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July 28, 2015

Submitted via Federal eRulemaking Portal

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

Re: Comments on Section 7704 Proposed Regulations (REG – 132634 – 14)

Westlake Chemical Partners LP ("WLKP") respectfully submits these comments on the proposed regulations (REG – 132634 – 14) under section 7704(d)(1)(E) of the Internal Revenue Code[1] (the "Proposed Regulations") relating to qualifying income from the exploration, development, mining or production, processing, refining, transportation, or marketing of minerals or natural resources. We commend the Internal Revenue Service (the "Service") and the Department of the Treasury ("Treasury") for their efforts to develop guidelines for qualifying income determinations, particularly given the increase in the number of private letter ruling requests submitted in recent years, and we appreciate the opportunity to comment. Our comments focus on the treatment under the Proposed Regulations of the "processing" and "refining" of ethane, propane, butane and natural gasoline ("natural gas liquids" or "NGLs").[2]

In November 2012, Westlake Chemical Corporation ("Westlake") requested rulings from the Service that (i) the processing of NGLs into olefins (such as ethylene and propylene) and certain co-products, including pyrolysis oil, pyrolysis gasoline, mixed C4s, fuel oil and hydrogen and (ii) the marketing, storing and transporting of olefins would each generate qualifying income for purposes of section 7704. Following receipt in June 2013 of a favorable private letter ruling from the Service,[3] Westlake invested considerable time and resources to form WLKP as an MLP, which completed its initial public offering in August 2014. We believe that the Service's ruling is correct and is consistent with the statute and the legislative history. Consequently, we believe that the effective revocation of that ruling under the Proposed Regulations is both improper and unfair.

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[1] All "section" references herein are to the Internal Revenue Code of 1986, as amended, and all references to the "regulations" or "Treas. Reg. §" are to the regulations promulgated thereunder.

[2] Ethane, propane and butane are components of both crude oil and natural gas and are gases when extracted. After extraction, they are compressed into liquid form and transported by pipeline to a facility to be processed or refined. As a result, these compressed gases, along with natural gasoline, are commonly referred to as "natural gas liquids" or "NGLs."

[3] IRS Priv. Ltr. Rul. 2013-40-011 (June 26, 2013).

We believe any effort to develop and finalize regulations must produce rules on qualifying income that are appropriate and administrable. Moreover, in light of the absence of regulatory guidance for more than 27 years following the enactment of the statute, taxpayers have necessarily relied on private letter rulings to determine the scope of qualifying income. We believe it is unfair to nullify (even on a deferred basis) interpretations of the statute and the legislative history provided by the IRS in private letter rulings to the entities that received those rulings.

I. Executive Summary

- There are two fundamental requirements to generate qualifying income under section 7704(d)(1)(E): (i) the income-generating activity must relate to a "mineral or natural resource" and (ii) the income must be derived from one or more listed activities, including "processing" and "refining." If these requirements are met, income from the activity is qualifying income for purposes of section 7704.
- NGLs are natural resources. NGLs are hydrocarbon components of oil and gas that exist in every underground deposit of oil and gas. NGLs are therefore oil and gas, falling squarely within the statutory definition of "natural resources."
- Under the depletion rules, NGLs are treated as depletable oil and gas, consistent with the fact that they are a hydrocarbon component of oil and gas that diminishes with extraction. Nothing in section 7704(d)(1)(E) or its legislative history suggests that NGLs are not natural resources or should be treated differently than other natural resources for purposes of determining qualifying income.
- NGLs do not cease to be natural resources merely because they are separated from one another. That is, ethane, propane, butane and natural gasoline are natural resources whether they are mixed together or separated. Each has the same attributes that it had when it was underground.
- Because NGLs are natural resources, the processing (as well as the refining) of NGLs creates qualifying income under the statute. Common processing techniques for NGLs include the "steam cracking" of NGLs to produce olefins. This relatively simple processing method has been in use for decades and was in widespread use in 1987 when Congress adopted section 7704. Steam cracking does not create a finished product. Rather, it is an initial processing step that creates a simpler molecule, which is then used as a feedstock for further processing into finished products such as fuels and plastics.
- Products of steam cracking such as ethylene and propylene belong to a class of oil and gas products that were intended to give rise to qualifying income under the legislative history: they are the direct result of simple processing applied to oil and gas, they are molecularly very similar to basic oil and gas hydrocarbon components, and they are products that commonly are, and historically have been, produced in petroleum refineries. In contrast, the legislative history contemplates that finished petrochemical products (such as plastics) are too remote from natural resources to give rise to qualifying income. Ethylene and propylene are very

different from plastics, which have extremely complex molecular structures bearing little resemblance to oil and gas, and which are the result of a long progression of complicated operations.

- Section 7704(d)(1)(E) lists both "refining" and "processing" as activities that give rise to qualifying income. Neither the statute nor the legislative history defines these terms. However, the activities performed by WLKP, as described in its private letter ruling, satisfy the common understanding of "refining" and "processing." The Proposed Regulations unduly restrict the definition of "refining," and essentially eliminate "processing" from the statute.
- The Proposed Regulations are inconsistent with existing Treasury Regulations, particularly with respect to the definition of "refining." In addition, the Proposed Regulations introduce several extraneous requirements having no basis in the statute or the legislative history.
- Under the Proposed Regulations, essentially identical processes used to create the same products would generate qualifying income if performed in a crude oil refinery but not if performed in a steam cracker processing NGLs. We believe such disparate treatment is not supportable, either as a matter of statutory interpretation or from a policy standpoint. The standards for applying the processing and refining aspects of section 7704(d)(1)(E) to oil and gas production should be the same, regardless of whether the production stream is natural gas, crude oil or NGLs.
- Taxpayers have been operating without regulatory guidance regarding these matters for over 27 years. During that time, the most conservative way to be certain that the requirements of section 7704(d)(1)(E) were met was to obtain a private letter ruling from the IRS, which WLKP did in June 2013. To revoke such rulings in the absence of any change in the taxpayers' facts and circumstances or any change in law, even after a transition period, would be unfair and would pronounce to both businesses and their investors that they are no longer able to rely on IRS guidance when making long-term business and investment decisions.

