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August 4, 2015

CC:PA:LPD:PR (REG – 132634 – 14)

Room 5203

Internal Revenue Service

P.O. Box 7604

Ben Franklin Station

Washington, DC 20044

Re: Comments regarding Section 7704 Proposed Regulations

Calumet Specialty Products Partners, L.P. (“*Calumet*”) respectfully submits these comments on the proposed regulations (REG – 132634 – 14) under section 7704(d)(1)(E) (the “*Proposed Regulations*”) of the Internal Revenue Code of 1986, as amended (the “*Code*”) to identify our concerns regarding the proposed definition of “processing and refining” and the treatment of the products of crude oil refineries.

I. Executive Summary

We believe that the Proposed Regulations erroneously limit certain qualifying activities from the processing and refining of minerals and natural resources, and reflect both a misconception of the refining industry and a deviation from the interpretation of refining and processing for the purposes of Section 7704(d)(1)(E). Prior to the release of the Proposed Regulations, there was no preference toward fuel refining— not in section 7704(d)(1)(E), not in its legislative history, not in the interpretations by the Internal Revenue Service in the issuance of private letter rulings regarding such activities, and not by the industry at large. Moreover, the Proposed Regulations ignore common refining and processing activities and arbitrarily treat hydrocarbons from the natural gas stream differently than identical hydrocarbons in crude oil. The Proposed Regulations also need clarification with respect to the definition of “marketing,” as the definition should be revised to include common refining practices, such as: blending and packaging, hedging, and the sale of renewable identification numbers (“*RINs*”).

II. Calumet’s Business and Private Letter Rulings

Calumet is a publicly traded partnership headquartered in Indianapolis, Indiana, primarily operating as a refiner in the oil and natural gas industry. We are a leading independent producer of high-quality, refined hydrocarbon products in North America. Our primary operating assets consist of crude oil refineries, crude oil logistics assets, and drilling and oilfield services assets located throughout the United States.



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We refine and process crude oil and other feedstocks into a wide variety of lubricating oils, white oils,¹ solvents,² petrolatums,³ asphalts and waxes (the “*Specialty Products*”) that are sold to domestic and international customers who purchase them primarily as raw material components. We also blend and market Specialty Products at our product terminals, including lubricants.⁴ In addition, we refine and process crude oil into a variety of fuel and fuel-related products, including butane, gasoline, diesel, jet fuel, asphalt and heavy fuel oils (the “*Fuel Products*” and, together with the Specialty Products, the “*Refined Products*”). We also resell purchased crude oil and other feedstocks internally and to third party customers depending on market conditions and other factors. We produce these Refined Products in a variety of ways and under varying arrangements. In many cases, we purchase crude oil and process the crude oil into Refined Products that we sell on our own behalf. In other cases, we acquire intermediate feedstocks from other refineries and further process those feedstocks into Refined Products. In some circumstances, we process intermediate feedstocks owned by third parties into Refined Products in exchange for a fee (“*toll processing*”).

Finally, we are in the process of expanding or developing a number of facilities, such as a gas-to-liquids project in Lake Charles, Louisiana. The facility would use natural gas as its feedstock and is expected to produce 1,100 barrels per day of fuel and other refined products, including waxes, drilling fluids, distillate and naphtha, from natural gas.⁵

We have requested and received two private letter rulings from the Internal Revenue Service (the “*Service*”). Private letter ruling 2008-48-018, issued on August 26, 2008 (the “*2008 Ruling*”), concluded that that gross income derived from the further refining of previously refined petroleum based feedstocks into specialty petroleum products (specifically, food grade mineral oils, petrolatums, hydrocarbon solvents, and other specialty products, including gelled hydrocarbons, cable filling compounds and petroleum sulfates), and the blending, packaging, marketing, and distribution of such products, constitutes “qualifying income” under Section 7704(d)(1)(E). Private letter ruling 2013-01-010, issued on January 4, 2013 (the “*2013 Ruling*”), confirmed and expanded upon the 2008 Ruling, concluding that gross income

¹ White oils are highly refined straight mineral oil that are produced from naphthenic crude or refined from base oils.

² Compounds with a strong capability to dissolve a given substance. The most common petroleum solvents are mineral spirits, xylene, toluene, hexane, heptane, and naphthas.

³ Semi-solid, waxy hydrocarbon, pale to yellow in color, composed primarily of high-molecular-weight waxes; used in lubricants and rust preventives. Derived from dewaxing of high-viscosity base oils, such as bright stock.

⁴ The lubricants are created from intermediate hydrocarbon feedstocks classified by the American Petroleum Institute into 5 Groups. Groups I to III are classified based on their saturate content and viscosity index. Group IV lubricants are created from polyalphaolefin feedstocks which are derived from crude oil refinery streams. The feedstock we most commonly use to produce Group IV lubricants is derived from ethylene. Finally, Group V lubricants are alcohols and esters used in small amounts as additives in our blending processes.

⁵ See Calumet press release dated June 9, 2014; <http://www.prnewswire.com/news-releases/calumet-specialty-products-partners-lp-announces-investment-in-gas-to-liquids-joint-venture-262434231.html>.



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from the refining, processing, and marketing of certain lubricants (including Group I, II, III and IV lubricants) and sales of Fuel Products and Specialty Products in bulk to governmental, commercial, and industrial end users in quantities and at prices which are not retail is qualifying income.

We continue to believe the Service's conclusion in the 2008 Ruling and the 2013 Ruling (together, the *Calumet Rulings*) are correct, and we believe that any revocation of the Calumet Rulings, whether by regulation or otherwise, would be inconsistent with the governing statute and its legislative history. For the reasons discussed in these comments, the Proposed Regulations should be revised to confirm the conclusions in the Calumet Rulings and adopt definitions of "mineral or natural resource" and "processing and refining" that are consistent with common industry practice, the statute, and its legislative history.

III. Background: Refining and Processing of Crude Oil

A. Refining is a Broad Activity

Petroleum refining, which began in the U.S. in 1861 with the opening of the first refinery, has continually evolved to incorporate the processes that comprise today's commercial refineries, as well as the variety of products they produce. Refining primarily involves (i) fractionation via distillation processes, (ii) conversion processes, which include separation via thermal and catalytic cracking, unification through alkylation and polymerization, and alteration via isomerization and catalytic reforming; (iii) treatment processes, which are intended to prepare hydrocarbon streams for processing or prepare finished products (iv) formulating and blending processes, which involve mixing and combining hydrocarbons to achieve specific performance characteristics; and (v) other refining operations such as light-ends recovery and hydrogen production.

The varied product mix of today's crude oil refineries is not a 21st century development. Most of the refining processes listed above have been in use for decades, while some are over a century old. For example, atmospheric distillation and vacuum distillation were in use for the production of kerosene and lubricants by 1870. Thermal cracking, which physically breaks large heavy fuel molecules to produce gasoline and distillate fuels, was developed in 1913 in response to demand for gasoline. Catalytic processes, such as cracking and alkylation, soon followed in the early 1940s to produce jet fuel, explosives, synthetic rubber, and higher-octane gasoline, the demand for all of which was exacerbated by World War II. Thus, refineries began producing a wide range of products early in the development of crude oil refineries, and have continued to evolve to meet consumer demand for fuels, lubricants, waxes, and other products of crude oil: by 1975, refineries were already capable of turning out an incredibly broad product mix from a single barrel of crude oil, including kerosene, lubricants, naphtha, tar, asphalt, bunker fuel, distillate fuels, residual fuels, sulfur, petroleum coke, aromatics such as benzene, waxes, solvents, petrochemical feedstocks, diesel fuel, gasoline, and high-octane aviation gasoline.



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B. The Composition of Crude Oils

The world’s crude oils are complex mixtures of hydrocarbons molecules that vary widely in appearance, composition, and chemical properties. Crude oils are classified in a variety of ways. They may be classified as paraffinic, naphthenic, or aromatic based on the predominant hydrocarbon molecule, may be “sweet” or “sour” depending on whether the proportion of hydrogen sulfide contained in the crude oil, and are also generally defined by the “gravity” assigned by the American Petroleum Institute.

The feedstock at each of our refineries is crude oil or an intermediate feedstock of crude oil. The refining processes to which a particular crude oil will be subject are heavily dependent upon the properties of such crude oil. For example, we refine Canadian Heavy Sour, Utah Yellow Wax, and Condensate crude at different refineries that are specially equipped to handle each type of crude oil, and their product mixes are very different, as illustrated by the table below and the graphic depiction on Exhibit A:

	Canadian Heavy Sour	Utah Yellow Wax	Condensate
Gasoline	35%	5%	-
Gasoline Feedstock	-	-	8%
Diesel Fuel	28%	35%	-
Diesel Feedstock	-	-	9%
Jet Fuel	-	20%	-
No. 6 Fuel Oil	3%	-	-
Base Oil Feedstocks	-	-	22%
Lubricants	-	20%	-
Waxes	-	10%	-
Naphthas	-	-	60%
Olefins	1%	-	-
LPG and Misc. Gases	3%	< 1%	1%
Asphalt	30%	9.5%	2%

C. Refinery Operations are Designed for Maximum Efficiency

As described above, a refinery’s product mix is primarily based on the type of crude oil it processes and the market conditions at the time of refining. As a result, many refineries specialize in a product type, such as fuels or lubricants, and will optimize feedstocks in order to maximize the value they can attain from their crude oil or intermediate feedstocks.

To the extent that a refinery process needs a specific feedstock as an input, the refinery may either adjust their other refinery units to produce the required input themselves or buy that input from another



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refinery. For example, some refineries specialize in dealing with lubricants and may purchase the base oils from other refineries that choose to focus on fuel production. The lubricant refinery may similarly sell non-lubricant intermediates to a fuel producer who is better suited to finish that intermediate into fuels. In addition, refineries may augment their own feedstocks. For example, we may purchase olefins or natural gas liquids for use in our alkylation units in order to produce gasoline.

Purchasing feedstocks from third parties is also useful in cases where the refinery is experiencing issues with a particular unit or during planned maintenance outages known as “turnarounds.” If only a single unit is out of service, the refinery can purchase the intermediate feedstocks necessary to keep the rest of the facility up and running.

The practice of producing inputs or purchasing them from other refiners allows each refinery to focus its capital and attention on its desired outputs. We maximize our feedstock flexibility and efficiency between our facilities by transporting intermediate products between our refineries as well as purchasing intermediate products from third party processors or refiners. Diagrams depicting our refined products and the processes by which we produce them are attached as Exhibit B.

IV. Products of Crude Oil and Natural Gas Refining and Processing are Clearly Natural Resources.

Section 7704(d)(1)(E) provides that income 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...” is qualifying income. Such activities are referred to herein as the “*Qualifying Activities*.”

A. “*Products Thereof*” are natural resources for purposes of Section 7704(d)(1)(E).

For purposes of Section 7704, “mineral or natural resource” means “any product of a character with respect to which a deduction for depletion is allowable.” The legislative history to Section 7704(d)(1)(E) explains that for purposes of Section 7704:

[O]il, gas, or products thereof means gasoline, kerosene, number 2 fuel oil, refined lubricating oils, diesel fuel, methane, butane, propane, and similar products which are recovered from petroleum refineries or field facilities. Oil, gas, or products thereof are not intended to encompass oil or gas products that are produced by additional processing beyond that of petroleum refineries or field facilities, such as plastics or similar petroleum derivatives.⁶

The Proposed Regulations ignore the legislative history, defining “mineral or natural resource” for purposes of Section 7704(d)(1)(E) as including only products subject to depletion under Section 611. By

⁶ H.R. Rep. No. 100-495, at 947 (1987 Conf. Rep.).



