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LEGEND

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Dear :

This letter replies to a letter, dated Date 2, in which Taxpayer requests permission to aggregate certain aggregate net profits interests pursuant to § 614(e) of the Internal Revenue Code and § 1.614-5(d) of the Income Tax Regulations, effective Date 1.

The facts and representations submitted are summarized as follows:

Taxpayer, a calendar year, accrual basis taxpayer, owns producing and nonproducing mineral, royalty, overriding royalty, net profits and leaseholds interests in approximately a counties and parishes in b states. A substantial part of Taxpayer's assets consists of aggregate net profits overriding royalty interests that burden various properties owned by Partnership, which is owned (directly and indirectly) by Taxpayer's general partner. Taxpayer receives monthly payments from Partnership based on the net profits Partnership actually realizes from the properties burdened by Taxpayer's aggregate net profits interests.

Taxpayer owns c aggregate net profits interests, d of which, A, B, and C, are relevant to this ruling request. A, the largest aggregate net profits interest, burdens properties located in various oil and gas properties throughout the United States. B, the second largest aggregate net profits interest, burdens properties located in various regions of the United States. Lastly, C, the smallest aggregate net profits interest, burdens multiple properties in the United States. Taxpayer represents that each of A, B, and C is a single economic interest that constitutes a single property for purposes of § 614.

Taxpayer represents that substantially all of the properties burdened by C are also burdened by A ("over-lapping properties"). The remainder of the properties burdened by C are also burdened by B (non-overlapping properties). C burdens approximately e properties, approximately f of which are over-lapping properties. Although the other approximately g non-overlapping properties are not burdened by A, Taxpayer represents that they either are adjacent to or in close proximity to properties burdened by A.

Taxpayer further represents that each of the g non-overlapping properties is located in reasonably close proximity to a property burdened by A. Each of the non-overlapping properties is in the same county as a property burdened by A. Additionally, of the g non-overlapping properties, (i) h are contiguous with properties burdened by A, (ii) i are located within j miles of a property burdened by A, (iii) k are located between j and l miles of a property burdened by A, and (iv) m are located between l and n miles of a property burdened by A. Thus, o% of the total properties burdened by C are located within l miles of a property burdened by A.

Both the properties burdened by A and the properties burdened by C historically have generated positive net profits. Taxpayer expects that these properties will continue to generate positive net profits in the future. Separately accounting for A and C is time consuming and expensive. Accordingly, Taxpayer desires to aggregate A and C to reduce the time and expense required to separately account for the two aggregate net profits interests. Taxpayer represents that the aggregation of A and C will not result in a substantial reduction in tax.

The aggregation of A and C would be accomplished by amending the terms of the conveyance creating A such that, following the amendment, A would burden both the properties currently burdened by A and the properties burdened by C. As a result, in determining the amount payable with respect to A, the total income from the properties currently burdened by A and the properties burdened by C would be offset by the total expenses of the properties currently burdened by A and the properties burdened by C . Thus, following the aggregation, there would be a single computation for all of the properties currently burdened by A and C.

In the case of mines, wells, and other natural deposits, § 614(a) and § 1.614-1(a)(1) define the term “property” to mean each separate interest owned by the taxpayer in each mineral deposit in each separate tract or parcel of land.

Section 1.614-1(a)(2) defines the term “interest” as an economic interest in a mineral deposit. It includes working interests or operating interests, royalties, overriding royalties, net profits interests, and, to the extent not treated as loans under § 636, production payments.

Section 614(e)(1) provides that if a taxpayer owns two or more separate nonoperating mineral interests in a single tract or parcel of land or in two or more adjacent tracts or parcels of land, the Secretary shall, on a showing by the taxpayer that a principal purpose of forming the aggregation is not the avoidance of tax, permit the taxpayer to treat all such interests as one property for all subsequent taxable years unless the Secretary consents to a different treatment.

Section 614(e)(2) and § 1.614-5(g) define the term “nonoperating mineral interests” to include only interests described in § 614(a) that are not operating mineral interests within the meaning of § 1.614-2.

Section 1.614-2(b) defines the term “operating mineral interest” to mean a separate mineral interest as described in § 614, in respect of which the costs of production are required to be taken into account by the taxpayer for purposes of computing the limitation of 50 percent of taxable income from the property in determining the deduction for percentage depletion under § 613, or such costs would be so required to be taken into account if the mine, well, or other natural deposit were in the production stage. The term does not include royalty interests or similar interests, such as production payments or net profits interests.

Section 1.614-5(d) provides that upon proper showing to the Commissioner, a taxpayer who owns two or more separate nonoperating mineral interests in a single tract or parcel of land, or in two or more adjacent tracts or parcels of land, shall be permitted, under § 614(e), to form an aggregation of all such interests in each separate kind of mineral deposit and treat such aggregation as one property. Permission shall be granted by the Commissioner only if the taxpayer establishes that a principal purpose in

forming the aggregation is not the avoidance of tax. The fact that the aggregation of nonoperating mineral interests will result in a substantial reduction in tax is evidence that the avoidance of tax is a principal purpose of the taxpayer. An aggregation formed under § 1.614-5(d) shall be considered as one property for all purposes of the Internal Revenue Code. In no event may nonoperating interests in tracts or parcels of land that are not adjacent be aggregated and treated as one property. The term “two or more adjacent tracts or parcels of land” means tracts or parcels of land that are in reasonably close proximity to each other depending on the facts and circumstances of each case. Adjacent tracts or parcels of land do not necessarily have any common boundaries, and may be separated by intervening mineral rights.