II. The Statute — Section 7704(d)(1)(E) and Its Legislative History

We begin our analysis with an examination of the plain meaning of the statutory language contained in section 7704(d)(1)(E) and the relevant legislative history. Section 7704(d)(1)(E) provides that qualifying income includes, *inter alia*,

> 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*. [Emphasis added.]

Thus, to constitute qualifying income under this subparagraph, two tests must be met: (i) the income-generating activity must be performed with respect to a "mineral or natural resource"

(hereinafter "Qualifying Natural Resources") and (ii) the income must be derived from one or more of the listed activities (hereinafter "Qualifying Activities").

A. NGLs Are Qualifying Natural Resources

According to the statute, the term "mineral or natural resource" means "any product *of a character* with respect to which a deduction for depletion is allowable under section 611."[4] The legislative history makes clear that the reference to depletable products was intended to identify those natural resources on which a Qualifying Activity could be conducted and was not intended to suggest that qualifying income must itself be income that would qualify for percentage depletion.[5]

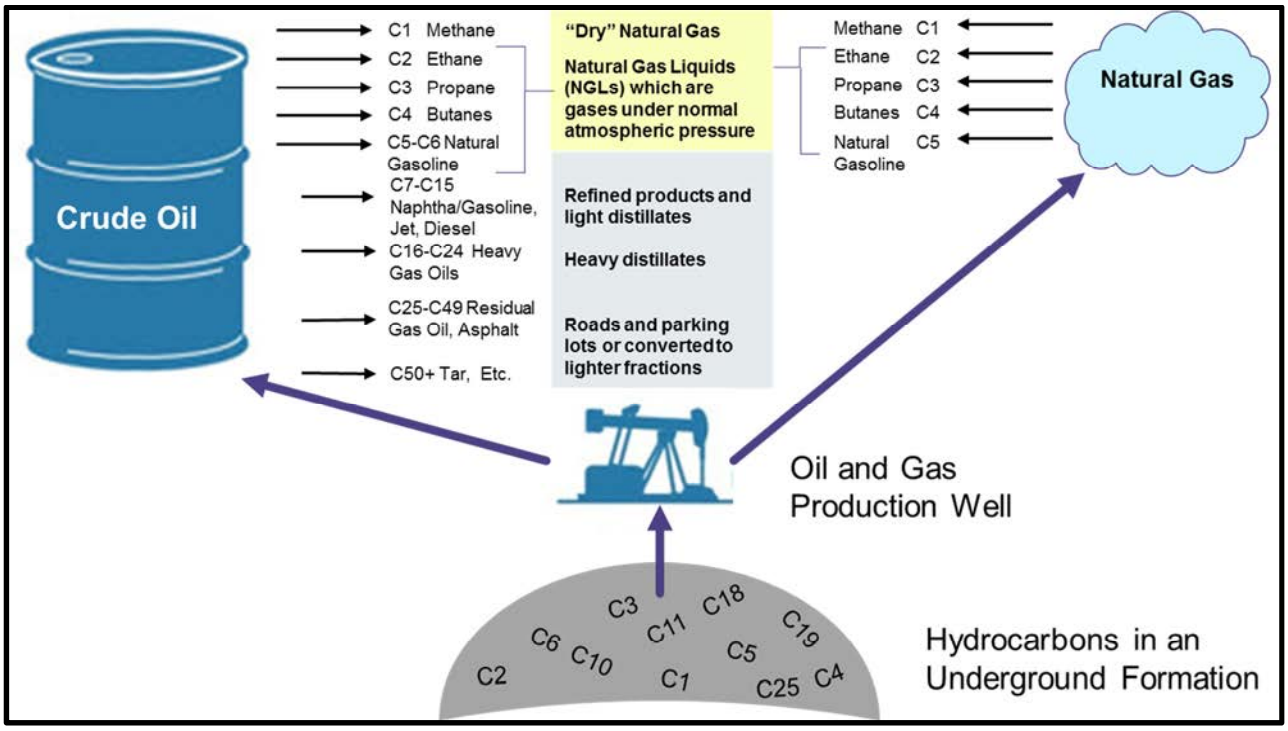
NGLs are oil and gas, a depletable natural resource that diminishes with extraction, and are therefore Qualifying Natural Resources. A barrel of crude oil is a mixture of hundreds of different types of hydrocarbon molecules ranging from the lightest hydrocarbons — methane (gas), and the NGLs: ethane (gas), propane (gas), butane (gas) and natural gasoline — to the heavier hydrocarbon molecules such as jet fuel, kerosene, gas oils and asphalt. The term "natural gas" means a combination of methane, ethane, propane, butane, and natural gasoline. See Figure 1.[6] NGLs are a hydrocarbon component of every barrel of crude oil and every natural gas stream.

[4] I.R.C. § 7704(d)(1) (flush language) (emphasis added).

[5] S. REP. NO. 100-445, at 424 (1988). For example, the transportation of oil or gas clearly generates qualifying income even though the transporter could not take a depletion allowance with respect to this activity.

[6] All figures were provided by IHS Inc. ("IHS"). IHS is the premier provider of information, analytics and technical expertise across the entire energy and processing value chain. IHS serves as consultants to the Department of Energy, the Environmental Protection Agency, and other federal agencies.

