Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
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Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:INTL:B04
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Date:
October 01, 2007

LEGEND

F1 =

F2 =

US1 =

Country A =

Date 1 =

Dear :

This replies to a letter from your authorized representative dated June 15, 2007, requesting a ruling on the applicability of Temp. Reg. §§ 1.367(a)-2T and 1.367(a)-4T to a transaction involving the transfer of certain oil and gas leasing activities. Additional information was received from your authorized representative in a letter dated July 10, 2007.

The relevant facts are as follows: US1, a domestic corporation, owns 90% and F1, a foreign corporation, owns 10% of F2, an entity treated as a partnership for U.S. income tax purposes and as a corporation under the laws of Country A. F2 owns and operates a working interest in an oil and gas field located in Country A. F2 is an eligible entity as defined by Treas. Reg. § 301.7701-3(a) and contemplates making an election

to change its classification from partnership to association pursuant to Treas. Reg. § 301.7701-3(c)(1).

Treas. Reg. § 301.7701-3(g)(1)(i) provides that an eligible entity classified as a partnership that elects to be classified as an association pursuant to Treas. Reg. § 301.7701-3(c)(1) is deemed to contribute all of the partnership assets and liabilities to an association and liquidating the partnership by distributing the association stock to the partners. It has been represented that the deemed contribution will qualify as an exchange under section 351.

Section 367(a)(1) provides that when a United States person transfers property to a foreign corporation in an exchange described in section 332, 351, 354, 356 or 361, the foreign corporation shall not be considered a corporation for purposes of determining gain.

Treas. Reg. § 1.367(a)-1T(c)(3)(i)(A) provides that if a foreign or domestic partnership transfers property to a foreign corporation in an exchange described in section 367(a)(1), then any U.S. person that is a partner in the partnership is treated as having transferred a proportionate share of the property in an exchange described in section 367(a)(1).

Section 367(a)(3)(A) generally provides that section 367(a)(1) will not apply to property transferred to a foreign corporation for use in the active conduct of a trade or business outside the United States. This general rule is subject to exceptions and definitions provided in the regulations. Treas. Reg. § 1.367-2T provides general rules for meeting the active trade or business exception and Treas. Reg. § 1.367-4T provides special rules applicable to specified transfers of property to a foreign corporation, including oil and gas working interests.

Treas. Reg. § 1.367-4T(e)(1) provides that a working interest in oil and gas properties shall be considered to be transferred for use in the active conduct of a trade or business if the transfer meets the conditions specified in Treas. Reg. § 1.367-4T(e)(2), the transferee has no intention at the time of the transfer to farm out or otherwise transfer any part of the transferred working interest, and no actual farm outs or other transfers occur within three years in which the transferee retains less than 50% of the transferred working interest.

Treas. Reg. § 1.367-4T(e)(2) provides criteria for establishing that a working interest in oil or gas is being used in the active conduct of a trade or business. These criteria are as follows:

(i) The transferor is regularly and substantially engaged in exploration for and extraction of minerals, either directly or

through working interests in joint ventures, other than by reason of the property that is transferred;

(ii) The terms of the working interest transferred were actively negotiated among the joint venturers;

(iii) The working interest transferred constitutes at least a five percent working interest;

(iv) Prior to and at the time of the transfer, through its own employees or officers, the transferor was regularly and actively engaged in--

(A) Operating the working interest, or

(B) Analyzing technical data relating to the activities of the venture;

(v) Prior to and at the time of the transfer, through its own employees or officers, the transferor was regularly and actively involved in decision making with respect to the operations of the venture, including decisions relating to exploration, development, production, and marketing; and

(vi) After the transfer, the transferee foreign corporation will for the foreseeable future satisfy the requirements of subdivisions (iv) and (v) of this paragraph (d)(2).

Treas. Reg. § 1.367(a)-4T(e)(4) also provides, in pertinent part, that:

> Oil and gas interests not described in this paragraph (e) may nonetheless qualify for the exception to section 367(a)(1) contained in § 1.367(a)-2T, relating to transfers of property for use in the active conduct of a trade or business outside of the United States. However, a mere royalty interest in oil and gas properties will not be treated as transferred for use in the active conduct of a trade or business outside the United States. Moreover, a royalty or similar interest that constitutes intangible property will be subject to the rules of § 1.367(d)-1(T), relating to the transfers of intangible property.

Based on the information provided, we rule that if US1's transfer of an oil and gas working interest to F2 is unable to meet all the criteria of Treas. Reg. § 1.367(a)-

4T(e)(2), then US1 may seek to qualify the transfer of the oil and gas working interest as property used in the active conduct of a trade or business under Treas. Reg. § 1.367(a)-2T, subject to the limitation on royalty or similar interests provided in Treas. Reg. § 1.367(a)-4T(e)(4).

No opinion is expressed as whether the property transferred is a working interest or will meet the requirements under Treas. Reg. § 1.367(a)-2T or -4T. However, the requirements specified in Treas. Reg. §§ 1.367(a)-4T(e)(1) & (2) are appropriate facts and circumstances to be considered in making this determination. In addition, except as provided herein, no opinion is expressed or implied regarding the tax consequences of the transaction.

A copy of this ruling letter should be attached with the statements and the notices mailed to the IRS. This ruling is directed to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely

_____
Charles P. Besecky
Branch Chief
Associate Chief Counsel
(International, Branch 4)