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Room 5203
Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Re: Comments regarding Section 7704 Proposed Regulations

MarkWest Energy Partners, L.P. (“*MarkWest*”) 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*”) relating to qualifying income from the exploration, development, mining or production, processing, refining, transportation, and marketing of minerals or natural resources.

I. Executive Summary

Our comments focus on (i) the treatment under the Proposed Regulations of the “processing” and “refining” of natural gas and products thereof; (iii) the treatment of income generated from pipeline interconnection agreements; and (ii) the treatment of income earned for operating and managing qualifying assets.

Perhaps the most striking error in the Proposed Regulations is their misapplication of the “refining” and “processing” activities to natural gas and natural gas liquids. The Proposed Regulations adopt an unnecessarily narrow definition of processing and refining and unnaturally apply the terms differently to crude oil and natural gas. Despite the fact that natural gas and natural gas liquids (“*NGLs*”) are clearly natural resources for purposes of Section 7704, common refinery processes that generate qualifying income with respect to crude oil would not generate qualifying income when applied to natural gas or NGLs. Such a result is not consistent with the statute and its legislative history.

Further, the Proposed Regulations’ treatment of qualifying income from the construction, operation, and maintenance of pipeline interconnections is unreasonably narrow. While the Proposed Regulations permit the construction of interconnects to

producers and refiners, the rules fail to take into account the commercial realities of the pipeline transportation market. The final regulations should not distinguish between identical interconnect agreements without regard to who is paying for the reimbursement or the type of customer requiring pipeline access.

Finally, the Proposed Regulations should be clarified with respect to the treatment of income earned for operating and managing qualifying assets or businesses. There is no statutory or legislative basis for distinguishing between partnerships that perform qualifying operating services utilizing third party assets and those that perform the exact same services using assets to which they have title (or which are under lease). The final regulations should reflect that the determination of whether an activity is qualifying is focused solely on the nature of the activities.

II. MarkWest's Business

MarkWest is a publicly traded limited partnership formed in January 2002. MarkWest is principally engaged in owning and operating midstream services businesses, including an integrated midstream asset network linking producers of natural gas, NGLs, and crude oil in the United States' oil and gas producing regions to national and international markets. Our assets include an extensive pipeline network, gathering systems, natural gas and NGL processing and fractionation facilities, and storage assets.

Our processing and fractionation assets include the Javelina gas processing facility in Corpus Christi, Texas, which treats, processes, and fractionates off-gas from six local crude oil refineries. Javelina includes 142 MMcf per day of cryogenic processing capacity and 29,000 barrels per day of NGL fractionation capacity. Javelina's products include ethane, ethylene, propane, propylene, isobutane, normal butane, butylenes, and pentanes recovered from refinery gases, as well as high-purity hydrogen. Javelina's products are separated out of refinery "off spec" gas streams that would otherwise be burned as fuel. While the recovered gases are valuable and could be separated at the refineries, the capital investment required to duplicate Javelina's separation capabilities would be material and would almost certainly be cost prohibitive, depending on the size of the refineries and the fluctuating value of these products. However, with Javelina, a centralized facility, the gases (including purity ethylene) can be recovered and sold at a price that exceeds the value of their heat content.

We believe the vast majority of our activities constitute qualifying activities under the Proposed Regulations. However, as one of the leading natural gas processors in the midstream space, we routinely evaluate potential natural gas and NGL processing activities to address specific market conditions (*e.g.*, an abundance of natural gas or NGLs in a region without available takeaway capacity or without sufficient demand for the natural gas or NGLs, compelling further processing of the natural gas or NGLs). Many such activities are consistent with Section 7704 of the Code and the legislative history thereto, and have historically been considered as generating qualifying income by the industry, including in

some cases by the Internal Revenue Service (the “*Service*”), but some of these common processing and refining activities would not generate qualifying income pursuant to the current draft of the Proposed Regulations.

Specifically, we urge the Service and the Treasury Department (“*Treasury*”) to adopt definitions for the terms “processing” and “refining” that are consistent with their common meanings and are broad enough to encompass each of the following natural gas or NGL refining and processing activities: (i) the production of methanol from natural gas; (ii) the conversion of isobutane and other NGL components into iso-octane, alkylate, and other motor gasoline blending components; (iii) the conversion of propane into propylene, and (iv) processing ethylene into propylene and/or mixed isobutylene.