Figure 1. Natural gas liquids are a hydrocarbon component of every barrel of crude oil and every natural gas stream. ***Source: IHS***



The Treasury Regulations regarding depletion recognize that NGLs are "oil and gas" and treat NGLs as crude oil for depletion purposes.[7] These Treasury Regulations recognize the physical reality that the hydrocarbon continuum is complex and that many different hydrocarbons, including NGLs, fit under the generic term "oil and gas." The legislative history to section 7704(d)(1)(E) confirms that oil and gas is a Qualifying Natural Resource.[8]

B. The Processing of NGLs to Create Olefins Is a Qualifying Activity

As Qualifying Natural Resources, NGLs may be either "processed" or "refined" to produce qualifying income. Indeed, NGLs are processed and refined in both crude oil refineries and in steam crackers and other NGL processing facilities.

The steam cracking of NGLs is a simple operation that meets the plain definition of both "processing" and "refining."[9] "Steam cracking" is the process of using heat to break down a hydrocarbon molecule and remove hydrogen molecules. This process can be applied to various

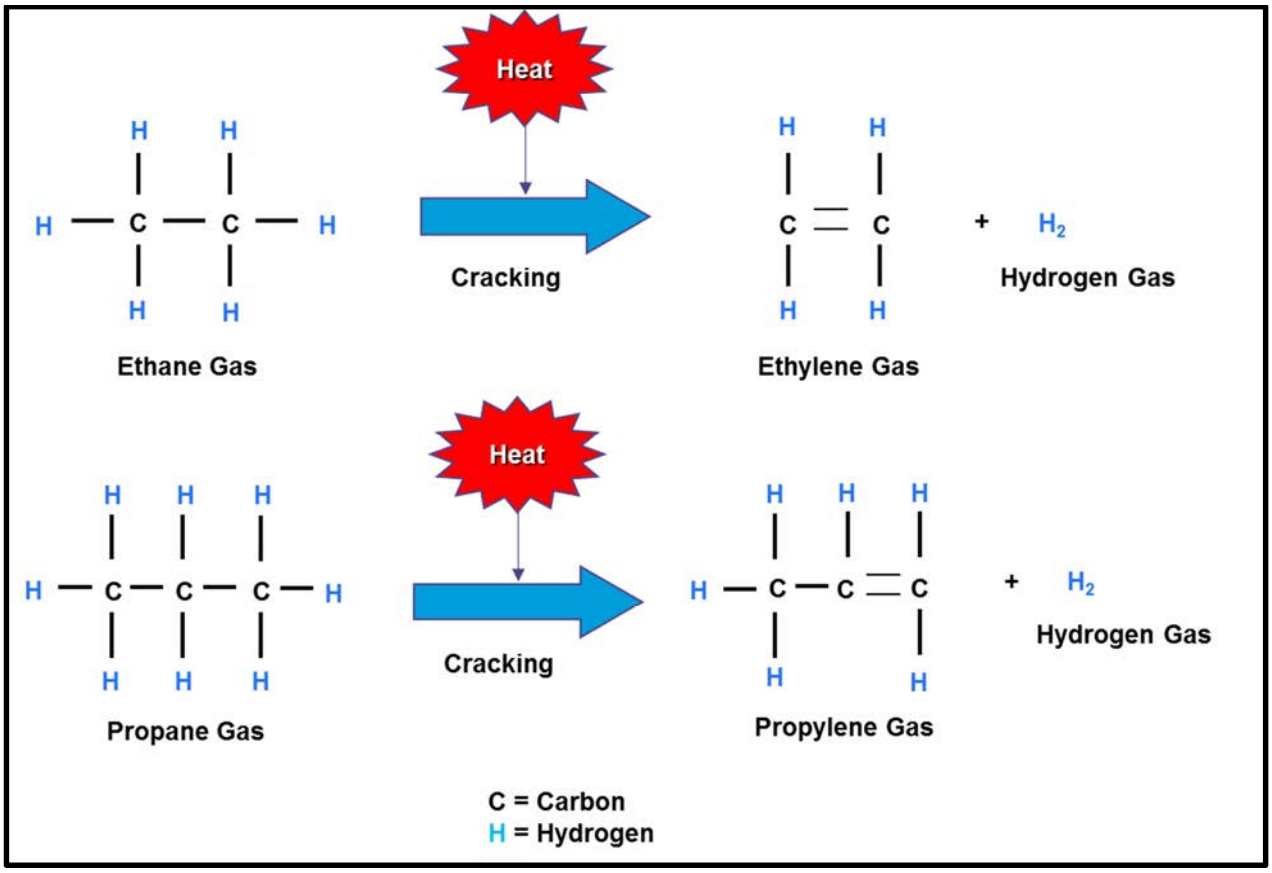
[7] Treas. Reg. § 1.613A-7(g)(3).

[8] H.R. REP. NO. 100-495, at 30 (1987) (providing that Qualifying Natural Resources include "oil, gas or products thereof"). The legislative history goes on to include a broad, non-exclusive list of basic hydrocarbon products that constitute oil, gas or products thereof.

[9] See Part IV.B.2, below, for additional discussion regarding the plain meaning of "processing" and "refining." Also note that naphtha, a hydrocarbon that is slightly heavier than an NGL, may also be processed via steam cracking. For the sake of clarity, these comments focus on the processing of NGLs, but the discussion applies equally to the processing of naphtha.

hydrocarbon components of oil and gas. Steam cracking of NGLs includes the cracking of ethane and propane to produce ethylene and propylene. The input and the output of these steam cracking processes are molecularly very similar. See Figure 2.

Figure 2. Steam cracking of ethane and propane is a relatively simple process that produces slightly simpler molecules. ***Source: IHS***



Moreover, steam cracking has been in use for decades and was in widespread use in 1987 when Congress adopted section 7704. It was the primary method to break down crude oil to produce fuels until catalytic cracking gained prominence in the 1940s. Steam cracking still exists in some crude oil refineries today.