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eliminating references to any non-depletable products of oil and gas, the Proposed Regulations have proposed a definition that is directly contrary to Congress' intent as expressed in the legislative history described above and inconsistent with rulings previously issued in the area by the Service.

We produce fuel products, asphalts, base oils, solvents, white oils, waxes, petrolatums, lubricants, and greases from crude oil within its refineries. Each product category is either listed in the legislative history as "oil, gas, or products thereof" or is substantially similar to the listed products and recovered from a petroleum refinery. None of our products are plastic or substantially similar to plastic; rather, they are the direct result of crude oil refining. The final regulations should, consistent with the legislative history, expressly state that "products thereof" of crude oil and natural gas (such as those we recover from our refineries or use in the gas-to-liquids process) are natural resources for purposes of Section 7704(d)(1)(E).

B. Intermediate products that are traditionally created from petroleum refining should be considered natural resources without regard to feedstock.

The Proposed Regulations draw an arbitrary distinction between the intermediate components of crude oil (which can be further refined under the Proposed Regulations) and the components of natural gas. In fact, the raw hydrocarbon stream produced from the ground often contains a mixture of crude oil, natural gas, and NGLs, making it possible for natural gas and crude oil to come from the exact same well. Natural gas and crude oil are complex hydrocarbons that, when separated into their component parts, can be used to create many of the same products. For example, in our gas-to-liquids facility currently under development, the products created from the natural gas stream are the same as those that could be produced in our crude oil refineries.

The exclusion of the intermediate products of natural gas refining and processing from the definition of natural resource is inappropriate. The legislative history simply reads that "oil, gas, and products thereof" and "similar products which are recovered from petroleum refineries or field facilities" are natural resources. Further, the feedstock, whether it is crude oil or natural gas, is still subjected to common refinery processes to produce the hydrocarbon product. Accordingly, products traditionally recovered from petroleum refineries should be treated as natural resources for purposes of Section 7704, even where the feedstock for such products is natural gas.

V. The Exclusion of Common Refinery Processes from "Processing and Refining" is a Misinterpretation of the Statute

A. Section 7704 is concerned with the "input" of a refining or processing activity, not the resulting product.

Section 7704 states simply that the processing or refining a mineral or natural resource is a Qualifying Activity. Neither the statute nor the legislative history limits the products that can be produced



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in a processing or refining activity, except to the extent such activities result in plastic; refining crude oil into fuel is treated no differently than refining crude oil into lubricants, waxes, solvents, etc. The statute is concerned only with whether the *input* of a refining or processing activity – not its output – is a natural resource.

As referenced above, the legislative history of Section 7704 provides that “products thereof” are considered natural resources for purposes of Section 7704(d)(1)(E). The Proposed Regulations, however, attempt to limit the products that may be produced from refining and processing to the products on the list, imposing a fuel-based standard that has no basis in the statute. Such a limitation is the result of a misinterpretation of the legislative history. Upon a close reading of the legislative history, it is clear that the listed products, as natural resources, are products that may be subjected to *further* refining and processing, rather than the only products that may be produced via processing and refining. Further, the composition of crude oils (and therefore the products that can be produced from them) varies wildly. Congress clearly did not intend to imply that some crude oils are natural resources while others are not, simply because they do not produce gasoline. The Proposed Regulations’ limitations on the products that may be produced via refining and processing activities are therefore directly contrary to the Congressional intent underlying Section 7704(d)(1)(E).

B. The definition of “processing or refining” in the Proposed Regulations is unnecessarily restrictive.

Section 1.7704-4(c)(5) of the Proposed Regulations provides that in general, “an activity is processing or refining if it is done to purify, separate, or eliminate impurities.” Proposed Regulations Section 1.7707-4(c)(5)(iii) further provides that with respect to petroleum, “qualifying” activities include activities performed to separate crude oil into its component parts (such as naphtha, gasoline, kerosene, fuel oil, lubricating base oils, waxes and similar products), chemically convert such separated component parts into products that are recombined with other components of crude oil for purposes of producing gasoline or other fuels, or physically separate products created through qualifying separation or chemical conversion activities. Unless specifically provided otherwise, an activity will not qualify as processing or refining if the activity “causes a substantial physical or chemical change in a mineral or natural resource” or transforms such mineral or natural resource into “new or different mineral products or into manufactured products.”⁷

By limiting qualifying refining activities to the separation of crude oil and the refining and blending fuels, the proposed definition of “processing and refining” excludes activities that commonly take place in U.S. refineries and have historically been part of the crude oil refining process. Refineries have long been engaged in the production of many products that are neither gasoline nor fuel blending products, such as lubricants, white oils, asphalts, and waxes. Such products are directly derived from, and

⁷ Prop. Reg. § 1.7707-4(c)(5).



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are present in, crude oil and “recovered from petroleum refineries” for purposes of Section 7704, even though they are not fuel products.

The Proposed Regulations’ limitation with respect to in-refinery chemical conversion processes has no basis in Section 7704 or its legislative history. Section 7704 contains no express limitation on the definition of “refining,” and the legislative history indicates that any process undertaken within a petroleum refinery generates qualifying income. As discussed above, hydrotreaters were common fixtures in refineries long before the catalytic cracker was available, and were prevalent in refineries at the time Section 7704 was enacted. Congress did not exclude any refinery process from qualifying treatment. As such, Congress clearly contemplated that *all* activities undertaken in petroleum refining would generate qualifying income, provided that such activities do not result in plastic or similar product.

Finally, the Proposed Regulations do not specifically address toll processing situations in which a refiner is processing feedstock owned by a third party for a fee. Regardless of who owns the hydrocarbons being processed or refined, the activities conducted are the same. Accordingly, the final regulations should be clear that refining a natural resource generates qualifying income without regarding to whether a refiner is processing its own feedstock or that of a third party.

C. The Proposed Regulations’ emphasis on fuels to the detriment other products of crude oil refining is a radical change in the interpretation of the statute.

The Proposed Regulations provide for preferential treatment for crude oil refining processes that result in fuel production. As currently drafted, certain processes, such as hydrotreating, that take place within a crude oil refinery would not be considered Qualifying Activities unless the products of such processes are used in fuel production. Further, natural gas-to-liquids processes other than integrated methane-to-gasoline processes – even if such processes result in other fuels - would not be treated as Qualifying Activities.

The Preamble to the Proposed Regulations indicates that the Service intended that such Proposed Regulations provide an exclusive list of qualifying activities, making it clear that the Service intended that processes that generate fuel products be treated differently than other refining processes. This fuel preference included in the Proposed Regulations is a radical change in interpretation of the statute. In the more than 27 years since Section 7704(d) was enacted there has not once been any suggestion of a preference for refining processes that result in fuel over other refined products such as lubricants, waxes, solvents and white oils.

As discussed above, Section 7704 focuses not on output, but on the input – a natural resource. Congress made no distinction between the products of different types of refinery processes in the legislative history of Section 7704, and included non-fuel products in its list of “oil, gas, and products thereof.” In fact, many of the references to fuels in the legislative history related to reservations Congress



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had regarding the scope of fuel related activities, as it generally chose to prohibit the retail transportation sale of fuels. Had Congress intended to limit Section 7704 Qualifying Activities to fuel production, it could easily have done so in the statute.

Even guidance from the Service regarding Section 7704 in the 27 years since the enactment of the statute failed indicate a preference for fuels; rather, the Service appears to have treated all refinery products equally, giving numerous rulings regarding processing of oil and gas into products other than fuels. The only limitation on refining and processing is with respect to activities that create products that are “produced by additional processing *beyond* that of petroleum refineries” such as processes that result in finished products that are plastic or equivalent to plastic.

Every product produced in a Calumet refinery is already in each barrel of crude oil. There is no plastic, the creation of which requires a number of non-refinery processes, in a barrel of crude oil. Our products simply must be recovered through purification or extraction via the traditional refinery processes discussed herein. Introducing a preference for fuels to Section 7704 without a corresponding statutory change is unprecedented and inappropriate. The final regulations should reflect that purifying products such as a lubricating oils, waxes, solvents, and white oils found in crude oil is no less qualifying than the production of fuel.

VI. Marketing includes Packaging Activities, Income from RINs, and Hedging Income

The term “marketing” is not defined in Section 7704 or the Treasury Regulations thereunder. The Proposed Regulations define marketing in Section 1.7704-4(c)(7) as activities “performed to facilitate the sale of minerals or natural resources and products” produce via qualifying refining, processing, and mining or production activities, including “blending additives into fuels.” Marketing does not, however, include sales made in quantities directly to end users, such as “operation of gasoline service stations, home heating oil delivery services, and local gas delivery services.”

A. Packaging products for sale to wholesalers should be expressly listed as a marketing activity.

Calumet’s business activities include packaging certain of its refinery products in containers (including 275 gallon totes, 55 gallon drums, 10 gallon pails, 5 gallon buckets and quart bottles) primarily for bulk sale to wholesalers, who then distribute and re-sell such products to the retail market. Such activities are common among crude oil refineries.

Packaging the products of Qualifying Activities in containers necessary for transport and conveyance should be considered a marketing activity where (i) the product is sold in large quantities to a re-seller and (ii) the taxpayer is not facilitating delivery of the product to the retail market. Calumet is generally not in the business of selling its products to end users at the retail level.⁸ If Calumet were to sell

⁸ To the extent Calumet has any retail level sales, Calumet treats such income as non-qualifying income.



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the same products to a reseller prior to the packaging of the product, such sales would be considered the wholesale sale of refinery products. Whether a product is resold in containers acceptable for the retail market or in barrels should not be determinative of whether a sales activity is considered “marketing” for purposes of Section 7704. Such activities are simply “performed to facilitate the sale of minerals or natural resources and products.” Accordingly, packaging activities such as Calumet’s should be treated as marketing activities pursuant to the final regulations.

B. Any income resulting from the use of RINs should be treated as qualifying income.

The Proposed Regulations include blending additives into fuels in the definition of “marketing.” The Environmental Protection Agency (“**EPA**”) requires refiners, including Calumet, to blend renewable fuels into the petroleum fuels it produced and sells in the United States. Calumet may meet these requirements by blending the necessary volumes of renewable transportation fuels produced either by Calumet or purchased from third parties. In order to ensure compliance with these standards, the EPA developed RINs.

RINs are the instruments through which refiners and blenders must demonstrate to the EPA that they have met their annual renewable fuel volume obligations. To the extent that refiners will not or cannot blend renewable fuels into the products they produce in the quantities required to satisfy their obligations under the EPA’s program, those refiners must purchase RINs, to maintain compliance. To the extent that a refiner exceeds the minimum volumetric requirements for blending of renewable transportation fuels, the refiner generates its own RINs for which the refiner has the option of retaining the RINs for current or future compliance or selling those RINs on the open market.

From time to time and depending on fuel market conditions and administrative action by the EPA, Calumet may either be in need of RINs or may hold excess RINs that can be sold to third parties at the prevailing market rate. As such, Calumet is exposed to market risk related to the volatility of RIN pricing, and may earn significant income relating to the sale of RINs. This income is not the result of a separate business activity. Calumet does not engage in speculative trading of RINs. The RINs are merely purchased and sold in the ordinary course of Calumet’s crude oil refining business and its compliance with applicable EPA regulations.

