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Department of the Treasury
Washington, DC 20224

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April 13, 2009

LEGEND

X =

A =

B =

C =

State =

Year =

Date =

Dear :

This letter responds to a letter dated November 14, 2008, and subsequent correspondence, submitted on behalf of X by its authorized representative, requesting a ruling under § 1362(d)(3) and § 1375(a) of the Internal Revenue Code.

FACTS

X was incorporated in Year in accordance with the laws of State. X made an election to be treated as an S corporation effective Date. X has accumulated earnings and profits from prior years.

From time to time, X has invested or will invest in certain publicly traded limited partnerships (PTPs) primarily engaged in the purchasing, transportation, storage and

marketing of oil and gas. X's investment strategy is to provide for liquidity and also to diversify its investment risk.

Presently, X has identified three specific PTPs, A, B, and C, which are engaged in the active trade of purchasing, gathering, transporting, trading, storage and/or resale of crude oil and refined petroleum products and related activities. X represents that A, B, and C each meet the qualifying income exception of § 7704(c) and, thus, each is taxed as a partnership for federal income tax purposes. X also represents that A, B, and C are not electing large partnerships (as defined by § 775); therefore, the normal flow-through provisions of subchapter K apply to their respective partners. X further states that it intends to invest in other PTPs that meet the qualifying income exception of § 7704(c) and are not electing large partnerships as defined by § 775.

LAW

Section 1361(a)(1) defines an "S corporation" as a small business corporation for which an election under § 1362(a) is in effect for the taxable year.

Section 1362(d)(3)(A)(i) provides that an election under § 1362(a) shall be terminated whenever the corporation (I) has accumulated earnings and profits at the close of each of 3 consecutive taxable years, and (II) has gross receipts for each of such taxable years more than 25 percent of which are passive investment income. Section 1362(d)(3)(A)(ii) provides that any termination under § 1362(d)(3) shall be effective on and after the first date of the first taxable year beginning after the third consecutive taxable year referred to in § 1362(d)(3)(A)(i).

Section 1362(d)(3)(C)(i) provides that except as otherwise provided in § 1362(d)(3)(C), the term "passive investment income" means gross receipts derived from royalties, rents, dividends, interest, and annuities.

Section 1375(a) provides that if for the taxable year an S corporation has (1) accumulated earnings and profits at the close of such taxable year, and (2) gross receipts more than 25 percent of which are passive investment income, then there is hereby imposed a tax on the income of such corporation for such taxable year. Such tax shall be computed by multiplying the excess net passive income by the highest rate of tax specified in § 11(b).

Section 702(a)(7) provides that, in determining income tax liability, each partner shall take into account separately his distributive share of the partnership's items of income, gain, loss, deduction, or credit to the extent provided by regulations.

Section 1.702-1(a)(8)(ii) of the Income Tax Regulations provides, in part, that each partner must take into account separately the partner's distributive share of any partnership item which, if separately taken into account by any partner, would result in

an income tax liability for that partner, or for any other person, different from that which would result if that partner did not take the item into account separately.

Section 702(b) provides that the character of any item of income, gain, loss, deduction, or credit included in a partner's distributive share under § 702(a)(1) through (7) shall be determined as if the item were realized directly from the source from which realized by the partnership, or incurred in the same manner as incurred by the partnership.

Section 7704(a) provides that, except as provided in § 7704(c), a publicly traded partnership (PTP) shall be treated as a corporation for federal income tax purposes.

Section 7704(b) provides that for purposes of § 7704, the term PTP means any partnership if (1) interests in that 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) states 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 consists of qualifying income.

Section 7704(d)(1)(E) provides, in relevant part, the term “qualifying income” means 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), industrial source carbon dioxide, or the transportation or storage of any fuel described in § 6426(b), (c), (d), or (e), or any alcohol fuel defined in § 6426(b)(4)(A) or any biodiesel fuel as defined in § 40A(d)(1). Section 7704(d)(1) provides that for purposes of § 7704(d)(1)(E), the term “mineral or natural resource” means any product of a character with respect to which a deduction for depletion is allowable under § 611; except that such term shall not include any product described in § 613(b)(7)(A) or (B).

Rev. Rul. 71-455, 1971-2 C.B. 318, deals with an S corporation that operates a business in a joint venture with another corporation. In the tax year at issue, the total business expenses exceeded gross receipts for the joint venture. The revenue ruling holds that, in applying the passive investment income limitations, the S corporation should include its distributive share of the joint venture's gross receipts and not its share of the venture's loss. In accordance with § 702(b), the character of these gross receipts were not converted into passive investment income upon their allocation to the S corporation.

X's distributive shares of gross receipts from A, B, and C, if separately taken into account, might affect its federal income tax liability. Under § 1362(d)(3), the status of X as an S corporation could depend upon the character of its distributive shares of gross receipts from A, B, and C. Thus, pursuant to § 1.702-1(a)(8)(ii), X must take into account separately its distributive shares of the gross receipts from A, B, and C. The character of these partnership receipts for X will be the same as the character of the partnership receipts for A, B, and C, in accordance with § 702(b).

CONCLUSION

Based upon the information submitted and the representations made, we conclude that: (1) X's distributive shares of the gross receipts of A, B, and C will be included in its gross receipts for purposes of §§ 1362(d)(3) and 1375(a); and (2) X's distributive shares of A, B, and C's gross receipts attributable to 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 will not constitute passive investment income as defined by § 1362(d)(3)(C).

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. Specifically, no opinion is expressed or implied as to whether X otherwise qualifies as an S corporation under § 1361. Furthermore, the passive investment income rules of § 1362 are completely independent of the passive activity rules of § 469.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Internal Revenue 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.

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.

Sincerely,

/s/

Leslie H. Finlow
Senior Technician Reviewer, Branch 3
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

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