C. The Legislative History Confirms that the Processing of NGLs to Create Olefins Generates Qualifying Income

1. The Legislative History Treats NGLs as Qualifying Natural Resources

The legislative history to section 7704 provides:

> *[Qualifying] natural resources include . . . oil, gas or products thereof* . . . . For this purpose, oil, 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.[10]

Overall, like the statute itself, the legislative history focuses on the input to determine whether a processing or refining activity creates qualifying income. In other words, the legislative history provides guidance with respect to what qualifies as a Qualifying Natural Resource to which Qualifying Activities can be applied. Neither the statute nor the legislative history requires a determination whether the output of the activity is a Qualifying Natural Resource. If an activity (1) takes a Qualifying Natural Resource as an input and (2) is a Qualifying Activity (such as "processing" or "refining"), that activity produces qualifying income.

The legislative history confirms that NGLs are Qualifying Natural Resources. The legislative history provides that oil and gas — as well as a broad, non-exclusive list of basic hydrocarbon products — are Qualifying Natural Resources. The legislative history then goes on to clarify the types of "oil or gas products" that are natural resources. Because NGLs are themselves *oil and gas* (not oil or gas *products*), this clarification is not relevant to the conclusion that NGLs are Qualifying Natural Resources and that processing or refining NGLs would produce qualifying income.

2. Olefins such as Ethylene and Propylene Are Not Plastics or Similar Petroleum Derivatives

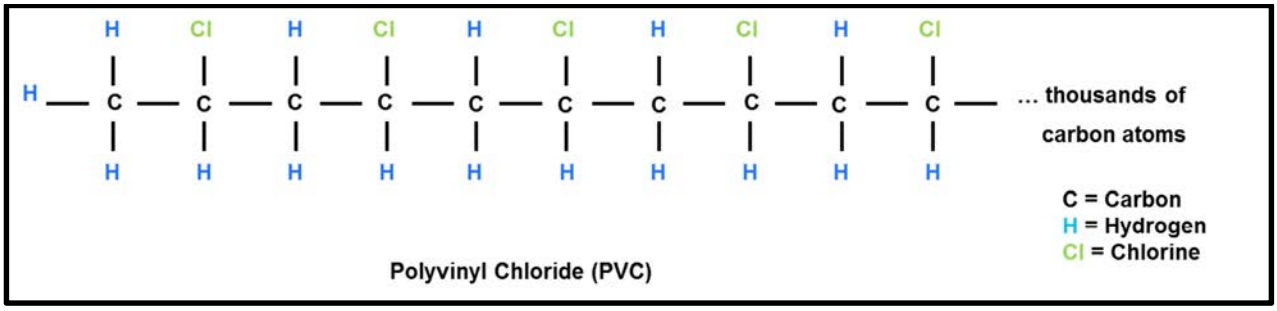
In context, by clarifying the types of "oil or gas products" that are natural resources, the legislative history is attempting to delineate between, on the one hand, natural resources that have merely been refined or processed, and on the other hand, plastics and similar petroleum derivatives. Presumably this is because plastics and similar petroleum derivatives are sufficiently distinct from Qualifying Natural Resources that they have lost their character as natural resources. We refer to these products as "Remote Derivatives."

Although the statute is silent on this topic, we believe that the limitation suggested by the legislative history is reasonable — plastic is not recognized as a refined or processed petroleum product as that term is commonly understood, and creating plastic requires further complex manufacturing, often including the addition of other components besides products of oil or gas during the manufacturing process. The use of the phrase "similar petroleum derivatives" logically would disqualify materials, and only those materials, having characteristics so far removed from oil and gas products as to be plastics or similar to plastics. Plastics include polyethylene, polyvinyl chloride (also known as PVC), polyester, polypropylene, nylon, polystyrene, acrylonitrile-butadiene-styrene, polycarbonate, and polyurethanes; other similar petroleum derivatives include styrofoam, rubbers and other chemical products that differ substantially from, and have more complex molecular structures than, the base petrochemical feedstocks from which they are produced.

[10] H.R. REP. NO. 100-495, at 30 (1987) (emphasis added).

Again, we believe the statute and the legislative history contain requirements only as to the inputs, not the outputs, of an activity. In any case, even if the legislative history can be read to place limitations on the types of *outputs* that create qualifying income, it is certain that both NGLs (such as ethane and propane) *and* the olefins that result from cracking NGLs (such as ethylene or propylene) are gases of a type that are commonly recovered in a refinery and not "plastics or similar petroleum derivatives."[11] WLKP, like other NGL processers, uses heat to "crack" the ethane, propane or other NGLs and thereby produce ethylene or propylene from each NGL molecule. The resulting olefin (ethylene or propylene) is a gas that is very similar to its corresponding NGL — in fact, it has a slightly simpler molecular structure than its corresponding NGL. See Figure 2, above. Contrasting the molecular structures of ethane, ethylene, propane, and propylene with those of plastics, such as PVC (polyvinyl-chloride), reveals significant differences. On a macro level, PVC is a solid used for making plastic pipes and other items. On a micro level, PVC contains thousands of carbon and chlorine atoms. See Figure 3.