RINs are not directly addressed in the Proposed Regulations. However, the use of RINs is required by the EPA in order to engage in the fuels sales and blending business. Therefore, non-speculative RIN-related activities are “performed to facilitate [the] sale” of fuel products produced by qualifying activities, and gross income derived from such RINs is a direct consequence of qualifying refining or marketing activities. The final regulations should clarify that income from RINs is qualifying income within the meaning of Section 7704.



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C. Income resulting from hedging activities should be treated as qualifying income.

Calumet and other publicly traded partnerships regularly enter into “hedging” transactions as part of their ordinary business activities. A hedging transaction is generally defined as a transaction entered into primarily to manage the risk of changes in the market price of ordinary property held or to be held by a concerned party.

Hedging needs of publicly traded partnerships vary based on their particular businesses. For example, publicly traded partnerships will generally enter into hedges for two reasons: (i) to manage the price risk associated with a particular commodity or (ii) to hedge interest rate risk. Refiners like Calumet are likely to enter into hedging transactions with respect to both their feedstocks and their refinery products. Refiners face price risk on two fronts: the purchase price of the crude oil and the sales price of their products. The difference between the value of the crude oil feedstock and the products to be produced from such feedstock is referred to as the “crack spread.” Accordingly, refiners will frequently hedge both the price of feedstocks and the products thereof as a method of protecting their anticipated crack spread.

While gross income from derivative financial instruments is not income from the sale of a mineral or natural resource, publicly traded partnerships and the Service have long treated hedging income associated with commodity and interest rate risk as qualifying income. Treasury Regulation Section 1.7704-3 provides that income from notional principal contracts (“NPCs”) is qualifying income if the property, income or cash flow that measures the amounts to which the partnership is entitled under the NPC would give rise to qualifying income if held or received directly by the partnership. Other “substantially similar” income from ordinary and routine investments, to the extent determined by the Commissioner, is also treated as qualifying income. NPCs are defined in Section 1.446-3(c)(1)(i) of the Code to include commodity swaps, though not futures contracts, forward contracts and options. Thus, only some income from commodity hedging (i.e., commodity swaps) is expressly addressed by current Treasury Regulations under Section 7704 of the Code.

Consistent with the principles of Treasury Regulation Section 1.7704-3, Section 1221(a)(7) of the Code and the regulations thereunder treat gain or loss from a “hedging transaction” as ordinary income if the transaction is clearly identified as a hedging transaction at the time the taxpayer enters into the transaction. This tax treatment reflects that hedging transactions are entered into in the ordinary course of a taxpayer’s trade or business to manage income risks associated with ordinary assets. Thus, for example, a publicly traded partnership that enters into a transaction to hedge an inventory of refined products that generate qualifying income is merely “locking in” the amount of the income from that qualifying activity.

Further, the Service has concluded in two private letter rulings that gross income from natural resource commodity hedging transactions described in Treasury Regulation Section 1.1221-2 is qualifying income. Private letter ruling 96-19-011 concluded that hedging transactions produce qualifying income



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if the activity is a true hedge with respect to the partnership's inventory of oil and gas rather than speculative hedging activity.⁹ The Service determined that the taxpayer's hedging activity was qualifying because it was "integral to a qualifying activity." Similarly, the Service concluded in private letter ruling 93-39-014 that income from the sale of natural gas futures contracts is qualifying income where the contracts were obtained by the partnership to secure the price of the natural gas necessary for fertilizer production.¹⁰ While these rulings predate Treasury Regulations Section 1.7704-3 and therefore do not expressly rely on the Commissioner's authority under such section to treat income from ordinary and routine investments that is substantially similar to income from NPCs as qualifying income, the rulings rely on the same principles to conclude that hedging transactions generated qualifying income where the commodity hedges were "ordinary and routine investments" that were integral to a qualifying activity.

Based on the foregoing, income from commodity hedges entered into to mitigate price risk with respect to qualifying activities should be treated as qualifying income, provided that such hedges are appropriately identified and treated as hedging transactions under Treasury Regulation section 1.1221-2. Nothing in the proposed regulations specifically addresses hedging activities, despite the fact that the Service and publicly traded partnership currently treat commodity hedging and interest rate hedging as qualifying activities. In failing to address hedging, the Proposed Regulations create unnecessary uncertainty because they attempt to provide an exclusive list of qualifying activities under the natural resources exception. The Proposed Regulations should therefore clarify that gross income from commodity hedging to reduce risk with respect to a qualifying activity and interest rate hedging to reduce risk with respect to partnership indebtedness is qualifying income.

VII. Blending Activities Include Non-Fuel Products

Blending activities include blending for fuels, lubricants, waxes, and other refinery products. In general, blending is the mixture of various liquid products, including intermediate, semi-finished, and finished refined products, to produce a more specific finished product with certain desired characteristics (e.g., fuels of various grades, or lubricating oils of various weights and grades and other properties to meet product specifications). Blending also includes the incorporation of additives into hydrocarbon-based products to meet desired product specifications or regulatory requirements, including improved octane in gasoline, higher viscosity index, increased resistance to oxidation, reduced friction and renewable fuel requirements.

The current draft of the Proposed Regulations primarily addresses blending activities in Section 1.7704-4(c)(7), in the context of the definition of "marketing" of natural resources. The Proposed Regulations state that a blending activity "constitutes marketing if it is performed to facilitate sale of minerals or natural resources and products produced under paragraph (c)(4) or (5) of this section, including blending additives into fuels." The Preamble to the Proposed Regulations states that this definition of

⁹ May 10, 1996.

¹⁰ June 28, 1993.



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marketing is intended to “include some additive blending into fuels provided to a customer’s specification.” Yet, the definition of “processing and refining” also contemplates blending activities, stating that petroleum processing also includes the chemical conversion of physically separated components of crude oil “if one or more of the products of the conversion are recombined with other physically separated components of crude oil in a manner that is necessary to the cost effective production of gasoline and other fuels.”¹¹ We believe that treating only fuel blending activities as qualifying activities is inconsistent with the statute, its legislative history, and the Service’s own guidance.

The Service has issued over 15 private letter rulings to taxpayers with respect to blending activities, 10 of which (including the Rulings) specifically address lubricants, since 2003.¹² As noted above, our refinery activities include blending additives and refinery products into refined petroleum distillates, lube oil base stocks, and wax stocks to create specialty lubricants and waxes that meet customer specifications.

In order to produce its refined products, Calumet refines or purchases additives from third parties. While the majority of the additives are petroleum based, they may also contain limited amounts of compounds such as zinc, phosphorous, and calcium. Non-petroleum based components generally comprise less than 10 percent of the total lubricant or wax blend, though may be higher depending on product specifications. After blending, we package the products for bulk sale to wholesalers. Calumet’s lubricant and wax blending activities constitute processing and refining activities, as confirmed by the Rulings.

There is no practical difference between blending ethanol, biodiesel, or other additives into fuels and blending additives into lubricating oils and waxes. Each activity involves blending additives into a direct derivative of crude oil refining; they are substantively identical. As neither the statute nor the legislative history distinguish between fuels and other products of crude oil refining, the introduction of

¹¹ Prop. Reg. § 1.7704-4(c)(5)(iii)(A)(2).

¹² Priv. Ltr. Rul. 2014-03-008 (September 13, 2013) (blending refined petroleum distillates and lube oil base stocks with a “soap” or “thickener” to create the desired lubricant-greases and packaging and sale of lubricant-greases); Priv. Ltr. Rul. 2013-01-010 (September 28, 2012) (blending, processing, packaging, marketing, and distribution of [redacted] lubricants that are a blend of hydrocarbon-based feedstocks and small amounts of additives); Priv. Ltr. Rul. 2012-26-018 (December 7, 2011) (blending and sale of private label automotive lubricants, as well as the sale of branded lubricants and related products, to automotive dealerships, “quick lube” stores and commercial and industrial end users); Priv. Ltr. Rul. 2011-29-028 (April 7, 2011) (purchasing refined petroleum distillates and lube oil base stocks from crude oil refineries, blending and processing the base stocks (in some cases adding non-petroleum additives of less than a% of the total lube blend) and packaging and marketing the resulting specialty lubricants to wholesale distributors); Priv. Ltr. Rul. 2008-48-018 (August 26, 2008) (refining and processing crude oil into a wide variety of customized lubricating oils, solvents and waxes and packaging and marketing the refined and processed products); Priv. Ltr. Rul. 2007-18-010 (January 19, 2007) (purchasing highly refined petroleum base oils from refineries, blending the petroleum base oil with latest additive technology to make it more suitable for its intended use as lubricating oil, packaging the lubricating oil and selling lubricating oil to retailers who then sell the product through their own retailers or in bulk to wholesale distributors); Priv. Ltr. Rul. 2007-18-009 (January 19, 2007) (same); Priv. Ltr. Rul. 2007-18-007 (January 19, 2007) (same); Priv. Ltr. Rul. 2007-18-006 (January 19, 2007) (same); Priv. Ltr. Rul. 2007-18-005 (January 19, 2007) (same).



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such a distinction in the Proposed Regulations is inappropriate. Accordingly, the Proposed Regulations should clarify that blending activities involving any “product thereof” of crude oil and natural gas refining and processing activities are qualifying activities for purposes of Section 7704(d)(1)(E).

VIII. Conclusion

The final regulations issued under Section 7704(d)(1)(E) should properly reflect that all crude oil refining and processing activities were intended to generate qualifying income pursuant to such Section. Further, clarification should be provided with respect to the marketing of products produced via crude oil refining, including with respect to blending and packaging, hedging, and renewable identification numbers. We appreciate the opportunity to provide comments to the Proposed Regulations and are happy to provide additional information upon request.

Sincerely,

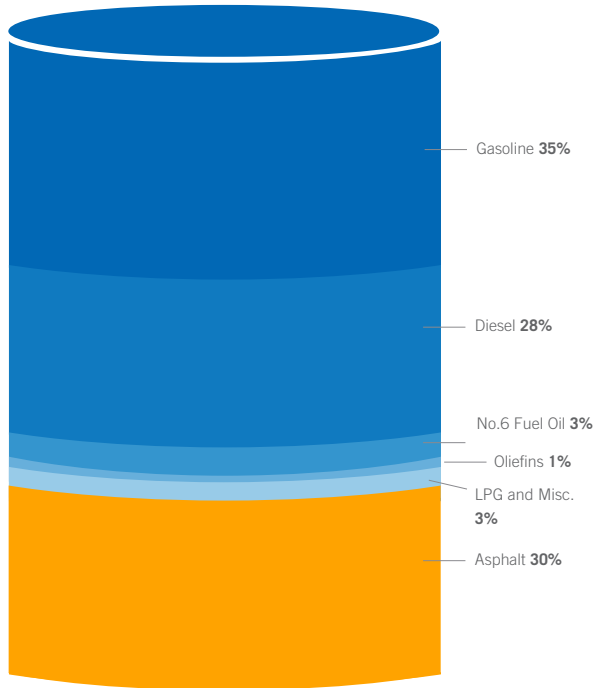
A handwritten signature in blue ink, appearing to read "John R. Krutz". The signature is fluid and cursive, with the first letters of each word being capitalized and prominent.