Section 1.614-5(e)(1) provides that an application for permission to aggregate separate nonoperating interests under § 614(e) and § 1.614-5(d) must be made in writing to the Commissioner and must be filed within 90 days after the beginning of the first taxable year beginning after December 31, 1957, for which aggregation is desired or within 90 days after the acquisition of one of the nonoperating mineral interests that is to be included in the aggregation, whichever is later.

Section 1.614-5(e)(4) provides that the application for permission to aggregate nonoperating mineral interests under § 614(e) and § 1.614-5(d) shall include a complete statement of the facts upon which the taxpayer relies to show that the avoidance of tax is not a principal purpose of forming the aggregation. Such application shall also include a description of the nonoperating mineral interests within the tract or tracts of land involved. A general description, accompanied by maps appropriately marked, which accurately circumscribes the scope of the aggregation and shows that the taxpayer is aggregating all the nonoperating mineral interests in a particular kind of mineral deposit within the tract or tracts of land involved will be sufficient. If the Commissioner grants permission, a copy of the letter granting such permission shall be attached to the taxpayer's return for the first taxable year for which such permission applies. If the taxpayer has already filed such return, a copy of the letter of permission shall be filed with the district director for the district in which such return was filed and shall be accompanied by an amended return or returns if necessary or, if appropriate, a claim for credit or refund.

Section 1.614-5(e)(5) provides that the election to aggregate separate nonoperating mineral interests under § 614(e) and § 1.614-5(d) is binding upon the taxpayer for the first taxable year for which made and for all subsequent taxable years unless consent to make a change is obtained from the Commissioner.

A net profits interest that burdens multiple properties (aggregate net profits interest) is treated as a single economic interest that constitutes a single property under § 614(a) if the burdened properties are economically interrelated. That is, in computing the amount owed to the holder of the aggregate net profits interest, the holder of the burdened working interests must take into account the revenues and expenses from all

of the burdened properties. The holder of an aggregate net profits interest must at all times look to all the burdened properties for a return of capital. Therefore, an aggregate net profits interest must be created and conveyed in a single transaction and all the burdened properties must be identified at the time that the net profits interest is created and conveyed. The addition of properties to an aggregate net profits interest after it is created, except as permitted under § 614(e), is an impermissible aggregation that disqualifies the aggregate net profits interest as a single economic interest.

If an aggregate net profits interest qualifies as a single economic interest, a single § 614 property, a net profits interest that burdens a working interest in the same tract or parcel of land as any one of the working interests burdened by the aggregate net profits interest would be considered to be in the same tract or parcel of land as the aggregate net profits interest for purposes of the aggregation rules of § 614(e) and § 1.614-5(d). Moreover, a property that is adjacent to, that is, in reasonably close proximity to, any one of the properties burdened by the aggregate net profits interest would be adjacent to the aggregate net profits interest.

Thus, under § 614(e) and § 1.614-5(d), a taxpayer that owns an aggregate net profits interest that qualifies as a single economic interest, may request permission to aggregate the aggregate net profits interest with a separate net profits interest that burdens a working interest in the same tract or parcel of land as any one of the working interests burdened by the aggregate net profits interest. Similarly, a taxpayer that owns an aggregate net profits interest may request permission to aggregate the aggregate net profits interest with a separate net profits interest that burdens a property that is adjacent to any one of the properties burdened by the aggregate net profits interest. In either case, permission to aggregate is granted only if the taxpayer establishes that a principal purpose in forming the aggregation is not the avoidance of tax.

Taxpayer has represented that each of A, B, and C is single economic interest that constitutes a single property for purposes of § 614. Taxpayer also has represented that substantially all of the properties burdened by C are in the same tracts or parcels of land as certain properties burdened by A, or in tracts or parcels of land that are adjacent to properties burdened by A. Finally, Taxpayer has represented that the purpose of the proposed aggregation is to eliminate the hardship and expense of separately accounting for the separate aggregate net profits interests, and that the proposed aggregation will not result in a substantial reduction in tax.

Based on the representations made and consideration of the descriptions and maps submitted, we conclude that the avoidance of tax is not a principal purpose of forming the aggregation. Based solely on the facts and representations submitted, we grant consent for Taxpayer to aggregate A and C. The aggregate net profits interest resulting from the aggregation of A and C must be treated as a single property for purposes of § 614 for the taxable year beginning Date 1, and for all subsequent tax years, unless consent is obtained from the Commissioner to change the aggregation.

Except as specifically set forth above, we express or imply no opinion concerning the federal income tax consequences of any aspect of any transaction or item discussed or referenced in this letter. In particular, we express or imply no opinion whether each of A, B, C, or the aggregate net profits interest resulting from the aggregation of A and C is a single economic interest that qualifies as a single property under § 614. This ruling is conditioned on each of A, C, and the aggregate net profits resulting from the aggregation of A and C qualifying as a single economic interest under § 614.

The rulings contained in this letter are based upon information and representations submitted by Taxpayer and accompanied by a penalties 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.

In accordance with the power of attorney, we are sending copies of this letter to Taxpayer's authorized representative. We also are sending a copy of this letter to the appropriate Industry Director, LB&I. A copy of this ruling must be attached to any federal income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

Sincerely,
Associate Chief Counsel
(Passthroughs and Special Industries)

Brenda M. Stewart
Senior Counsel, Branch 6
Office of Associate Chief Counsel
(Passthroughs & Special Industries)