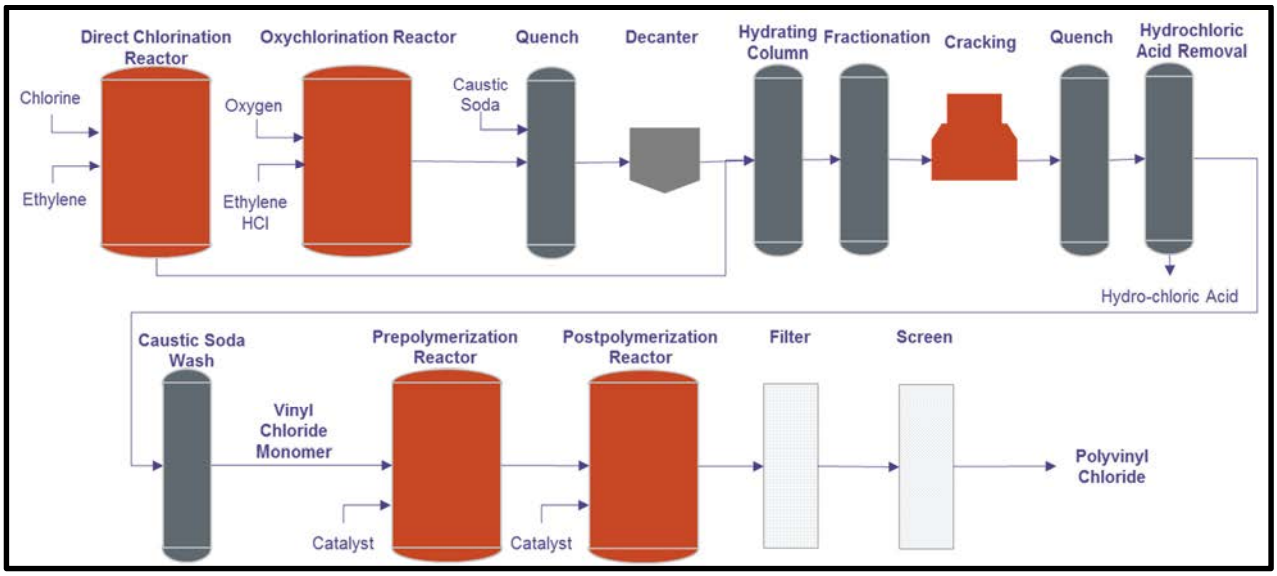
Figure 3. Plastics have a complex molecular structure. The figure shows polyvinyl chloride as an example. *Source: IHS*



Furthermore, the steam cracking of NGLs to produce olefins is a relatively simple process compared to the numerous, complex steps required to convert an olefin gas such as ethylene or propylene into a finished plastic product. See Figure 4.

[11] Note that ethane and propane exist in crude oil and natural gas deposits. Ethylene and propylene also occur naturally in trace amounts.

Figure 4. Numerous steps are required to create a plastic. The figure shows the steps required to create polyvinyl chloride as an example. *Source: IHS*



Note that the differences between olefins and plastics (and similar petroleum derivatives) are equally striking regardless of the intended use of the olefin. Olefins, such as ethylene or propylene, are fungible products. An ethylene or propylene molecule does not somehow become a "plastic or similar petroleum derivative" simply because it is not being produced incidentally to fuel production.

3. Conclusion

Importantly, while ethylene and propylene are products that can be recovered from petroleum refineries, the manufacture of plastics does not take place in petroleum refineries. Recall that the legislative history clarifies that qualifying income does not arise from "*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."[12] Olefins such as ethylene and propylene are oil or gas products that are produced by processing in petroleum refineries; thus the legislative history indicates that olefins *as a class of product* can create qualifying income, regardless of where they are actually produced. In contrast, plastics and similar petroleum derivatives are products that require further processing beyond the type of processing that occurs in petroleum refineries, so they do not give rise to qualifying income (again, regardless of where they are actually produced).

Ethylene and propylene are "similar" to the products expressly listed in the legislative history (such as propane), they are products which are recovered from petroleum refineries (as well as from other facilities such as steam crackers), and they are not plastics or similar petroleum derivatives. Thus, not only is the input of steam cracking (ethane, propane) a Qualifying Natural Resource, but the output (ethylene, propylene) is described in the legislative

[12] H.R. REP. NO. 100-495, at 30 (1987) (emphasis added).

history as a similar product to other natural resources[13] and cannot be considered a Remote Derivative (such as a plastic). Consequently, under the legislative history, and consistent with the PLR received by Westlake, processing NGLs such as ethane and propane into ethylene and propylene by steam cracking creates qualifying income.

III. The Proposed Regulations

A. Exclusive List of Operations

The Proposed Regulations provide guidance on those activities with respect to minerals and natural resources (as defined in section 7704(d)(1)(E)) that will generate qualifying income. Under the statute, Qualifying Activities include the exploration, development, mining or production, processing, refining, transportation, or marketing of any mineral or natural resource. The Proposed Regulations provide an exclusive list of "operations" that comprise Qualifying Activities that may generate qualifying income and then apply definitions to those "operations."

B. "Processing or Refining" NGLs

In general, the Proposed Regulations provide that an activity is "processing or refining" only if (i) the activity is done to purify, separate or eliminate impurities, (ii) the activity does not (a) cause a substantial physical or chemical change in a mineral or natural resource or (b) transform the mineral or natural resource into new or different mineral products or into manufactured products, and (iii) the assets used in the activity are depreciated in accordance with the MACRS class life prescribed for assets used in the activity for which processing or refining characterization is sought. We refer to this three-pronged test as the "Proposed Processing or Refining Test."

In delineating the permitted activity of "processing or refining," the Proposed Regulations distinguish between oil and natural gas and provide much broader parameters for the processing or refining of crude oil. In the case of natural gas, the Proposed Regulations state that NGL extraction and separation of the components of the NGLs (ethane, propane, butane, etc.) will create qualifying income. However, under the Proposed Regulations, further processing or refining of those NGL components beyond initial separation operations does not qualify.

Further, the Proposed Regulations specify, as exceptions to the Proposed Processing or Refining Test, that (i) processing will include converting methane in one integrated conversion into liquid fuels, provided that such liquid fuels are otherwise produced from the processing (or presumably refining) of crude oil, and (ii) the production of ethylene, propylene and similar petrochemical feedstocks in a refinery will create qualifying income, provided such products are produced in the steps required to make fuels. We refer to these two provisos as the "Fuel Production Requirement."