John R. Krutz

Vice President of Finance
Calumet Specialty Products Partners, L.P.

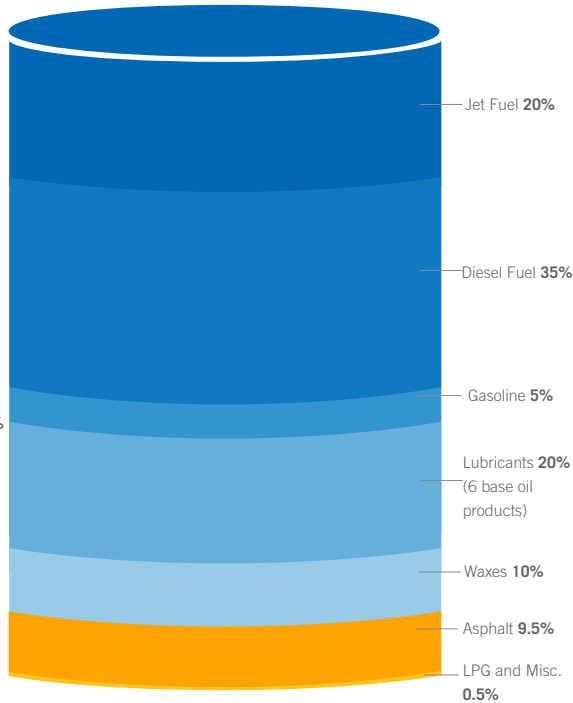
What's in a Barrel of Calumet Unique Crudes (Percent Yield)

CRUDE TYPE: Canadian Heavy Sour Crude
CALUMET FACILITY: Superior, WI refinery

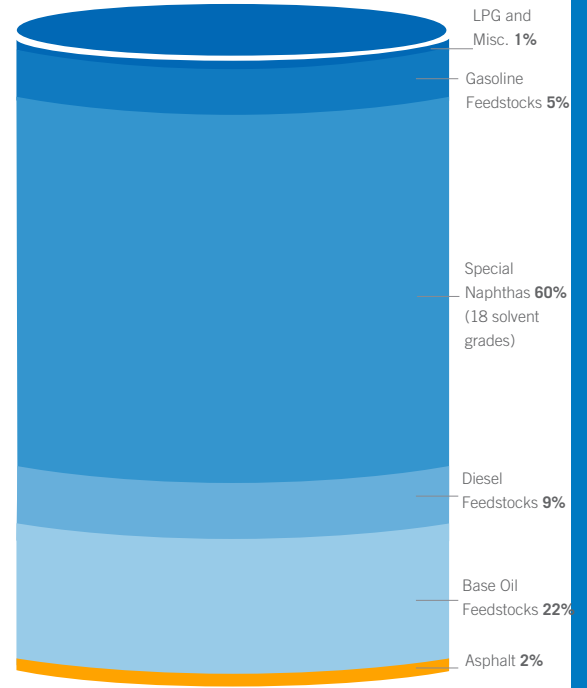


PROCESSING GAIN: 3%

CRUDE TYPE: Utah Yellow Wax Crude
CALUMET FACILITY: Shreveport, LA refinery



CRUDE TYPE: Condensate Crude
CALUMET FACILITY: Cotton Valley, LA refinery

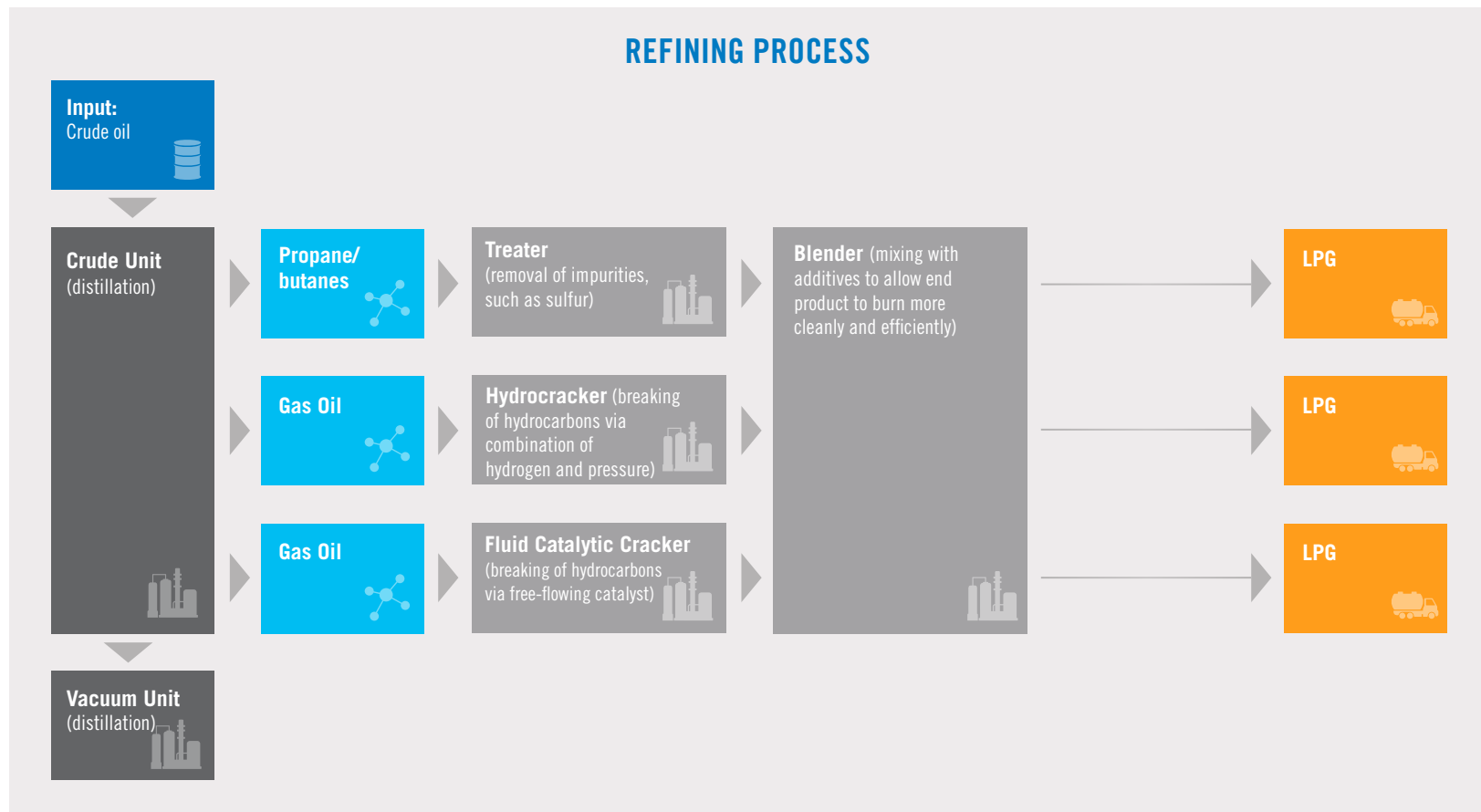


Refined Products

- Liquefied Petroleum Gases
- Diesel
- Gasoline
- Kerosene – including Kerosene Solvents
- Jet Fuel
- Naphtha
- Heavy Fuel Oils
- Asphalt
- Base Oils – Lubricants
- Aliphatic Solvents – Special Naphthas
- Waxes
- Petrolatums
- Formulated Lubricants
- Grease
- White Oils
- Esters

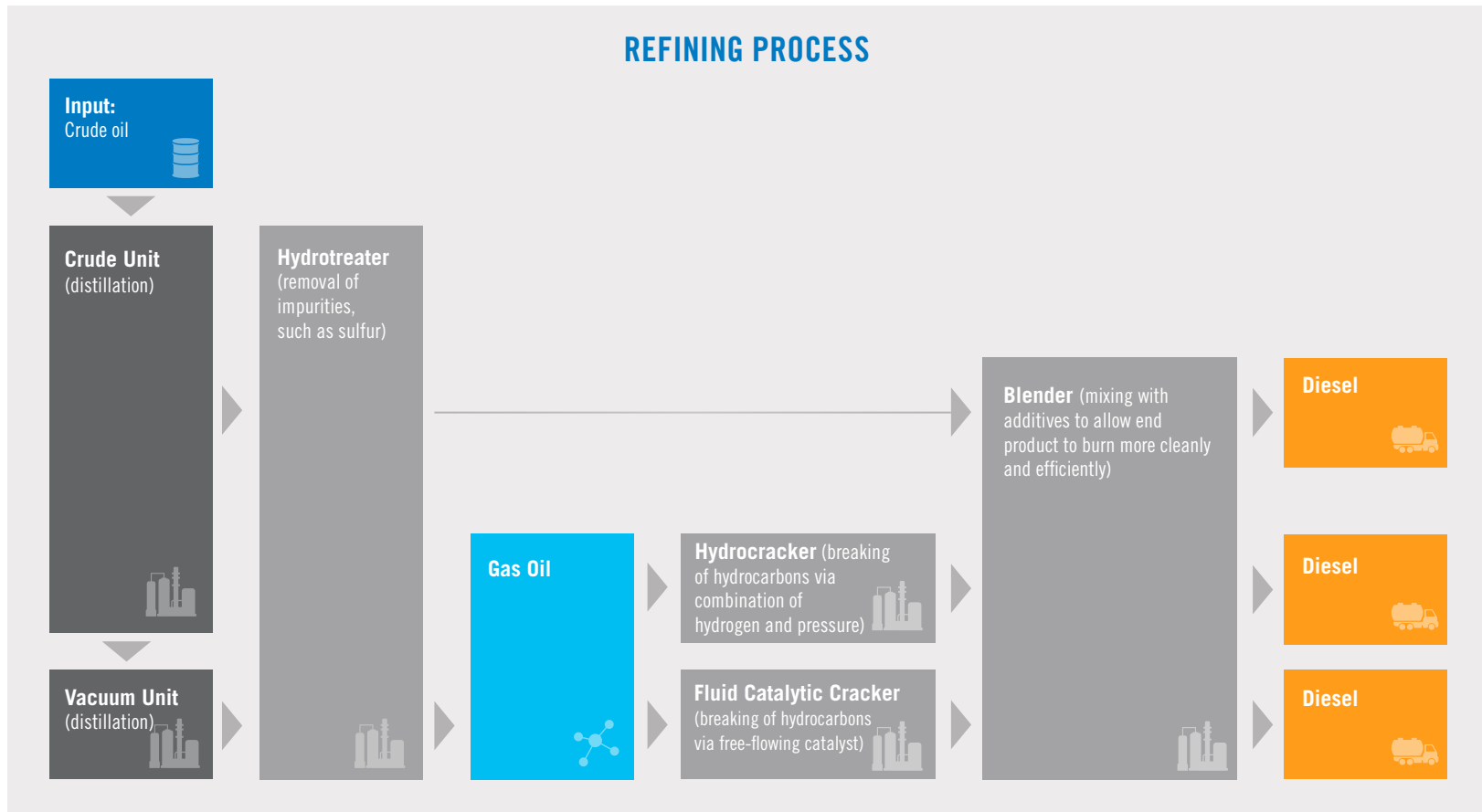
Liquefied Petroleum Gases (LPG)

- Liquefied petroleum gases are primarily propane and butanes, which are used as fuels and feeds to other refining processes such as alkylation units
- LPG comes directly from crude oil and is also produced in many of the gasoline conversion units such as the fluid catalytic cracker, where propane, butane and olefins are made



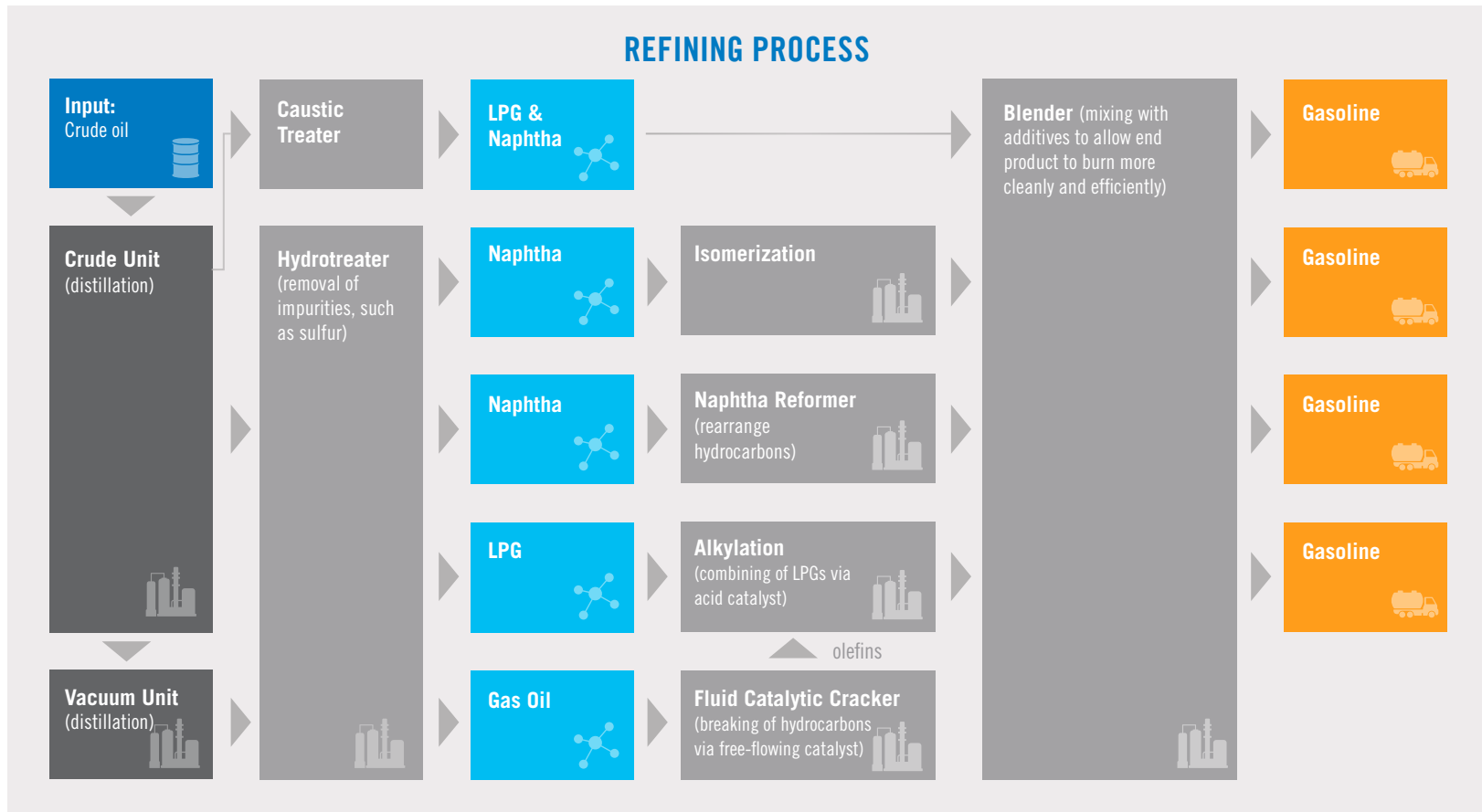
Diesel

- Distillate of crude oil with a greater boiling point and specific gravity than gasoline or jet fuel
- Used for diesel engines in trucks, cars, buses, other mechanical equipment and heating oil
- Diesel is either produced as a natural product of crude oil or as a converted product in hydrocracking or fluid catalytic cracking operations; some smaller amounts of diesel are produced from purification steps that are part of specialty lubes processes



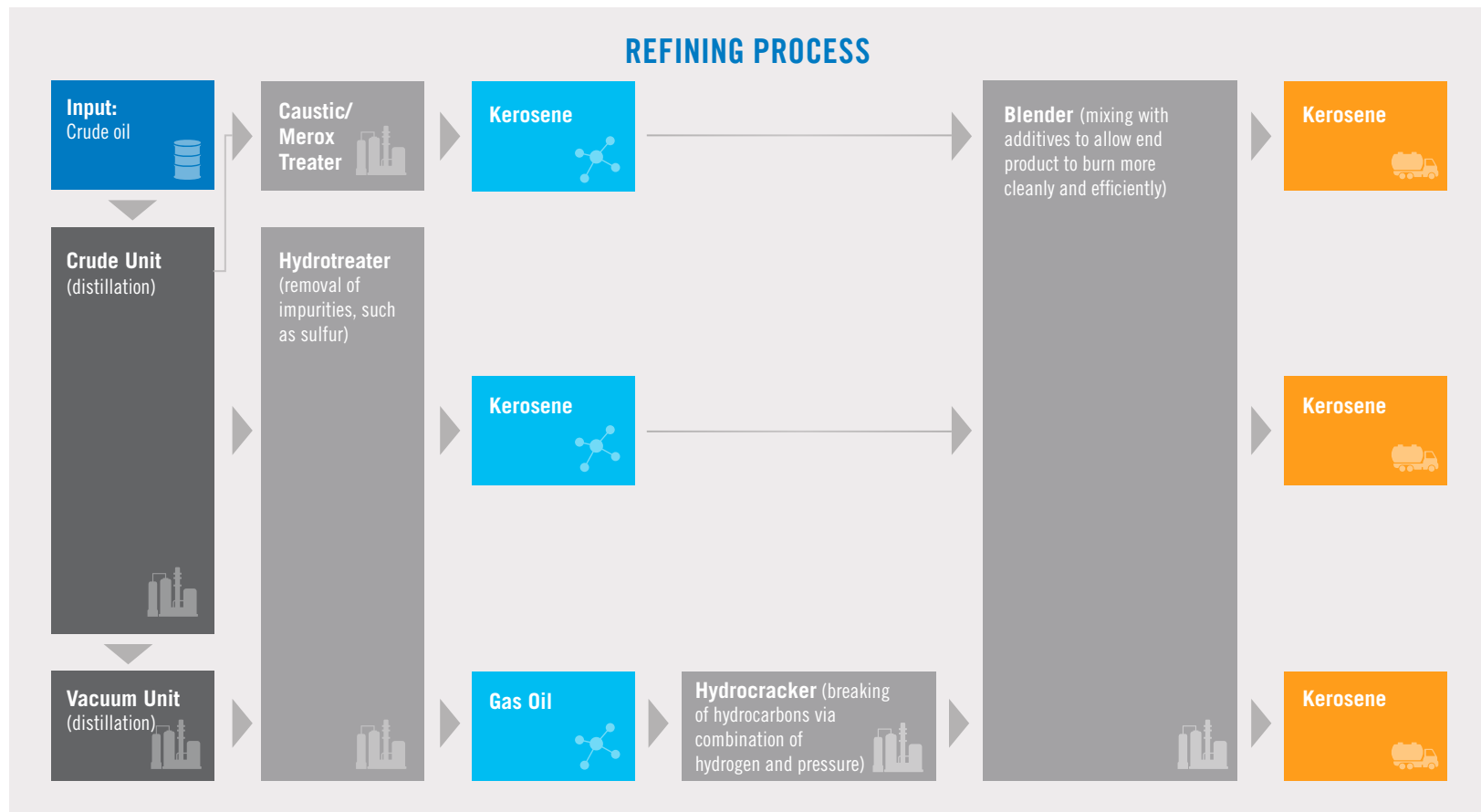
Gasoline

- Transparent, petroleum-derived liquid obtained during the distillation process of crude oil, as well as conversion processes such as isomerization, hydrotreating, re-forming, fluid catalytic cracking, hydrocracking, alkylation, etc.
- Used as fuel for internal combustion engines



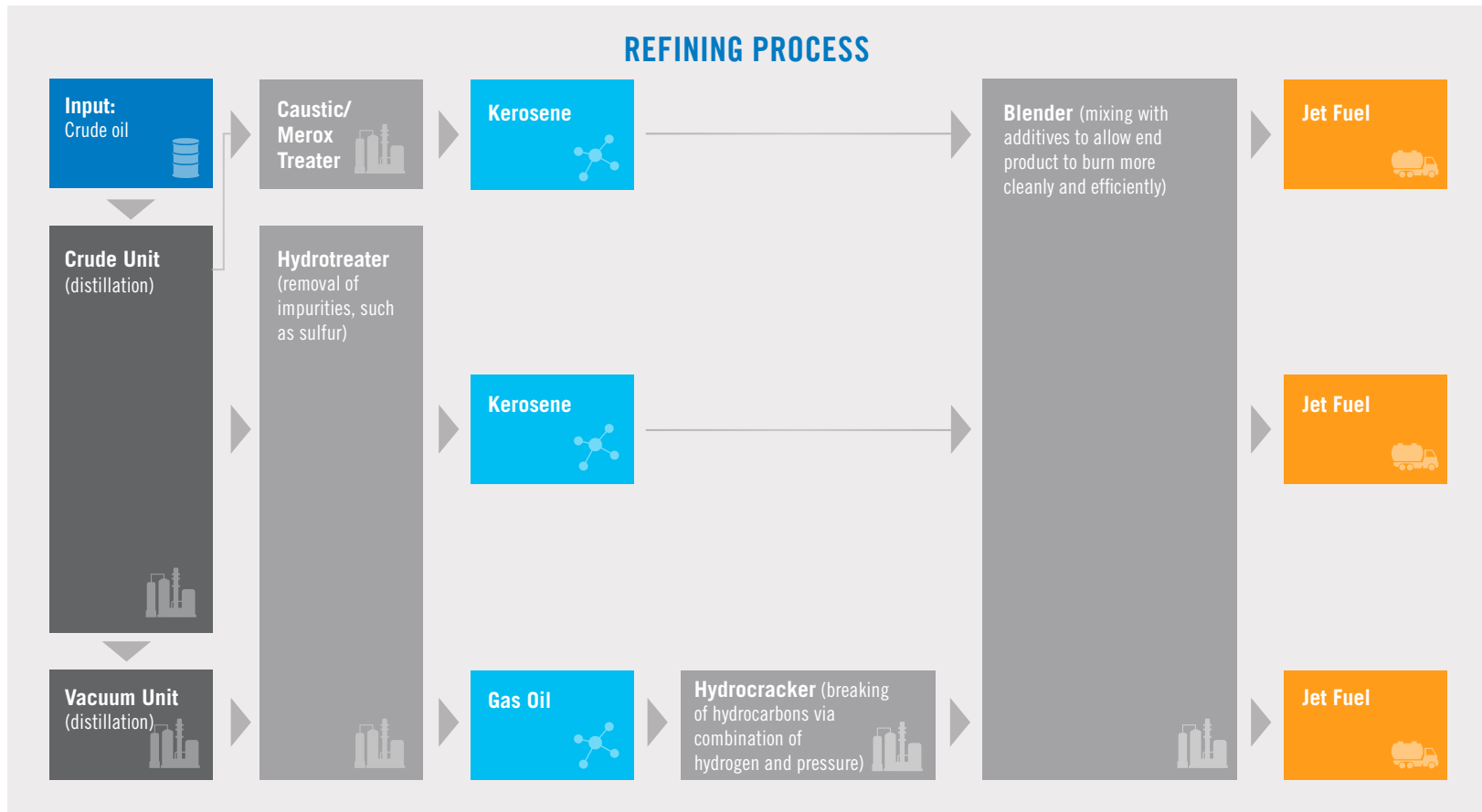
Kerosene

- Combustible hydrocarbon light fuel oil obtained by distilling crude oil with some hydrotreating or by hydrocracking gas oil
- Used especially in jet engines, tractors, domestic heaters and lamps, and for further refining into aliphatic solvents



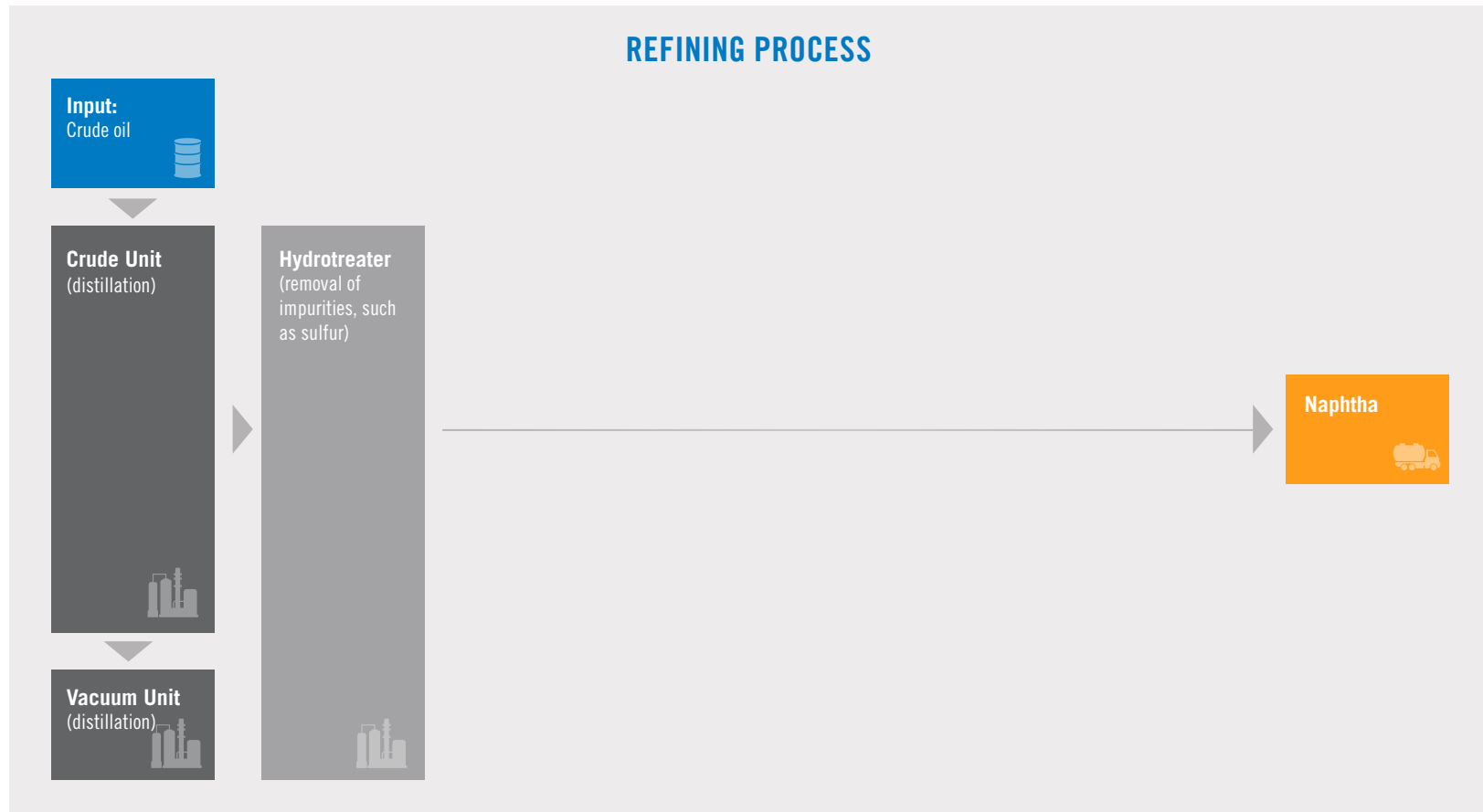
Jet Fuel

- Similar to kerosene, with tighter specifications to ensure clean and efficient burning
- Used especially in jet engines and specialty turbines



Naphtha

- Light intermediate produced from the distillation of crude oil
- Most often used as a starting material for gasoline, but can also be used to make aliphatic solvents or diluent for transportation of heavy crude and bitumen



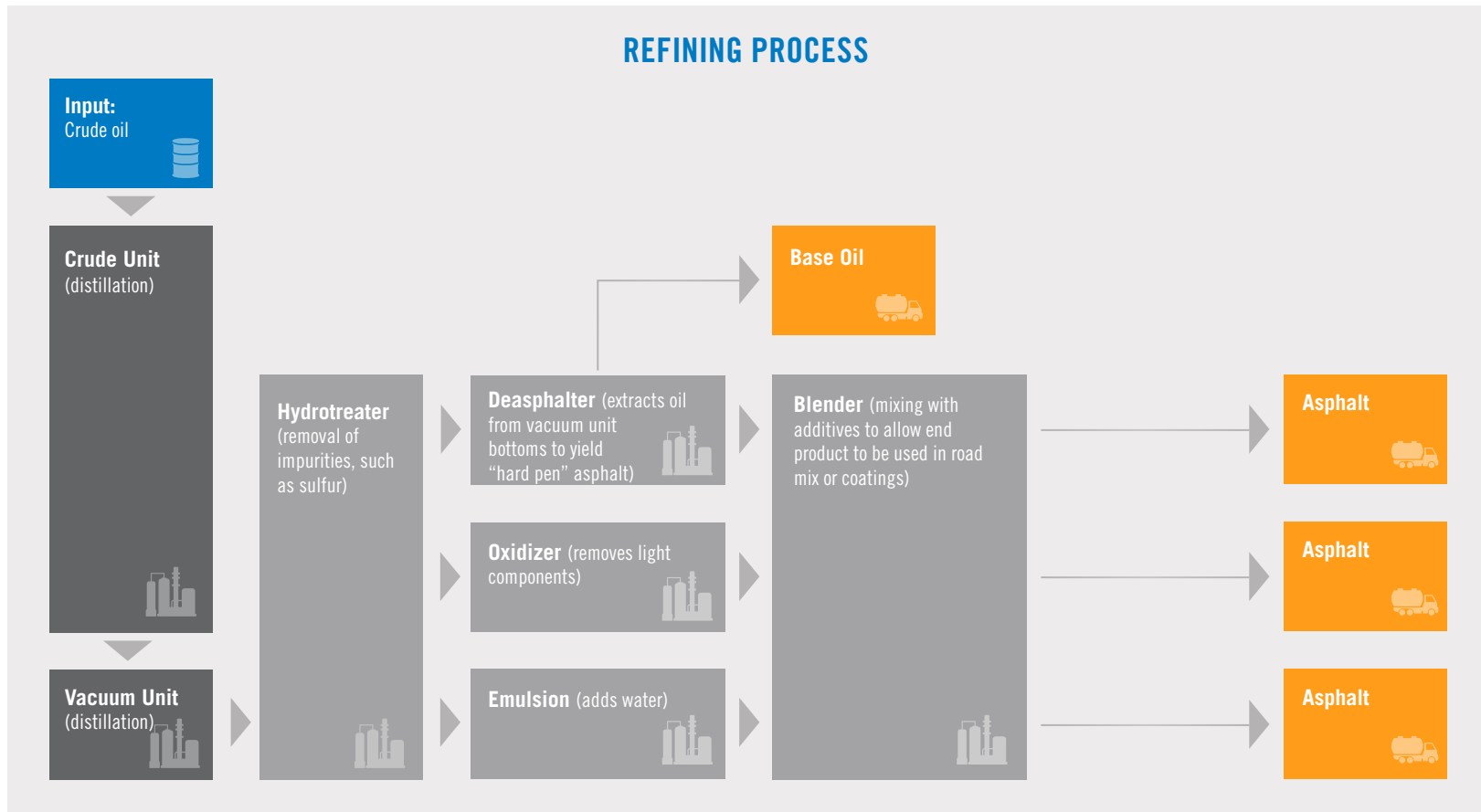
Heavy Fuel Oils

- Residual oil remaining from the distillation of crude oil
- Used for industrial fuel, marine fuel and coatings but can be converted via delayed coker or fluid catalytic cracker to lighter products



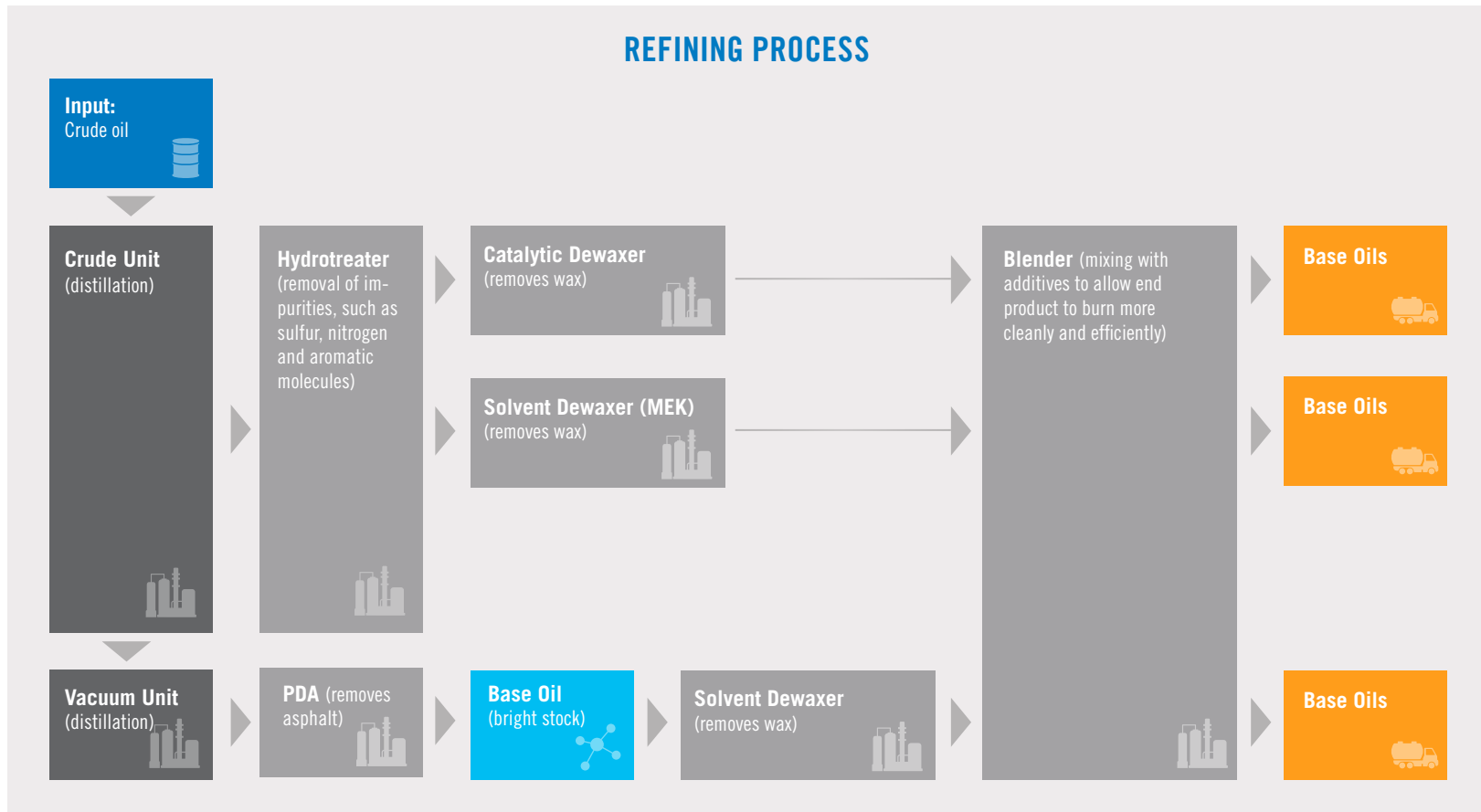
Asphalt

- Residual oil remaining from the distillation of crude oil
- Used in a wide variety of applications depending on the final blending composition; it is a basic building component of roads and parking lots when mixed with aggregate such as stone, gravel or rock, but can also be used to make specialty coatings, finishes and roofing materials



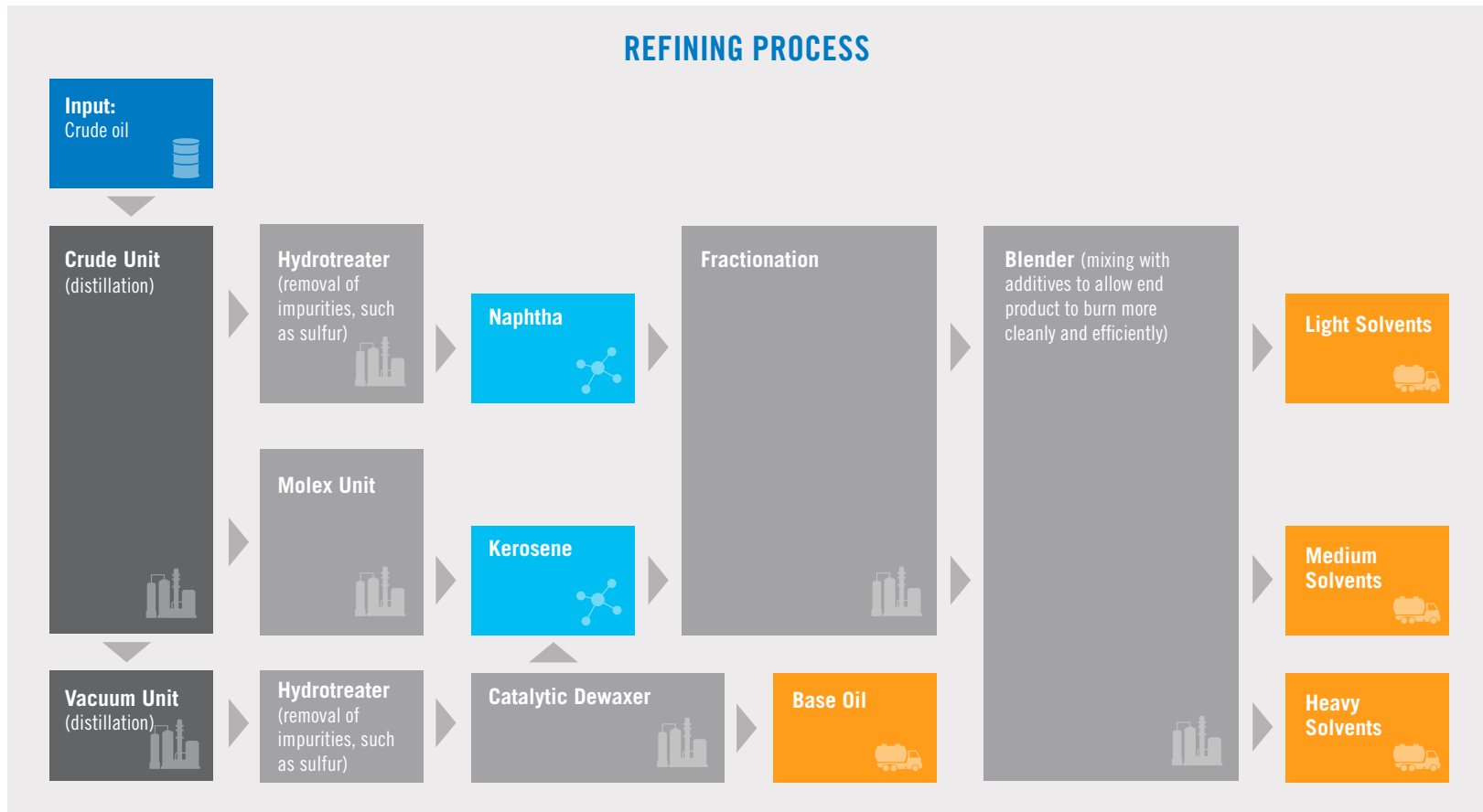
Base Oils

- Distillate of crude oil produced by a fine fractionation step and multiple purification steps to remove impurities such as wax, nitrogen or sulfur compounds, and heavy aromatic oils
- Highly refined products including process oils (such as rubber oils), lubricants, waxes and greases



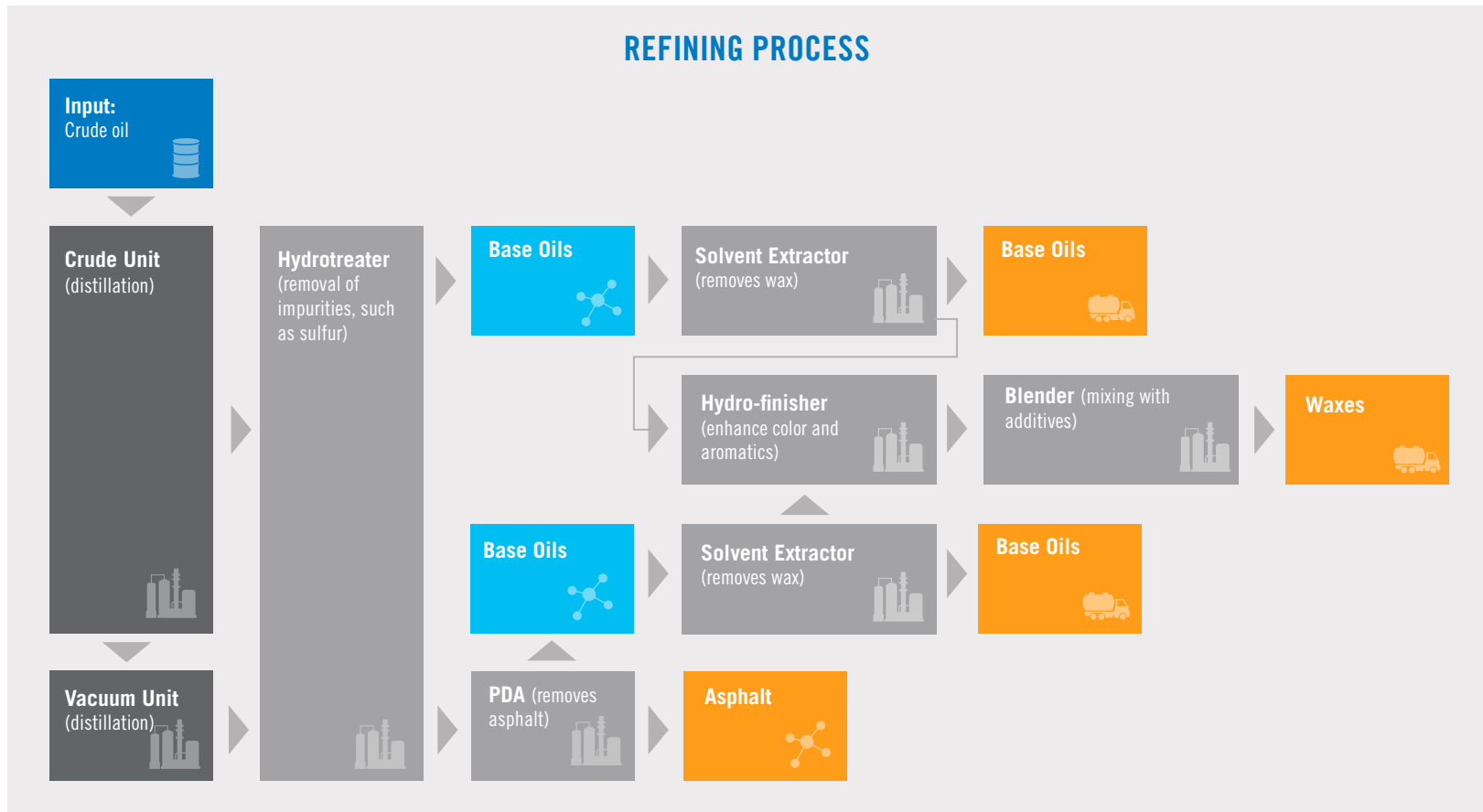
Aliphatic Solvents

- Highly refined petroleum product similar to naphtha, kerosene or diesel; highly purified via a series of fractionation and treatment steps to remove impurities such as nitrogen, sulfur and aromatics
- Used in many industries such as paints, agriculture, printing, domestic cleaning, consumer products, extraction processes, pesticide and agricultural formulations



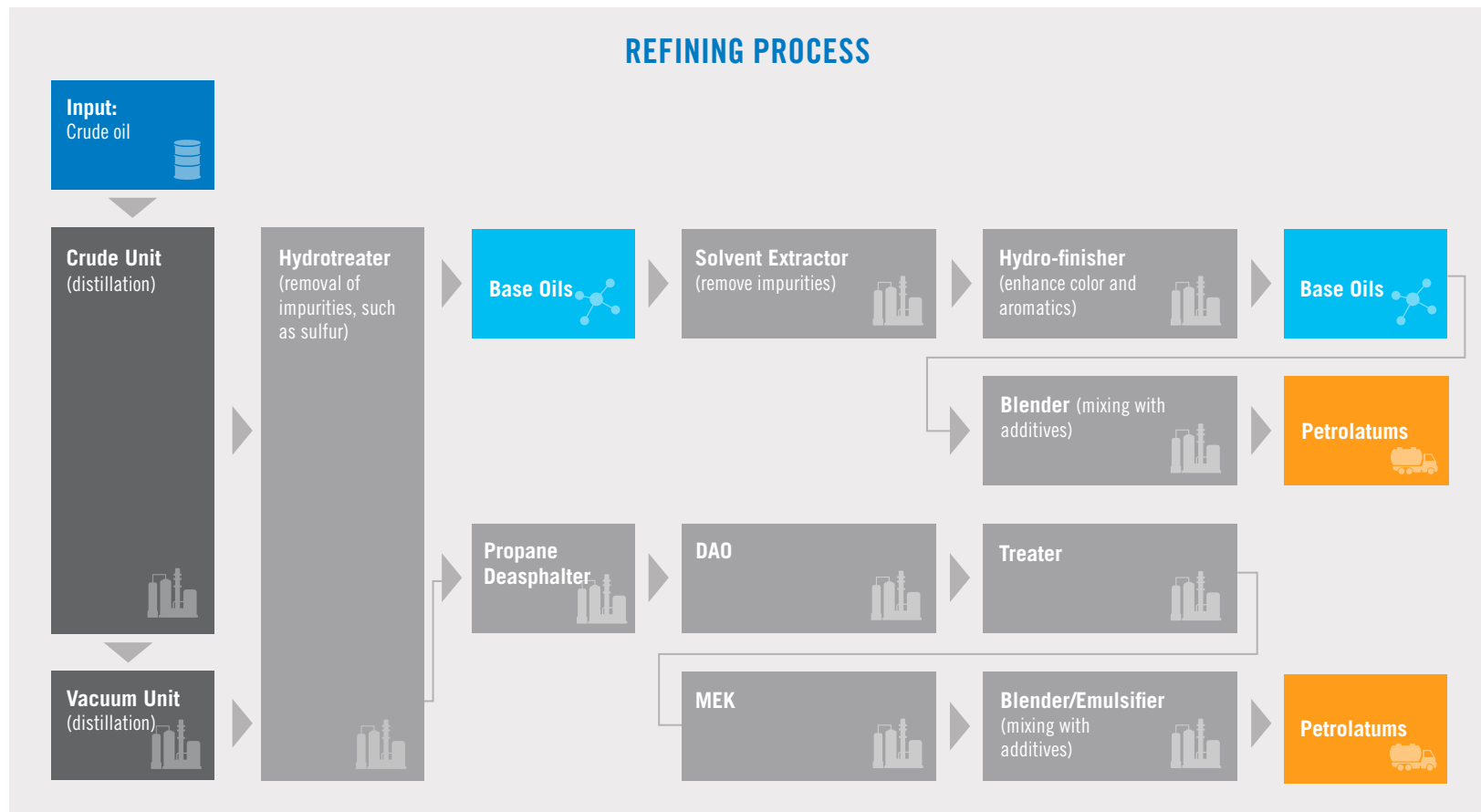
Waxes

- Class of primarily straight-chain, medium-to-heavy hydrocarbons called paraffins that are solid at ambient temperatures
- Waxes, like other specialty products, are highly refined products derived from crude oil or crude oil products; they are distilled, solvent extracted, crystallized and hydrotreated to produce a very pure class of hydrocarbons
- Used in candles, adhesives, crayons, skin and hair care, cosmetics, pharmaceutical formulations and various food applications



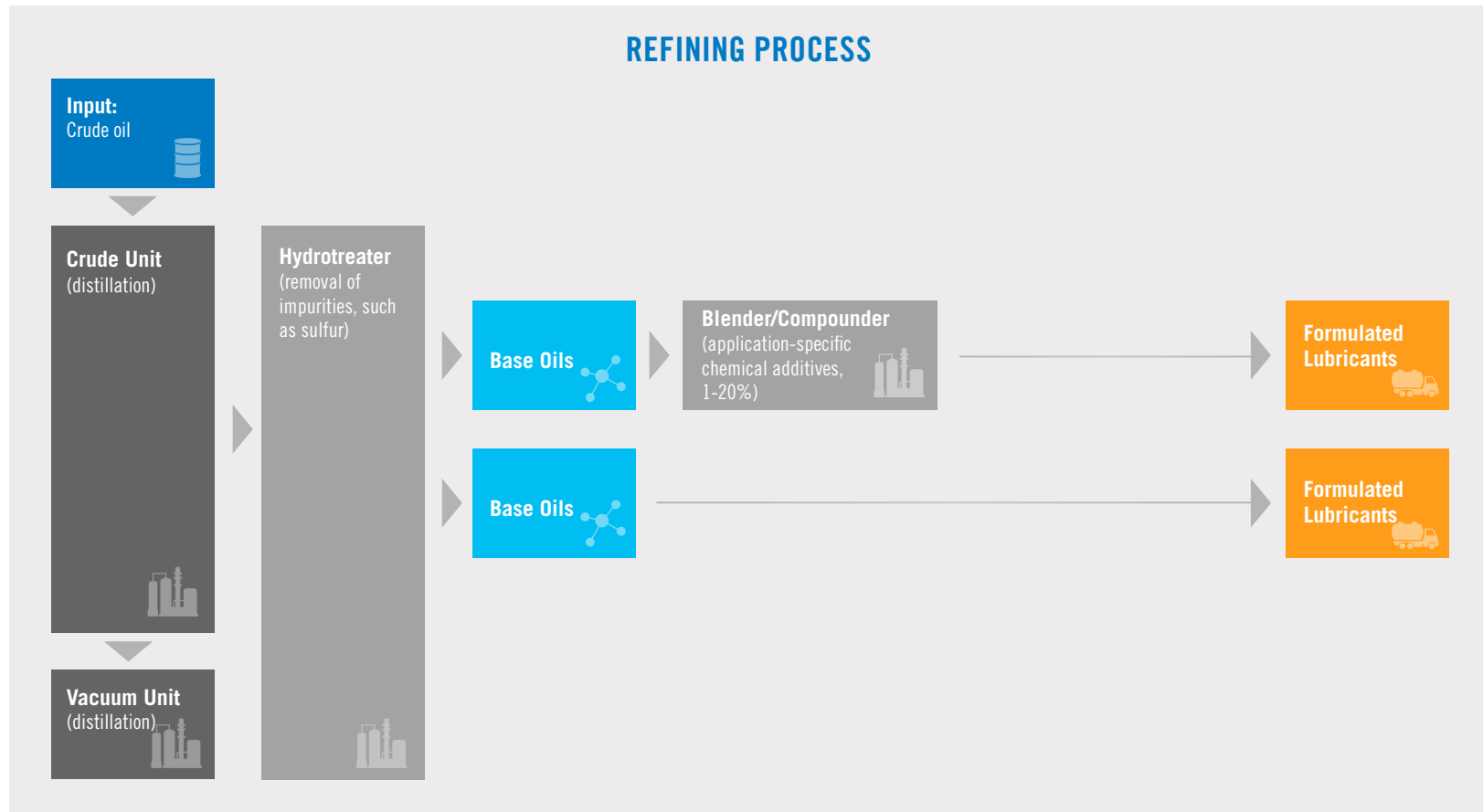
Petrolatums

- Highly refined, complex mixture of hydrotreated white oils and waxes that are further modified to meet customer specifications
- Wide variety of applications in food, cosmetic, pharmaceutical formulations
- One of the most refined products in the refinery industry



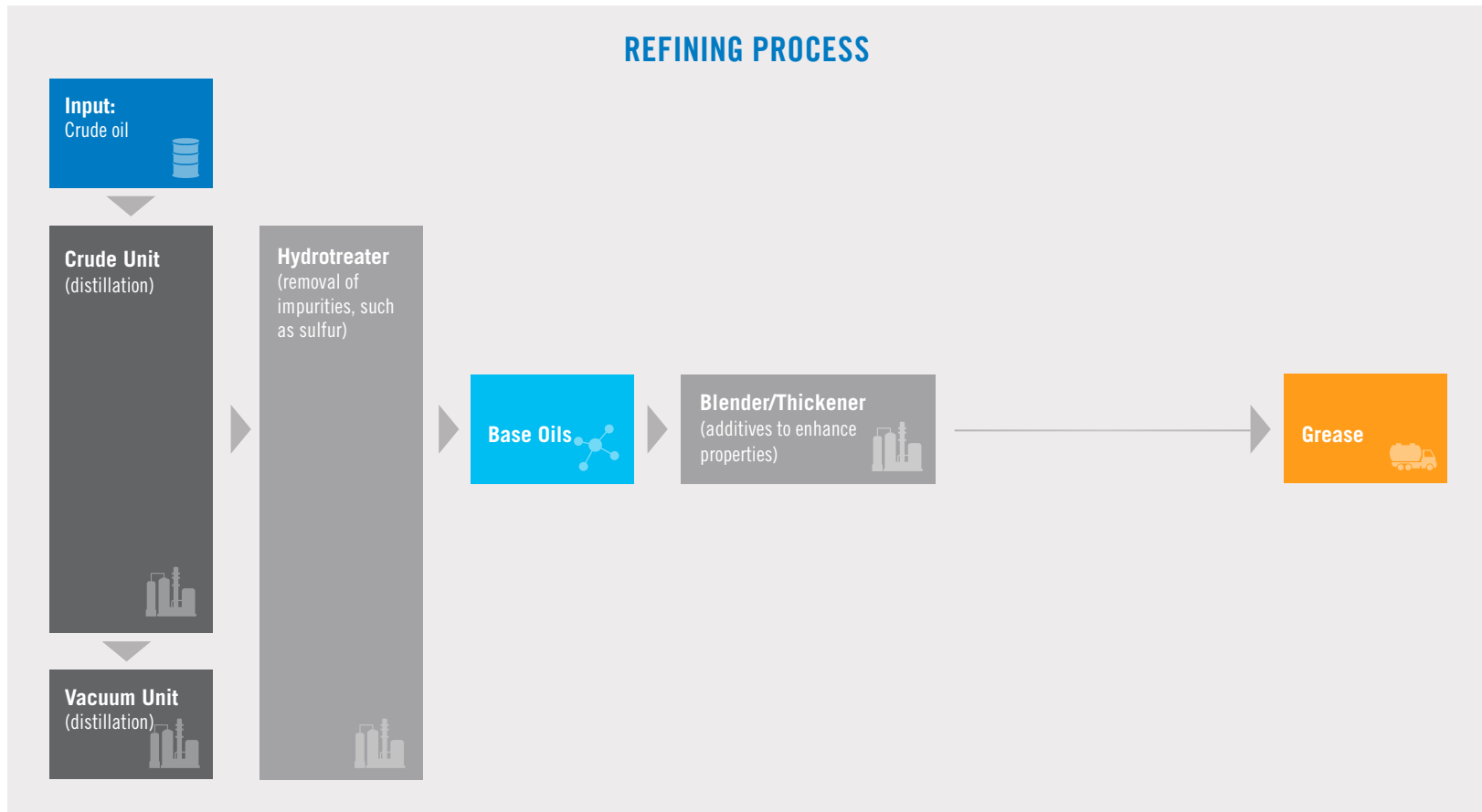
Formulated Lubricants

- Base oils plus additives that enhance, add or suppress properties depending on the application
- Used in a wide variety of applications, including passenger car motor oils, metalworking fluids, hydraulic oils and gear oils and grease



Grease

- Thick, oily lubricant with base oil as its source
- Used as an industrial and consumer lubricant



White Oils

- Wide range of highly refined petroleum products that are distilled from crude oil
- Typically heavier than jet fuel but lighter than heavy residual fuel oil
- White oils are lubricants and process oils that are used in pharmaceuticals, cosmetics, food processing and many other industries