A. Methanol from Natural Gas

Methanol plants involve three main sections: the conversion of natural gas into synthesis gas, the reaction of synthesis gas to create methanol, and the purification of the resulting methanol. Synthesis gas is produced from the reaction of oxygen and pre-reformed natural gas at high temperatures in a process known as autothermal reforming. The synthesis gas is then fed through a reactor known as an adiabatic catalyst bed, creating raw methanol comprised of methanol, a small amount of water, dissolved gases, and traces of natural gas byproducts. Finally, the methanol is purified as necessary.

B. Gasoline Blending Component Production from NGLs

The conversion of NGL components into gasoline blending components begins with a feed stream of high-purity NGL component, such as isobutane or normal butane, which is then dehydrogenated in the presence of a catalyst to create butylene and a hydrogen-rich byproduct. The isobutylene product is then sent to an alkylation unit, where the isobutylene is reacted with isobutane to form “C4 alkylate,” a highly desired gasoline blend component for reformulated gasoline grades. Alternately, the isobutylene product from dehydrogenation can be dimerized and then saturated to produce “isooctane,” another high quality gasoline blending material needed for reformulated gasoline production. The process produces hydrogen, light ends (condensable gases), propane, and some excess isobutane. The isobutane is recycled through the facility and much of the hydrogen can be used on-site for use in making isooctane in the dimerization process.

C. Conversion of Propane to Propylene

The conversion of propane to propylene can be accomplished via a propane dehydrogenation, or PDH, process. PDH is used to supply propylene from NGL feedstocks without the use of a steam cracker and with limited byproducts. The process consists of a reactor, a product recovery process, and a catalyst regenerator. In the first stage of the process, propane feed is mixed with hydrogen-rich recycle gas and is introduced into the

heater to be heated to the desired temperature (over 540 degrees Celsius). After heating, the propane enters the reactors to be converted in the presence of a catalyst. Several inter-stage heaters are used to maintain the conversion. The resulting propylene stream is sent to a selective hydrogenation process where dienes and acetylenes are removed. Finally, the propylene stream goes to a de-ethanizer where light-ends are removed prior to the propane-propylene splitter. Unconverted propane can be recycled to the PDH reactor.

D. Ethylene to Butylenes or Propylene

Ethylene can be converted to butylenes or propylene through the use of an ethylene dimerization unit integrated with a metathesis unit. To begin the process, ethylene is fed into a dimerization loop reactor where, in the presence of a catalyst, the ethylene is dimerized into butene-1 and butene-2, a gasoline by-product, and a fuel oil by-product. The gasoline and fuel oil byproducts are separated from the butane via fractionation. Butylenes are routinely purchased by refiners to supplement internal production as incremental feedstock for their refinery alkylation units, to make C4 alkylate as described in Section 2 B. above. Demand for C4 alkylate has made these supplemental butylenes increasingly valuable to refiners.

If propylene is the desired end product, the butylenes from the dimerization reactor can be further processed through an integrated metathesis unit with additional ethylene feedstock. In this case, a chemical reaction takes place between ethylene and butylene-2 to produce propylene and butylene-1 is isomerized into butylene-2 as butylene-2 is consumed in the metathesis reaction.

III. NGLs and Products of Natural Gas and NGL Refining are Natural Resources, Regardless of their Source.

A. Where the input of a refining and processing activity is a natural resource, the products of such activities should be irrelevant.

Section 7704 provides that processing and refining a mineral or natural resource is a qualifying activity. It is clear from the words of the statute that the object of the processing or refining activity – the mineral or natural resource input – determines whether a particular refining or processing activity is qualifying. Nothing in the statute or legislative history indicates or implies that the nature of the particular processing or refining activity (such as whether it causes a physical or chemical change) or the outputs of a process (such as whether the process produces fuel) are relevant, let alone determinative. To the extent we process and refine natural resources without the addition of non-natural resources as inputs in the particular activity, such processing and refining activities should be treated as qualifying activities pursuant to Section 7704(d)(1)(E).

B. *The statute and its legislative history treat “oil, gas, and products thereof” as natural resources.*

Section 7704(d)(1)(E) provides that “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...” generates qualifying income. Section 7704(d)(1)(E) further provides that “mineral or natural resource” means “any product of a character with respect to which a deduction for depletion is allowable” for purposes of Section 7704. The legislative history to Section 7704(d)(1)(E) explains that for purposes of Section 7704, “natural resources include fertilizer, geothermal energy, and timber, as well as oil, gas or products thereof.” The legislative history states:

[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.¹

There is nothing that suggests Congress intended the above list to be exclusive. On the contrary, it is clear that the list simply contains examples of products that are included as natural resources – and therefore may be subject to additional refining or processing.

C. *NGLs, Olefins and Other Products of Natural Gas Refining are Natural Resources*

As noted above, a “mineral or natural resource” for purposes of Section 7704 includes any product “of a character” with respect to which a deduction for depletion is allowable under Section 611 of the Code. NGLs comprise a portion of both natural gas and raw crude oil streams and are even included in the definition of “crude oil” for purposes of Section 613A(e)(1) and Treasury Regulations Section 1.613-7(g).² Yet, the Proposed Regulations treat NGLs as though they are no longer a natural resource for purposes of “processing and refining” activities once they are separated. There is no justification for an NGL to lose its characterization as a natural resource simply as a result of its separation from a raw crude oil or natural gas stream.

¹ H.R. Rep. No. 100-495, at 947 (Conf. Rep.) (emphasis added).

² The U.S. Energy Information Administration, or EIA, defines NGLs as follows: “Natural gas liquids (NGLs) are hydrocarbons—in the same family of molecules as natural gas and crude oil, composed exclusively of carbon and hydrogen.” See <http://www.eia.gov/todayinenergy/detail.cfm?id=5930>.

Similarly, ethylene, propylene, and similar hydrocarbon derivatives of crude oil and natural gas (collectively, “*Olefins*”) are natural resources for the purposes of Section 7704(d)(1)(E). Olefins are hydrocarbons derived from crude oil, natural gas and NGLs, produced by removing hydrogen atoms to decrease the size of a particular hydrocarbon molecule. The most common feedstocks used to produce Olefins are naphtha, gas oil, ethane, propane, and butane, each of which is derived directly from oil and gas production or refining.³ Further, although not specifically enumerated by the legislative history, Olefins are commonly “recovered from petroleum refineries or field facilities.” EIA data illustrates that thousands of barrels of Olefins are produced each month within U.S. refineries.⁴

Further, there is no question that olefins are not equivalent to plastic. Ethylene and propylene are simply refined hydrocarbon “building blocks” for further processing. Olefins inherently exist in each barrel of crude oil; they simply must be extracted. Plastic, however, is a final product that results from many processes and materials that are neither produced in nor common in petroleum refineries. Therefore, Olefins are natural resources for purposes of Section 7704 that should be treated as natural resources without regard to their source.

IV. Processing and Refining Natural Gas and NGLs are Qualifying Activities.

The Proposed Regulations state that activities constitute “processing or refining” only to the extent that they purify, eliminate impurities from, or separate natural gas into its constituent parts, as well as do not cause a chemical or physical change and are consistent with the MACRS class life prescribed for assets used in the relevant activity.⁵ However, the restrictions on what kinds of activities can qualify as refining and processing have the result of excluding many common processing or refining activities from the definition of qualifying activities on the basis of whether the input of the process is crude oil or natural gas. Any distinctions drawn with respect to crude oil versus natural gas processing and refining activities are inconsistent with the language of Section 7704(d)(1)(E) and its legislative history.

A. *The definitions of processing and refining are not consistent with principles of statutory interpretation or the legislative intent underlying Section 7704.*

1. Separate meanings should be given to each word in the statute.

Section 7704(d)(1)(E) clearly identifies processing and refining as separate activities that may be applied to any natural resource. Long-established principles of statutory

³ In 2009, ethane accounted for 65% of ethylene production, butane and propane accounted for 19%, and naphtha and gas oil accounted for 16%. Bernstein Black Book, North American E&Ps: Manifest Destiny & the Unconventional Resource; Nov. 2011, at 105. Globally, however, naphtha is the feedstock for over half of all ethylene production. *Id.*

⁴ See http://www.eia.gov/dnav/pet/pet_pnp_refp2_a_EPLLEY_y py_mbbl_m.htm.

⁵ Treas. Reg. § 1.7704-4(c)(5)(i)

interpretation require that to the extent possible, effect should be given “to every clause and word of a statute.”⁶ Accordingly, “processing” and “refining” should each be interpreted as having a separate meaning.

Definitions of “processing” include “the act or process of treating or preparing something by a special method”⁷ and “[p]erform[ing] a series of mechanical or chemical operations on (something) in order to change or preserve it.”⁸ Neither Section 7704 nor its legislative history suggests that the word “processing” was intended to have a specific meaning or serve as a limitation on the types of activities that generate qualifying income. Logically, the processes similar to those applied in crude oil refineries would be qualifying processes. The Service has confirmed this treatment in the private letter rulings over the last several years.⁹

Unlike processing, the word “refining” is defined in Service materials. The Internal Revenue Manual (the “IRM”) states that a modern refinery involves the “breaking down, restructuring and recombining of hydrocarbon molecules” in Section 4.41.1.6.1. IRM Sections 4.41.1.6.1.1(2) and 4.41.1.6.1.1(4) further state that a “refinery process” includes converting petroleum feedstocks through a cracking process where olefins, among other hydrocarbons, are produced and that cracking produces both saturated and unsaturated hydrocarbons.¹⁰ While it appears that certain activities that constitute “processing” may also meet the definition of “refining,” the common definitions of “processing” indicate that the term includes activities that would not fall within the definition of “refining.” Based on the foregoing, Congress clearly intended that “refining” and “processing” have independent meanings.

2. Excluding processes that cause a “substantial chemical or physical change” from being treated as qualifying activities is inconsistent with legislative intent.

The Proposed Regulations state that 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 the extracted mineral or natural resource into new or different mineral products or into manufactured products.”

⁶ *Montclair v. Ramsdell*, 107 U.S. 147, 152(1883); *Astoria Federal Savings & Loan Ass’n v. Solimino*, 501 U.S. 104, 112 (1991); *Bailey v. United States*, 516 U.S. 137, 146 (1995).

⁷ Collins English Dictionary

⁸ Oxford English Dictionary

⁹ See, e.g., Priv. Ltr. Rul. 1996-39-011 (May 20, 1996) (natural gas processing), Priv Ltr. Rul. (May 30, 2013) (NGL processing or refining); 2013-37-014; Priv Ltr. Rul. 2012-41-004 (July 2, 2012) (NGL processing); Priv. Ltr. Rul. 2012-36-005 (June 5, 2012) (NGL processing via hydrogenation and catalytic cracking); Priv. Ltr. Rul. 2007-18-005 (May 4, 2007) (processing of highly refined lubricating oils).

¹⁰ I.R.M. exhibit 4.41.1-11 lists ethylene (C₂H₄), propylene (C₃H₆) and butylene (C₄H₈) as olefins, or ethylene series unsaturated hydrocarbons.

There is no basis for the determination that processes that cause a substantial physical or chemical change should not generate qualifying income under Section 7704. By including the refining of crude oil among the activities that are considered qualifying activities under Section 7704, Congress clearly contemplated that processes which cause substantial physical or chemical change to a natural resource would generate qualifying income. Treasury Regulations Section 1.613A-7(s) defines crude oil refining as “any operation by which the physical or chemical characteristics of crude oil are changed, exclusive of such operations as passing crude oil through separators to remove gas, placing crude oil in settling tanks to recover basic sediment and water, dehydrating crude oil, and blending of crude oil products.” Neither the language of Section 7704 nor its legislative history suggests that refining or processing should be limited to activities that do not cause a physical or chemical change, unless plastic or a product similar to plastic is the result of such activities.

B. *Common refinery processes should be included in any regulatory definition of “refining” or “processing.”*

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.” As described in the Treasury regulations and the IRM, “refining” includes the process of causing a physical or chemical change to the molecular structure of a product. Historically, refining processes have included (i) fractionation via distillation processes, (ii) conversion processes, such as thermal and catalytic cracking, alkylation and polymerization, and isomerization and catalytic reforming, (iii) treatment processes used to prepare hydrocarbon streams for processing or prepare finished products, and (iv) formulating and blending processes, which involve mixing and combining hydrocarbons. Additionally, the IRM specifically states that converting petroleum feedstocks through a cracking process to produce Olefins meets the definition of “refining.” There is no basis in the statute or the legislative history for excluding common refinery processes from qualifying treatment simply because the input is natural gas or an NGL rather than crude oil.

1. Converting Propane to Propylene involves a natural resource input and common refinery processes.

The propane to propylene process discussed herein is a catalytic process identical to those used in petroleum refineries. The process begins with propane, a component of natural gas, and results in a hydrocarbon feedstock via a process using hydrogen, heat, and a metal catalyst. Many crude oil refinery processes result in products that can be produced via NGLs using the same or similar processes. Refinery processes that use natural gas and NGLs as their input, such as the propane to propylene process, should be treated as qualifying activities.

2. Converting Ethylene to Propylene is a qualifying refining activity.

As discussed above, Olefins are natural resources for purposes of Section 7704. Accordingly, a refining or processing activity with an Olefin as an input should be treated as a qualifying activity.

In some cases, it is economical to produce certain Olefins from less expensive Olefins rather than maximize the production of a particular Olefin in the crude oil refining process. The ethylene to propylene process is a prime example. Propylene can be produced from ethylene in a refining process that involves “cracking” ethylene into its component parts, fractionating the product mix in order to separate it, then recombining additional ethylene with the resulting butene components to produce propylene. The process also involves isomerization, which is a refinery process that causes the conversion of a “straight chain” molecule into a “branched chain” molecule. Isomers already exist in raw hydrocarbon streams. The isomerization process simply rearranges the atoms of straight-chain hydrocarbons to produce additional isomers of the particular hydrocarbon.

Like the propane to propylene process, the processes used to convert ethylene to propylene are also refinery processes: such processes simply involve the breaking down and recombining of hydrocarbon molecules. As a process similar to those conducted in refineries, the ethylene to propylene conversion process should be treated as a qualifying activity.

3. Producing fuels and fuel products from NGLs should be treated as qualifying activities.

The Proposed Regulations state that the further refining of the components of crude oil is a qualifying activity to the extent the resulting product is fuel or for use in fuel blends, yet contains no such exception for natural gas and NGLs. There is no basis in the statute or its legislative history for determining that products derived from crude oil should be given preferential treatment over an identical product produced from natural gas or an NGL. As such, the production of fuel blending additives, such as iso-octane and alkylate, and methanol, a light fuel, from NGLs and natural gas should generate qualifying income.

The gasoline component production process begins with normal butane or isobutane rather than crude oil, and the methanol process begins with methane. Therefore, the inputs of both processes are natural resources and the processes themselves are common refinery operations.

The gasoline component production process involves the use of a dehydrogenation unit and an alkylation unit, each of which is common in crude oil refineries, to produce a fuel blending product. The methanol production process begins with methane, the primary component of natural gas. While the Proposed Regulations treat fuel derived in an integrated

GTL process as qualifying, it inexplicably excludes methanol, the intermediate product of the GTL process, from qualifying treatment.

To perform each activity, a refinery or refinery-type process that begins with a natural resource results in a fuel product that is also treated as a natural resource for purposes of Section 7704. In order to conclude that the production of fuel and fuel products from natural gas are qualifying activities, it is only necessary to conclude that (i) the input of the process is a mineral or natural resource for purposes of Section 7704 and (ii) the process is considered a “processing or refining” activity. The final regulations should treat fuels and fuel products produced from natural gas the same as those produced via crude oil refining.

C. *Processing and refining activities that produce identical products should not be treated differently.*

To the extent the final Section 7704 regulations focus on the output of an activity, they should at least ensure consistent treatment of similarly situated taxpayers. The Proposed Regulations fail to do so and instead distinguish between processes that create identical products. For example, Example 1 of the Proposed Regulations describes a publicly traded partnership that chemically converts the components of natural gas, including ethane and propane, into “ethylene, propylene, and other gases” with the use of a steam cracker.¹¹ Example 2 describes a publicly traded partnership that owns a petroleum refinery at which it produces “refinery-grade ethylene” as a byproduct of the catalytic cracking of the components of crude oil.¹² While ethylene and other Olefins are the products of crude oil, only the activities in Example 2 are considered qualifying activities under the Proposed Regulations.

Further, the Proposed Regulations place a particular emphasis on so-called “refinery grade” versions of Olefins,¹³ a distinction inapplicable to certain types of Olefins. While propylene may be “graded” into polymer-grade or refinery-grade (typically determined by the amount of propane that is in the propylene, but not converted to propylene), ethylene is simply sold as a purity product. For example, MarkWest’s Javelina plant isolates refinery sourced ethylene that is sold as a purity product.

It does not logically follow that the identical products of two separate processes, the inputs of which are certainly natural resources for purposes of Section 7704(d)(1)(E), should not be accorded equal treatment as natural resources. Further, facilities like Javelina, which separate crude oil refinery gases to produce purity ethylene, should generate qualifying income. The final regulations should eliminate the disparate treatment of crude oil refining

¹¹ Prop. Treas. Reg. 1.7704-4(e), Example 1.

¹² Prop. Treas. Reg. 1.7704-4(e), Example 2.

¹³ See Prop. Reg. § 1.7704-4(e).

processes and natural gas refining processes, as there is no statutory or legislative basis for the distinction.

V. **Qualifying Transportation Activities Should Include All Pipeline Interconnects**

The construction of a pipeline is treated as a qualifying activity under the Proposed Regulations only to the extent that “a pipe is run to connect a producer or refiner to a preexisting interstate or intrastate line owned by the publicly traded partnership.”¹⁴ The Proposed Regulations also state that “development” activities include “...constructing and installing gathering systems and custody transfer stations.”¹⁵ The Proposed Regulations therefore create a standard by which only interconnect agreements with refiners and producers generate qualifying income, which is inconsistent with the commercial realities inherent in the development of pipeline systems. The final regulations should be modified to include common industry practice and provide a more workable standard.

A. *Interconnect agreements are commonly required by non-refiners and non-producers.*

The Federal Energy Regulatory Commission, which regulates a portion of our pipeline network, requires that pipelines cooperate and connect with other pipelines, including intrastate and offshore pipelines, to facilitate the efficient movement of natural gas throughout the country. The construction of pipeline interconnects is therefore a critical part of the crude oil and natural gas transportation industry.

Pipeline interconnects are commonly requested by transportation customers, including producers and refiners. However, in our experience, requests more often come from other types of industry participants, such as another pipeline (upstream or downstream), a gathering system, a utility, a power generation facility, a refinery, a local distribution company, or other commercial, industrial or governmental consumer. While the pipeline interconnect will normally provide access to new customers or provide existing customers with new destinations, it is common that the party requesting (and paying for) the interconnect may not be the transportation customer.

Generally, interconnect agreements provide for payments to the pipeline company that lead the coordination of the construction of the pipeline interconnect to compensate it for the design, materials, and construction or assembly of pipes, valves, meters, meter stations, and other associated property. The coordinating pipeline company may also need to be compensated for the inspection or oversight of work performed by third parties to assemble or construct the property owned by the pipeline and/or the connecting party. Compensation for managing or constructing the interconnect may be limited to a cost reimbursement

¹⁴ Prop. Treas. Reg. 1.7704-4(c)(6)(v).

¹⁵ Prop. Treas. Reg. 1.7704-4(c)(3)(vi).

(whether partial or full) that includes third-party costs and an allocation of direct and indirect costs such as overhead, depending on the arrangements and the anticipated relative benefit of the interconnect. Alternatively, the interconnect agreement may be structured with a flat fee or a cost-plus arrangement with the possibility that the pipeline company may earn a profit.

The final regulations should be clarified to provide that revenue realized by a pipeline transportation business from pipeline interconnects and related services are qualifying income, regardless of whether the reimbursement comes directly from a transportation customer and regardless of the type of customer to which that interconnect provides access. Such revenue is derived from, and dependent on, the business of transporting a mineral or natural resource or products thereof as required by Code Section 7704(d)(1)(E), and should be treated as such under the final regulations.

B. *Interconnect agreements should not be limited to preexisting interstate or intrastate lines.*

The Proposed Regulations should recognize that it is not uncommon for interconnections to be made during the construction of a new pipeline. Once a pipeline project is announced, pipelines and potential customers that are adjacent to the proposed pipeline project may request an interconnection with the proposed pipeline. Under the language of the Proposed Regulations, interconnect agreements with existing pipelines are permissible, yet the fact that the interconnection happens as the pipeline is being built appears to change the treatment of the payments for the interconnection. This distinction is not warranted and should be eliminated in the final regulations.

VI. Income Earned from the Management of Qualifying Assets and Businesses Should Be Qualifying Income.

Section 1.7704-4(c)(6) of the Proposed Regulations states that providing storage services, terminalling services, operating gathering systems and custody transfer stations, and operating pipelines, barges, rail, or trucks generates qualifying income.

MarkWest earns income from the receipt of management fees and reimbursement income for operating transportation or processing assets owned by third parties or through joint ventures to which MarkWest is a party. In each case, MarkWest (or one of its subsidiaries) performs all of the activities necessary for the function of the asset under an operating agreement, pursuant to which MarkWest performs all functions associated with the transportation or processing facility, including: (i) contracting with customers for the use of the transportation or processing facility, (ii) taking delivery of the natural gas, NGLs, or condensate from various gathering systems or common carrier pipelines, (iii) performing the tasks necessary to transport or process the natural gas, NGLs, or condensate, (iv) metering the quantities of the relevant product, (v) monitoring the specifications of the products, (v) performing the tasks necessary to off-load the NGLs, or condensate for receipt by the

customer, and (vi) managing and coordinating the construction of any assets necessary for the completion of these or other qualifying activities. In addition, MarkWest is responsible for all the functions associated with the ownership of each transportation or processing facility, including staffing each facility, employing, either directly or through an affiliate, all personnel who physically control the transportation or processing facility, handling all commercial transactions and conducting routine maintenance, as well as identifying and purchasing all supplies necessary to operate each facility. Finally, MarkWest is responsible for all “back-office” functions, such as payroll and other administrative services.

Operating agreements similar to those under which MarkWest earns income are common in the oil and gas transportation industry. The Service has previously addressed the management and operation of energy infrastructure assets by entities with no or only a partial ownership interest in the operated assets in a number of private letter rulings. In all such private letter rulings, the Services concluded that gross income from the operation of assets owned partially or wholly by third parties, including management fees, general administrative expenses and cost reimbursements, constitutes qualifying income.¹⁶

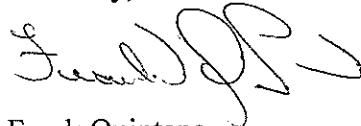
There should be no question that the activities MarkWest performs pursuant to its operating agreements constitute qualifying transportation activities. In each instance, MarkWest is performing all of the services necessary to move the relevant natural resource product to market. Distinguishing between partnerships in MarkWest’s position and that of partnerships performing those exact services in cases in which such partnerships have title to (or a lease of) the assets creates a distinction without a difference. The determination of whether activities constitute “transportation” under Section 7704 should be focused solely on the nature of the activities performed while using the assets. The final regulations should reflect that performing the functions required for the operation of qualifying assets or qualifying businesses constitutes qualifying income.

¹⁶ See Priv. Ltr. Rul. 2004-22-023 (February 10, 2004) (management fees for operating two pipelines transporting NGLs and refined petroleum products); Priv. Ltr. Rul. 2006-38-018 (June 13, 2006) (operating fees and certain cost reimbursements from the operations of pipelines partially or wholly owned by third parties constitutes qualifying income); Priv. Ltr. Rul. 2007-12-002 (December 7, 2006) (gross income from operating refined product pipelines and terminals constitutes qualifying income); Priv. Ltr. Rul. 2007-40-010 (December 7, 2006) (gross income (including cost reimbursements) as contract operator of pipelines and terminals constitutes qualifying income); Priv. Ltr. Rul. 2011-32-012 (April 29, 2011) (fees and cost reimbursements from operating natural gas processing plants, a refrigeration plant, NGL fractionators, and storage facilities for NGLs and products thereof constitutes qualifying income); Priv. Ltr. Rul. 2012-33-010 (April 20, 2012) (gross income from operating a partially owned natural gas processing plant and related facilities constitutes qualifying income); Priv. Ltr. Rul. 2013-13-015 (December 18, 2012) (gross income from a partnership’s distributive share of operating services fee income and related cost reimbursements from activities including general and administrative services with respect to an undisclosed asset constitutes qualifying income); Priv. Ltr. Rul. 2014-18-021 (October 25, 2013) (a percentage of sales fee for managing a joint venture engaged in coal mining constitutes gross income).

VII. Conclusion

The suggested changes to the Proposed Regulations described above are consistent with the plain meaning of Section 7704, as well as its legislative history. The final regulations should reflect that NGLs and Olefins are natural resources under Section 7704 and eliminate the distinction drawn between “oil, gas, and products thereof” based on the source of such resources with respect to processing, refining, and transportation activities. Further, the final regulations should afford equal treatment to processing and refining activities that use a mineral or natural resource as their input, rather than imposing a distinction between crude oil and natural gas that has no statutory basis. Finally, the final regulations should reflect the practical realities of the pipeline transportation industry with respect to interconnect agreements, as well as treat income from the operation and management of qualifying businesses as qualifying income.

Sincerely,

A handwritten signature in black ink, appearing to read "Frank Quintana", written in a cursive style.

Frank Quintana

Vice President of Tax
MarkWest Energy Partners, L.P.