Thus, Example 1 of Prop. Treas. Reg. § 1.7704-4(e) provides that income derived from the conversion by *steam* cracking of a mixture of ethane and propane obtained from the physical

[13] Natural resources in the legislative history specifically include, for example, gasoline, diesel fuel, butane and propane. Ethylene and propylene are products similar to propane.

separation of a natural gas stream is not qualifying income. In contrast, Example 2 of Prop. Treas. Reg. § 1.7704-4(e) provides that income derived from the *catalytic* cracking of a crude oil stream to produce a liquid stream suitable for gasoline blending and a gas stream containing ethane, ethylene and other gases, and the separation of the components of that stream to produce refinery grade ethylene, all produce qualifying income. As described below, we believe the distinction drawn between the processing of NGLs through *steam* cracking and the *catalytic* cracking of gas oil is not supported by the statute or the legislative history, and results in disparate treatment of very similar activities.

IV. Specific Comments on the Proposed Regulations — Processing or Refining NGLs

A. Summary

In contrast to the Proposed Processing or Refining Test and the Fuel Production Requirement contained in the Proposed Regulations, neither the statute nor the legislative history defines, limits or restricts the terms "processing" and "refining." As such, each term should be given its plain meaning, as discussed below. In addition, as noted above, existing Treasury depletion regulations and the legislative history to section 7704(d)(1)(E) make it abundantly clear that NGLs (which are recovered from both oil and natural gas field facilities and crude oil refineries) are Qualifying Natural Resources to which each of the Qualifying Activities can be applied to produce qualifying income.

We believe the standard adopted by the Proposed Regulations to determine what activities qualify as "processing or refining" is unduly restrictive because it (i) contravenes the plain meaning of the statute and the relevant explanations contained in the legislative history and existing Treasury Regulations, (ii) results in inconsistent treatment of fungible products (e.g., ethylene or propylene) depending on the method of their production (e.g., catalytic cracking or steam cracking) or the location where they are processed (e.g., crude oil refineries vs. steam crackers processing NGLs), ultimately treating similarly-situated taxpayers engaged in the same business in a different manner, (iii) incorporates process restrictions that are fundamentally inconsistent with definitions of "mining," "processing" and "refining" used both by the Treasury and the IRS as well as the commonly accepted meaning of such terms, (iv) imposes a Fuel Production Requirement that is not supportable by the statute or its legislative history, and (v) interjects a MACRS-based qualification test having no probative value or statutory support in determining whether an activity is processing or refining.

B. The Plain Meaning of the Statute and Its Legislative History

1. Processing and Refining Are Separate Operations

As a preliminary matter, section 7704(d)(1)(E), unlike the Proposed Regulations, does not treat "processing" and "refining" as a single activity. Instead, the statute includes the two terms among a long list of separate and distinct activities plainly intended to encompass the full range of activities involving minerals or natural resources: "exploration, development, mining or production, processing, refining, transportation . . . , or the marketing of any mineral or natural

resource[.]"[14] Thus, Congress explicitly sought to include within the activities producing "qualifying income" every stage of mineral and natural resource production, from the initial steps of identifying and accessing resources ("exploration", "development"), to their extraction ("mining or production"), to rendering the extracted raw materials commercially useful ("processing", "refining"), to delivering and selling them ("transportation", "marketing"). Congress plainly meant each of the terms set off by commas to be given distinct meanings because it listed them separately. When Congress meant terms to be considered as equivalents, it unambiguously expressed that in the text of the statute: For example, "mining or production" are the only terms in section 7704(d)(1)(E) that are separated by "or" rather than being set off by a comma, to recognize that minerals and ores are "mined" and oil, gas and other resources are analogously "produced."

By giving the separately-listed terms "processing" and "refining" the very same meaning, the Proposed Regulations violate a "cardinal principle of statutory construction," that a statute must be read to "give effect . . . to every clause and word of a statute."[15] A statute should be constructed to give effect to all its provisions, so that no part will be inoperative or superfluous, void or insignificant.[16] Under the Proposed Regulations, either "processing" or "refining" is redundant.

2. "Processing" and "Refining" by Definition Involve One or Both of Chemical and Physical Changes to the Feedstock

The second prong of the Proposed Refining or Processing Test in the Proposed Regulations states that processing and refining can neither cause a substantial physical or chemical change nor transform a mineral or natural resource into different or manufactured products. When applied to NGLs, the Proposed Regulations essentially define processing and refining to be only those activities that involve *no* physical or chemical change or transformation.

These restrictions are irreconcilably at odds with established understandings of those terms. The Oxford Dictionaries defines "to process" as "to perform a series of mechanical or chemical operations on (something) in order to change or preserve it." "To refine" is defined as "to remove impurities or unwanted elements from (a substance), typically as part of an industrial process."[17] Consistent with this, as discussed further below in Part IV.D.1, existing Treasury Regulations generally define "refining" as "any operation by which the physical or chemical characteristics of crude oil [including NGLs] are changed[.]"[18] Both "refining" and "processing" contemplate, by their very definitions, physical and chemical changes to the input material.

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[14] I.R.C. § 7704(d)(1)(E).

[15] *Williams v. Taylor*, 529 U.S. 362, 404 (2000) (quoting *United States v. Menasche*, 348 U.S. 528, 538-39 (1955)).

[16] *Duncan v. Walker*, 533 U.S. 167, 174 (2001) (citing *Market Co. v. Hoffman*, 101 U.S. 112, 115 (1879)).

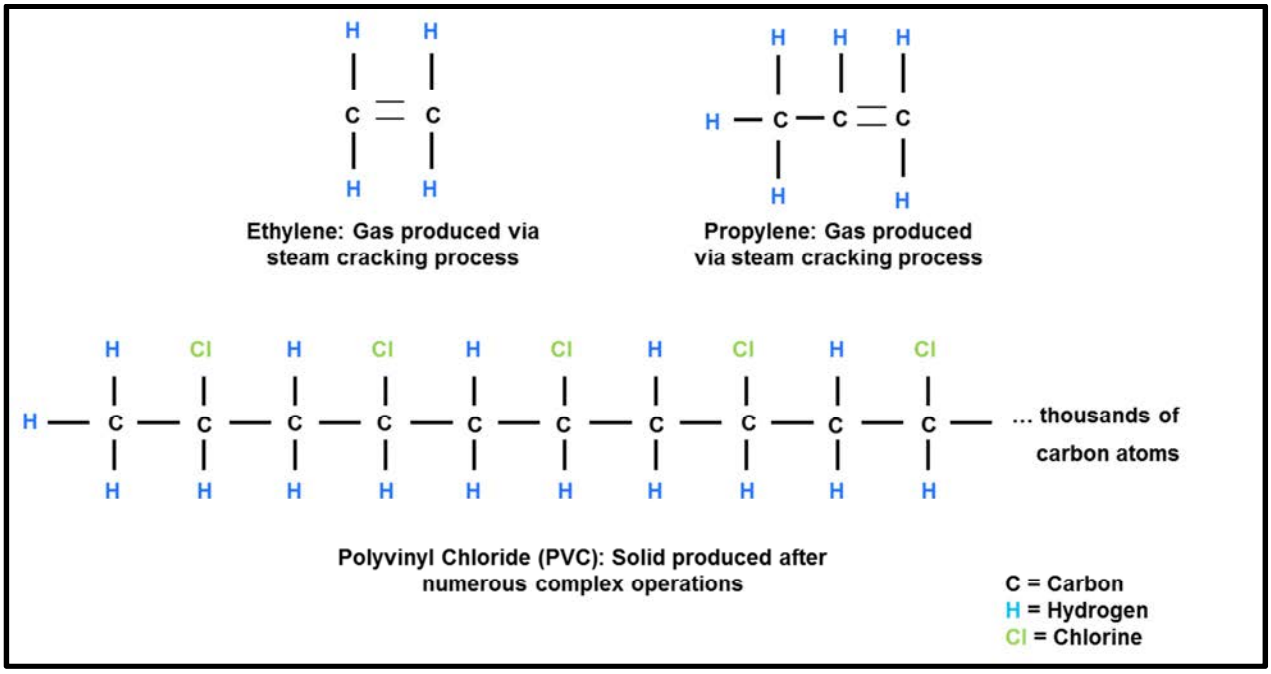
[17] Note that the definition of "refining" contemplates that refining is a specific type of process. "Processing" is thus the broader term. This is consistent with usage of these terms in the industry. For example, the U.S. Energy Information Administration defines "catalytic cracking" as a "refining process." *See* Definition of *Catalytic Cracking*, U.S. ENERGY INFORMATION ADMINISTRATION, http://www.eia.gov/tools/glossary/index.cfm?id=C (last visited July 27, 2015).

[18] Treas. Reg. § 1.613A-7(s).

3. Steam Cracking of NGLs Is the Refining and Processing of a Natural Resource and Should Be Treated as a Qualifying Activity

As discussed above, NGLs are Qualifying Natural Resources, and, as such, they may be either "refined" or "processed" to produce qualifying income. The steam cracking of NGLs to produce olefins meets either definition. "Steam cracking" is the process of breaking down a molecule and removing hydrogen molecules. Cracking is commonly carried out within a refinery operation. And the cracking of an NGL (e.g., ethane, propane) to produce an olefin (e.g., ethylene, propylene) is simply converting one gas into another gas that can be used for further processing into fuels or as a petrochemical feedstock. Olefins such as ethylene and propylene are certainly not "plastics or similar petroleum derivatives." See Figure 5.

Figure 5. The physical properties and molecular structure of ethylene and propylene are very different from those of plastics such as polyvinyl chloride. ***Source: IHS***



Consequently, any concern that the steam cracking of NGLs results in the production of a petroleum derivative similar to plastics is unwarranted. Moreover, NGLs have been processed in steam crackers for decades, and were certainly being processed in steam crackers prior to 1987, when section 7704 was enacted. Had Congress desired to exclude this activity from the application of section 7704(d)(1)(E), it could have used more restrictive statutory terms or included exceptions based on feedstock, type of facility, or even intended use of the output (e.g., fuel versus non-fuel), but it did not.

C. Similarly-Situated Taxpayers Are Not Treated in the Same Manner

1. Inconsistent Treatment of Hydrocarbon Sources

As a result of exceptions for the refining of crude oil and the conversion of methane into liquid fuels, both of which would otherwise violate the Proposed Processing or Refining Test, the

