditions favor paying a floating rate when it has fixed rate debt outstanding (or vice versa), it will engage in an interest rate swap. To obtain a cash flow at a floating rate in exchange for one at a fixed rate, Company will agree to pay an unrelated party, usually a financial institution, a fixed interest rate on a notional principal amount. In return, the counterparty agrees to pay Company a floating interest rate (determined by reference to some established index) on the notional principal amount. If the index rate for a given month exceeds the fixed rate, the counterparty owes Company an amount equal to the excess interest rate multiplied by the notional principal amount. If, however, the fixed rate exceeds the index rate in a month, Company owes the counterparty. Amounts owing are netted, with settlement occurring at the end of the swap's term.

Exchanging a floating rate cash flow for a fixed rate flow operates in a similar manner, except that Company will pay the counterparty a floating interest rate on a notional principal amount, and it will receive fixed rate payments in return.

In some cases, the treasury locks and interest rate swaps entered into by Company may be integrated with the related debt instruments under § 1.1275-6 of the Income Tax Regulations. Company is requesting a ruling to apply only where a treasury lock or interest rate swap can not be so integrated.

Section 7704(a) provides generally that a publicly traded partnership shall be treated as a corporation.

According to § 7704(b), the term "publicly traded partnership" means any partnership if (1) interests in the partnership are traded on an established securities market, or (2) interests in the partnership are readily tradable on a secondary market (or its substantial equivalent).

Section 7704(c)(1) exempts from treatment as a corporation any publicly traded partnership for any tax year if the partnership meets the gross income requirements of § 7704(c)(2) for that year and each preceding tax 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 for any tax year if 90% or more of the partnership's gross income for that year consists of qualifying income.

Section 7704(d)(1)(A) defines "qualifying income" to include interest, unless, according to § 7704(d)(2), the interest is derived in the conduct of a financial or insurance business, or would be excluded from the term "interest" under § 856(f).

Section 1.7704-3(a)(1) provides that qualifying income includes income from notional principal contracts (NPCs, as defined in § 1.446-3) and other substantially similar income from ordinary and routine investments to the extent determined by the Commissioner. However, income from an NPC is included in qualifying income only if the property, income, or cash flow that measures the amounts to which the partnership is entitled under the contract would give rise to qualifying income if held or received directly by the partnership. Section 1.7704-3(a)(2) provides that income from an NPC is not qualifying income if it is derived in the ordinary course of a trade or business.

Company is principally engaged in the acquisition, exploitation and development of oil and natural gas properties and the acquisition, ownership and operation of related assets. Company does not conduct a financial or insurance business, nor is it engaged in the business of entering into NPCs.

Section 1.446-3(c)(1) defines an NPC to include interest rate swaps. An interest rate swap is a bilateral agreement whereby one party undertakes to make periodic payments to another party calculated by reference to a specified index (an interest rate or interest rate index) upon a notional principal amount in exchange for a promise to pay

similar amounts calculated by reference to a different specified index upon the same notional principal amount.

Payments due under an interest rate swap are not interest (there is no borrowing and, hence, no compensation for use or forbearance of money). However, such payments are measured by reference to an interest rate or interest rate index, with a cash flow that would be treated as interest income -- and would not be excluded under § 856(f) -- if held or received directly by the partnership.

Company's treasury locks will be common and routine transactions, entered into for the same purpose as interest rate swaps (to manage the risk of interest rate movements on Company's borrowings). Under § 1.7704-3(a)(1), the Commissioner may determine the extent to which income from ordinary and routine investments substantially similar to NPC income is included in qualifying income.

Based solely on the facts and representations submitted, we conclude that the income Company derives from the treasury lock and interest rate swap transactions is qualifying income within the meaning of §§ 7704(d)(1) and 1.7704-3(a)(1).

Except for the specific ruling above, we express or imply no opinion concerning the federal tax consequences of the facts of this case under any other provision of the Code. Specifically, we express or imply no opinion as to whether Company's treasury locks and interest rate swaps can be integrated with the related debt securities under § 1.1275-6, as well as to whether Company is taxable as a partnership for federal tax purposes.

This ruling is directed only to the taxpayer requesting 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 Company's authorized representative.

Sincerely,

Bradford R. Poston  
Senior Counsel, Branch 2  
Associate Chief Counsel  
(Passthroughs and Special Industries)

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

cc: