



August 3, 2015

CC:PA:LPD:PR (REG-132634-14)
Room 5203
Internal Revenue Service
P.O. Box 7604, Ben Franklin Station
Washington DC, 20044

RE: Notice of Proposed Rulemaking Qualifying Income from Activities of Publicly Traded Partnerships With Respect to Minerals or Natural Resources

Dear Sir or Madam:

Martin Midstream Partners L.P. ("*Martin*") appreciates the opportunity to comment on and to offer our suggestions with respect to the proposed Treasury regulations that would affect the current interpretation of qualifying income for publicly traded partnerships published in the *Federal Register* on May 5, 2015.

Martin is a publicly traded partnership engaged in diversified business activities focused on transportation, storage and processing of petroleum products, natural gas and natural gas liquids. Martin, to a lesser extent, also engages in sulfur and sulfur-based gathering, processing, and marketing activities. Thus, Martin operates its business within "natural resources exception" of Section 7704(d)(1)(E) by deriving 90 percent or more of our income from the transportation, storage and processing of natural resources.

In the past five years, Martin has requested and received guidance from the Internal Revenue Service (the "*IRS*") with respect to various activities related to its core business. While we do not believe that any significant portion of such prior guidance is nullified by the proposed Treasury regulations, we believe that clarification is required with respect to several activities. Primarily, we believe that the proposed regulations should not attempt to provide an exclusive list of so-called "section 7704(d)(1)(E) activities" and that the rules set forth with respect to "intrinsic activities" should be simplified and broadened to include activities previously approved by the IRS.

Since the enactment of Section 7704 of the Code, the investors in publicly traded partnerships have required certainty with respect to which activities constitute qualifying income because of the extraordinary effects of operating a publicly traded entity under the wrong entity classification. Prior to the issuance of the proposed regulations, such certainty could, in most cases, be achieved through an opinion of legal counsel. However, with respect to particular

activities engaged in by a publicly traded partnership in a private letter ruling request to the IRS, who, in turn, would make a determination of whether such activities constituted qualifying income. The proposed regulations have not identified which of the over 120 private letter rulings issued by the IRS with respect to Section 7704 of the Code would be revoked, in whole or in part, by the publication of the proposed regulations, if finalized in this form. Instead, the proposed regulations have created uncertainty while intensifying the market's desire for certainty, as historically publicly traded partnerships have been attractive to investors for their investment stability and emphasis on distributable cash flow.

EXECUTIVE SUMMARY

Martin believes that the proposed Treasury regulations can be clarified and improved with the following changes:

First, the definitions of Section 7704(d)(1)(E) activities should be simplified to reflect their common and historic meaning and should not attempt to provide an exclusive list of all activities that qualify as the exploration, development, mining or production, processing, refining, transportation or marketing of a mineral or natural resource as well as any activity that may be "intrinsic" thereto;

Second, the term "mineral or natural resource" should be modified such that it does not distinguish between identical products from different sources;

Third, blending activities should be modified to include blending with respect to any natural resource (not only fuels) and should contemplate blending activities by a terminal operator in addition to a product owner;

Fourth, the "intrinsic activity" standard should be modified to better reflect (i) the difficulty of exploring for, developing, and producing crude oil and natural gas in marine environments and (ii) to provide that supply of, collection and recycling for catalysts in refining is an intrinsic activity in addition to supply of, collection and recycling for injectants; and

Fifth, the transportation of a natural resource should be clarified to include transportation by ship or vessel, including by time charter.

DISCUSSION

A. Martin's Business

Martin is in the business of transporting, storing, and processing natural resources. Martin's four primary business lines include:

- Terminalling and storage services for petroleum products and by-products including the refining of naphthenic crude oil, blending and packaging of finished lubricants;

- Natural gas liquids transportation and distribution services and natural gas storage;
- Sulfur and sulfur-based products gathering, processing, marketing, manufacturing and distribution; and
- Marine transportation services for petroleum products and by-products.

In connection therewith, Martin owns or operates (i) twenty-nine shore-based marine terminal facilities and eighteen specialty terminal facilities located in the United States Gulf Coast region, which provide storage, processing and handling services for producers and suppliers of petroleum products and by-products, lubricants and other liquids, including the refining of various grades and quantities of naphthenic lubricants and related products; (ii) ten full service terminals which provide logistical support services and storage and handling services for fuels and lubricants, (iii) natural gas liquid (“NGL”) supply and storage facilities with an aggregate storage capacity of approximately 2.4 million barrels as well as an NGL pipeline which spans approximately 200 miles from Kilgore to Beaumont, Texas; (iv) a fleet of forty-two inland marine tank barges, twenty-five inland push boats, two commercial pushboats and four offshore tug barges that transport petroleum products and by-products largely in the United States Gulf Coast region; and (iv) three retail propane distribution terminals.¹

B. Transportation and Support Activities

a. Blending

Since 2003, the IRS has issued at least 11 distinct private letter rulings to taxpayers with respect to blending activities, including 5 relating specifically to lubricants.² The IRS and the

¹ Please reference the excellent comments submitted to the IRS with respect to the transportation and marketing of propane to retail customers submitted by Suburban Propane Partners L.P. dated June 4, 2015 and Amerigas Partners, L.P. dated June 26, 2015.

² 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,

Treasury Department should clarify the Proposed Regulations such that each taxpayer may continue to rely on the prior IRS guidance with confidence, or the IRS should notify each partnership that has received a ruling with respect to blending activities that its ruling would not be revoked by the publication of the proposed regulations as final regulations.

Currently, the proposed regulations primarily address blending activities in the context of marketing fuels. Proposed Regulation Section 1.7704-4(c)(7) states that “[a]n 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 also states, “[m]arketing may also include some additive blending into fuels provided to a customer’s specification.” With respect to processing or refining, 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.”³ Thus, the proposed regulations also recognize blending as a part of petroleum processing or refining.

In addition to blending additives into fuels, Martin blends additives into refined petroleum distillates and lube oil base stocks to create specialty lube oils and greases.⁴ We believe that the use of the word “fuels” in the proposed regulations thus inadvertently excludes our previously approved blending activities. To produce its high quality lubricating oils and greases, Martin purchases refined petroleum distillates and lube oil base stocks from crude oil refineries, which are transported via pipeline or truck to one of Martin’s packaging plants. At those sites, base stocks are blended with additives to create Martin’s unique lubricating oils and greases. The additives are acquired from third-party additive manufacturers, and although the additives are petroleum based, they may include limited amounts of certain other chemicals, such as zinc, calcium and phosphorous. For grease blending, a “soap” or “thickener” is also used to create the semi-solid suspension. The semi-solid nature of grease allows the grease to be used where typical lubricating oils do not function, such as in slides or sealed bearings. The non-petroleum derived components of the resulting lube blends and greases generally makes up less than 10 percent of the total lube blend. The resulting lube blends are then packaged into quarts, pails and drum containers for sale under one of Martin’s brand names, which are marketed and sold into a diverse network of wholesale lubricant marketers. None of Martin’s customers are end users of the packaged products.

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);

³ Prop. Reg. § 1.7704-4(c)(5)(iii)(A)(2).

⁴ Lubricants, including greases, are listed as a “Major Refinery Product” in the OSHA Technical Manual’s section on petroleum refining. OSHA Technical Manual, Section IV Chapter 2, available at https://www.osha.gov/dts/osta/otm/otm_iv/otm_iv_2.html.

Our lubes and grease blending activities are clearly identifiable as the processing and marketing of refined petroleum products and the IRS has provided us with two private letter rulings concluding that such activities generate qualifying income.⁵ Practically, there is no difference between blending additives, ethanol, or biodiesel into fuels or blending additives into petroleum distillates and lube oils. Further, there is no limitation in the legislative history on the type of packaging used with respect to marketing a natural resource, but solely a limitation on the quantity of the sale. On the other hand, the IRS has specifically addressed packaging as a part of marketing natural resources in several prior instances.⁶ As such, Martin recommends that the IRS and the Treasury amend the definition of marketing in Proposed Regulation Section 1.7704-4(c)(7) to state,

“An 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 minerals or natural resources and associated packaging activities.*”

In addition, Martin recommends that blending and packaging be specified as a terminalling activity. In many instances, a terminal owner or operator will not own the products that it is blending. In such case, the blending activity is better considered an aspect of terminalling itself than marketing, as the blending is simply performed to meet the customer’s specifications. As such, Martin recommends that Proposed Regulation Section 1.7704-4(c)(6)(ii) state,

“Terminalling, *including blending additives into minerals or natural resources and associated packaging activities.*”

b. Transportation of Refined Products

Martin regularly purchases, stores, transports and markets ethane, propane, butane, isobutane, and pentane (“*NGLs*”) and refinery products such as ethylene, propylene, butylene, butadiene, and isoprene (“*olefins*”). If the proposed regulations are finalized with unequal treatment of identical products based on whether sourced from a crude oil refinery or another facility,⁷ Martin will have the difficult task of trying to identify the source of certain refinery products like olefins purchased, stored, transported or sold in order to calculate (or, attempt to calculate) our gross income from activities with respect to natural resources and non-natural

⁵ Priv. Ltr. Rul. 2011-41-013 (April 7, 2011); Priv. Ltr. Rul. 2014-03-008 (September 13, 2013).

⁶ See, e.g., 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. 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).

⁷ See Prop. Reg. § 1.7704-4(e), Examples 1 and 2.

resources. Exceptional difficulty would occur if, for example, Martin purchased a product such as ethylene from another ethylene wholesaler that has acquired its available ethylene from multiple sources. Since no storage facility does, or would reasonably have the ability to, separately store refinery-sourced ethylene from other ethylene, it would be impossible for the seller to distinguish which molecules of ethylene originated in a crude oil refinery and which did not. As discussed above, publicly traded partnership must have a high degree of confidence that their activities produce qualifying income. An inability to confidently source certain products may lead to treating all income from these products as nonqualifying income, which we believe is contrary to the intent of the statute to create a broad exception for natural resource activities. Thus, Martin recommends that the proposed regulations treat any product which may be produced in a crude oil refinery as a natural resource regardless of its source.

c. Terminalling Activities

Martin operates 29 shore-based marine terminal facilities. In connection with its shore-based marine terminal facilities, Martin derives income from allowing access to and use of its marine docks and terminals as a support base for unrelated third party oilfield service companies selling products and providing services in the Gulf of Mexico in support of the exploration and production of oil and natural gas. Specifically, Martin, for example, supplies oilfield service companies with use of its docks and support services to facilitate the supply and transportation of drilling mud, barite, completion fluids, casing cement and dry products. Offshore oil rigs are capable of drilling in water up to 12,000 feet deep and can be located up to hundreds of miles offshore. Drilling offshore thus combines the complexity of the process of extracting and producing oil with the complexity of operating in a remote marine environment. Drilling rigs, from shallow water barge rigs to jackups, semi-submersibles, drill ships, mobile offshore drilling units and manned platforms, require significant shore-based activities in order to explore for and produce crude oil and natural gas in the marine environment. Martin's activities at its marine terminals are the logistical lifeline to these rigs. Even more so than other remote environments, offshore drilling, exploration and production cannot occur without staging, shore-based support, and a constant stream of supplies. These types of services have been addressed by the IRS in at least two private letter rulings, including ours.⁸

We believe that definition of "specialized" in the three-part test with respect to "intrinsic activities" in Proposed Regulation Section 1.7704-4(d) should be modified to address operating in difficult, specifically marine, environments. As such, we propose that Proposed Regulation

⁸ Priv. Ltr. Rul. 2010-25-037 (March 12, 2010) (marine services to customers at LNG terminal); Priv. Ltr. Rul. 2013-47-015 (July 22, 2013). *See also* Priv. Ltr. Rul. 2014-11-004 (November 8, 2013) (fuel delivery to mining customers in remote locations); Priv. Ltr. Rul. 2012-27-001 (March 1, 2012) (fuel delivery to drilling, exploration and production and mining customers in remote locations); Priv. Ltr. Rul. 2012-26-018 (December 7, 2011) (delivery and sale of refined petroleum products (principally diesel fuel and lubricating oil), antifreeze, methanol and other chemicals to customers engaged in drilling, exploration and production, and mining activities at the site of such activities in remote locations).

Section 1.7704-4(d)(2)(i) be modified to include activities that service a section 7704(d)(1)(E) activity that is specialized due to the location or nature of the activity.

d. Products Required for Refining

The proposed regulations provide that “intrinsic activities” include activities that are specialized to support a section 7704(d)(1)(E) activity, that are essential to the completion of the section 7704(d)(1)(E) activity, and require the provision of significant services to support the section 7704(d)(1)(E) activity. With respect to the “specialized” requirement, a special rule is set forth with respect to injectants commonly used outside of section 7704(d)(1)(E) activities if the partnership also cleans, recycles or otherwise disposes of the injectant after use in accordance with regulations concerning waste products from mining or production activities. This rule should be expanded to encompass the supply of, cleaning or recycling of products required for refining. Additionally, because such cleaning or recycling activities may occur offsite, but may also be accomplished with respect to waste products that are not associated with Section 7704(d)(1)(E) activities, the requirement that an activity be solely offered to those engaged in performing Section 7704(d)(1)(E) activities should be removed.

Background Example – Sulfuric Acid Regeneration

Gasoline burned in motor vehicles is a blend of various hydrocarbon components produced in a crude oil refinery. The octane number of the gasoline produced reflects how completely and efficiently that gasoline burns in an engine. Low octane gasoline promotes incomplete combustion and inefficiency and, consequently, air pollution and loss of engine power (reflected in engine “knocking”). As a result, refineries are required by law to produce gasoline that meets a minimum octane rating and, in accomplishing this goal, must use additives that comply with strict environmental standards.

Alkylate is the industry-standard additive used to produce higher octane ratings in gasoline and thus is an essential component in most gasoline sold in the United States. Alkylate has exceptional antiknock properties and burns cleanly, as it does not contain any olefins, aromatics, or sulfur. Moreover, its use in gasoline provides an economically feasible outlet for several of the very light olefins produced from a crude oil catalytic cracking unit within a refinery, as the production of alkylate involves the combination of low-molecular-weight olefins (primarily a mixture of propylene and butylene) with isobutene in the presence of a catalyst, either a strong sulfuric acid or hydrofluoric acid. Refineries generally use sulfuric acid as a catalyst for purposes of alkylation because sulfuric acid provides the lowest cost, safest and most efficient and reliable process to produce alkylate.

Over time, the sulfuric acid catalyst used in alkylation slowly becomes diluted by water inherent in the olefins and contaminated with hydrocarbons, known as red oils, that are released in the process. As the concentration of the sulfuric acid catalyst is reduced, it becomes less effective, and the contaminated acid (referred to as “spent sulfuric acid”) must be removed and

either regenerated or disposed of. Typically, the absorption of contaminants causes the spent sulfuric acid volumes to exceed the fresh sulfuric acid volumes by up to 2%; however, the spent sulfuric acid contains up to 10% less sulfur than the fresh sulfuric acid because a portion of the sulfur is lost in the alkylation process at the refinery. The amount of spent sulfuric acid generated by the alkylation process is substantial (typically in the range of 13 to 30 pounds per barrel of alkylate). Accordingly, the handling of the spent sulfuric acid is critical to the alkylation process and the overall refining of crude oil into motor vehicle gasoline.

Spent sulfuric acid that is removed from the alkylation process must either be disposed of or regenerated in a specialized plant for reuse in the alkylation process. Disposing of spent sulfuric acid is both costly and complicated due to its chemical and physical properties and the myriad applicable state and federal environmental and hazardous waste restrictions. As a practical matter, in consideration of the proven technology used in regenerating spent sulfuric acid recovered from an alkylation process, regeneration of spent acid rather than disposing of the acid as a waste is the preferred method of operation. The re-use of sulfuric acid regenerated from spent acid also is environmentally beneficial because it eliminates the need for a source of new acid that otherwise would be required in the alkylation process and, further, because it eliminates a waste stream. As a result, nearly all the spent sulfuric acid generated at refineries is regenerated and recycled.

Some large refineries have onsite acid regeneration capabilities. Others, however, remove the spent sulfuric acid via pipeline, barge, railcar, or tank truck to an adjacent or regional regeneration plant. Regeneration plants decompose the spent sulfuric acid at high temperatures into sulfur dioxide, water, and carbon dioxide. Sulfur acquired from the refinery is commonly used as a fuel in the regeneration furnace because burning sulfur reduces the need for other fuels and replenishes the sulfur in the sulfuric acid that is lost at the refinery. Impurities are removed from the gaseous sulfur dioxide before it is sent through a catalyst, where the sulfur dioxide is combined with oxygen to form sulfur trioxide. The sulfur trioxide is combined with water to form fresh sulfuric acid. The newly concentrated sulfuric acid is then sent back to the refinery for use in the alkylation reactor.

Spent acid regeneration is a closed loop service, as the plant regenerates the spent acid and returns the recycled clean sulfuric acid back to the oil refinery. For refineries without onsite acid regeneration capabilities, this reliable closed loop system, including both the removal of spent sulfuric acid and return of fresh sulfuric acid, is essential for alkylation operations. Any service interruption by the regeneration plant will cause the refinery to slow or shut down, and therefore spent acid regeneration services are critical to the operations of the refinery.

Sulfuric acid regeneration as a service can be provided to customers operating outside of a crude oil refining business. While a company providing sulfuric acid regeneration as a service could expect a majority of its customers would be crude oil refiners, or even the vast majority of customers would be crude oil refiners, sulfuric acid does have other uses. Under the significant

services requirement, as presently drafted, significant pressure is applied to create an economic inefficiency with respect to sulfuric acid regeneration; the section requires that the services be “offered exclusively to those engaged in one or more section 7704(d)(1)(E) activities.” Under close analysis, this requirement actually adds very little to the character or type of activity that is being performed with respect for a customer engaged in exploration, development, mining or production, etc., activities. Whether Martin provides a certain amount of sulfuric acid regeneration to non-crude oil refiners does not change the nature of the activity when performed for crude oil refiners. In fact, the process is identical in either case. However, if Martin is the party in the logical position to provide sulfuric acid regeneration to a non-crude oil refiner, it could make the decision not to provide such service so that the entirety of its income with respect to sulfuric acid regeneration is not tainted. This is an irrational result. Instead, simply the income derived from such service to a non-crude oil refiner should be considered non-qualifying income.

Combined Proposal With Respect to Intrinsic Activities

Just as mining or production activities require injectants for the mining or processing of particular natural resources (such as sand or water for hydraulic fracturing), refining processes require various substances to perform refining. We believe that there is no policy reason to distinguish between a substance used and disposed of or recycled in mining or processing activities versus refining activities. As such, and in combination with the above discussion of terminalling activities, we proposed that Prop. Reg § 1.7704-4(d)(2) be modified as follows:

An activity is a specialized activity if:

(i) The partnership provides personnel to perform or support a section 7704(d)(1)(E) activity and those personnel have received training unique to the mineral or natural resource industry that is of limited utility other than to perform or support a section 7704(d)(1)(E) activity, *or the activity is required to support a section 7704(d)(1)(E) activity in a remote environment*; and

(ii) To the extent that the activity includes the sale, provision, or use of property, either:

(A) The property is primarily tangible property that is dedicated to, and has limited utility outside of, section 7704(d)(1)(E) activities and is not easily converted (based on all the facts and circumstances, including the cost to convert the property) to another use other than supporting or performing the section 7704(d)(1)(E) activities; ~~or~~

(B) The property is used as an injectant *or catalyst* to perform a section 7704(d)(1)(E) activity that is also commonly used outside of section 7704(d)(1)(E) activities (such as water, lubricants, and sand) and, as part of the activity, the partnership collects and cleans, recycles, or otherwise disposes of the injectant *or catalyst* after use in accordance with federal, state, or local regulations concerning waste products from *refining, processing, mining or production activities*; *or*

(C) *the property is required to support a section 7704(d)(1)(E) activity in a remote environment.*

In addition, we recommend that Proposed Regulation Section 1.7704-4(d)(4) be modified to remove “and are offered exclusively” from the second sentence of the section.

e. Transportation and Marine Charters

The transportation of crude oil, refined petroleum products and other products that are natural resources under section 7704(d)(1)(E) by ship or vessel often occurs pursuant to contracts specific to marine transportation referred to as charters. One type of charter is a time charter, where the shipping customer will contract with the shipper to transport cargo for a particular period of time. While the shipping customer generally directs the destination of the vessel, the shipper provides the crew and is responsible for all aspects of the operation and the maintenance of the vessel. The IRS has issued at least four rulings to taxpayers that income from the time charter of a vessel transporting natural resources constitutes qualifying income.⁹

As a typical question arising among publicly traded partnerships, we recommend that the IRS clarify that income from the transportation of natural resources under a time charter constitutes qualifying income. In addition, we recommend that the definition of transportation include by “ship” or “vessel” to clarify that income from marine transportation constitutes qualifying income whether transporting on vessels moving under their own power or a barge being pushed or towed.

As such, Martin proposes that Proposed Regulation Section 1.7704-4(c)(6) be modified as follows:

“Transportation is the movement of minerals or natural resources and products produced under paragraph (c)(4) or (5) of this section, including by pipeline, barge *or vessel (including under time charter)*, rail, or truck, except for transportation (not including pipeline transportation) to a place that sells or dispenses to retail customers.”

Respectfully submitted,



Martin Midstream Partners L.P.

By: Robert D. Bondurant

Title: EVP/CFO

⁹ Priv. Ltr. Rul. 2014-17-005 (October 21, 2013); Priv. Ltr. Rul. 2010-27-003 (March 5, 2010); Priv. Ltr. Rul. 2009-39-016 (June 25, 2009); Priv. Ltr. Rul. 2005-51-002 (September 20, 2005).