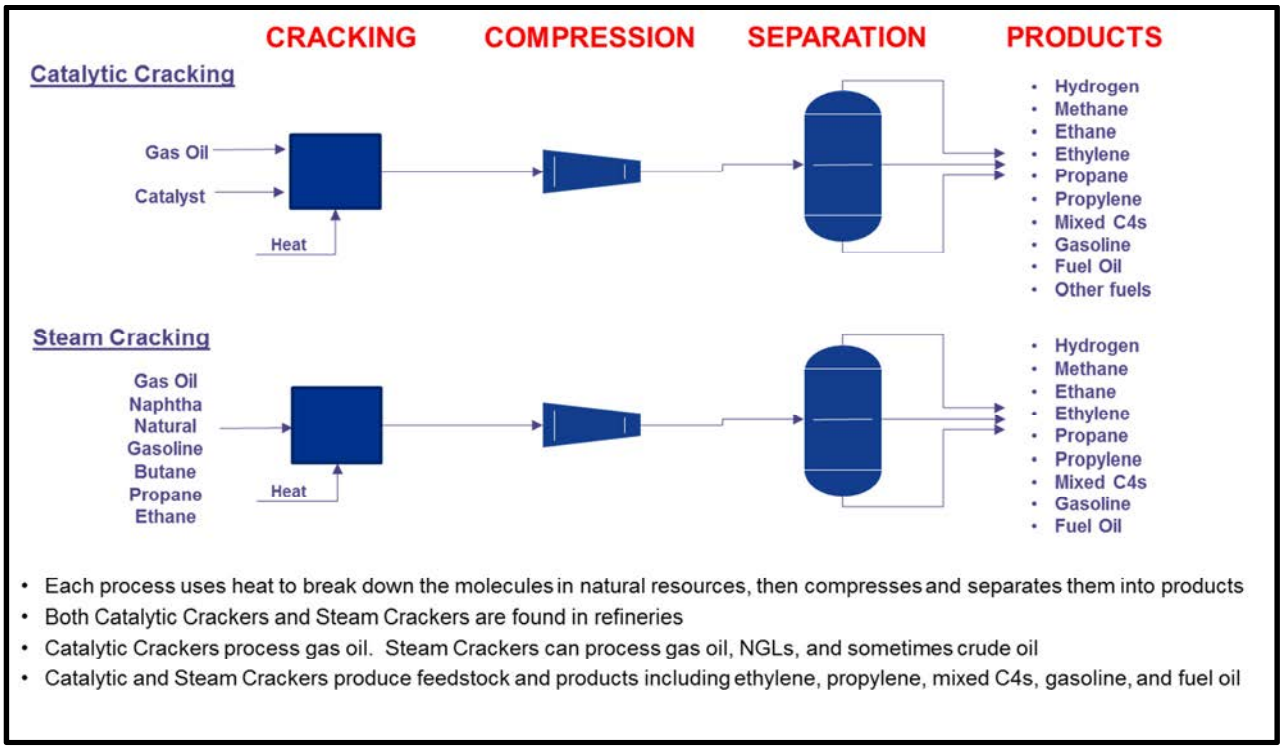
Proposed Regulations differentiate between fungible oil and gas products, such as ethylene and propylene, based on (i) the particular natural resource from which they are derived and (ii) the type of facility that produces them. This is made clear by contrasting Example 1 with Example 2 of the Proposed Regulations, as discussed above. Example 1 concludes that the conversion of NGLs into olefins (such as ethylene) through *steam* cracking does not give rise to qualifying income, while Example 2 concludes that the conversion of crude oil into various components (again, such as ethylene) through *catalytic* cracking does give rise to qualifying income. The Proposed Regulations' distinction based upon the particular natural resource or facility type from which a product is produced treats the same products from the same or substantially similar inputs via essentially the same processes inconsistently. This disparate treatment is not supported by the wording and legislative history of section 7704.

2. Catalytic Cracking Is Essentially the Same as Steam Cracking

The NGL steam cracking described in Example 1 is essentially the same as the catalytic cracking described in Example 2. Each uses essentially the same processes to generate the same products in varying proportions. As noted above, cracking is the process of breaking down a hydrocarbon molecule into simpler molecules and removing hydrogen. A steam cracker accomplishes this through the application of heat. A catalytic cracker likewise uses heat to break down a hydrocarbon molecule, but also uses a catalyst to speed up the reaction and to influence the ratio of the product mix. Thus, the only difference between steam cracking and catalytic cracking is that the latter is a slightly more complicated process. Moreover, dozens of current refinery complexes worldwide include both steam crackers and catalytic crackers. Indeed, by 1987, the number of refineries in the United States that were integrated with steam cracking facilities was in the double digits.

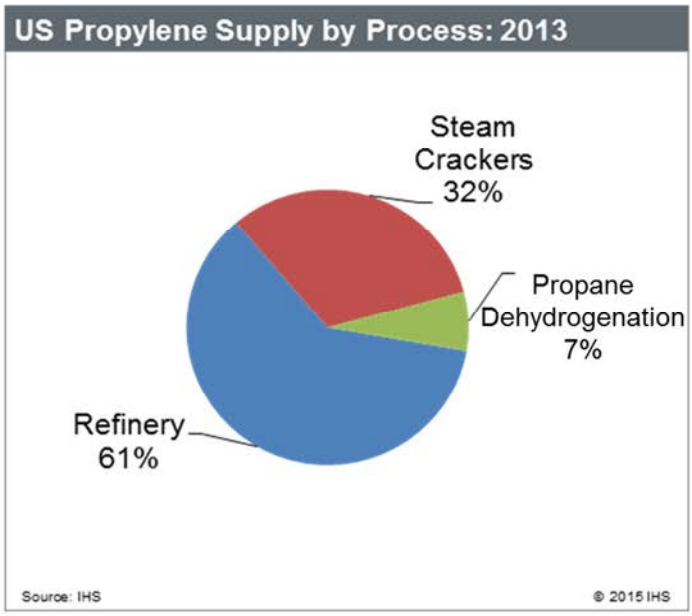
The processing of NGLs and other hydrocarbons can occur either in a crude oil refinery or a steam cracker. Both types of facilities employ processes that result in physical and chemical changes to the hydrocarbon feedstocks. These processes can involve cracking with heat, cooling, compression, separation, blending and other processing steps. In the end, the list of products from a crude oil refinery includes the same products as the list of products from a steam cracker processing NGLs. See Figure 6.

Figure 6. Catalytic cracking in a refinery and steam cracking of NGLs share many similarities, including the products that they produce. ***Source: IHS***



For example, propylene comes from both crude oil refineries and steam crackers that process NGLs; indeed, approximately 61% of the propylene sold in the United States market comes from refineries using catalytic crackers, while most of the remaining propylene supply is produced through the processing of NGLs using steam crackers. See Figure 7.

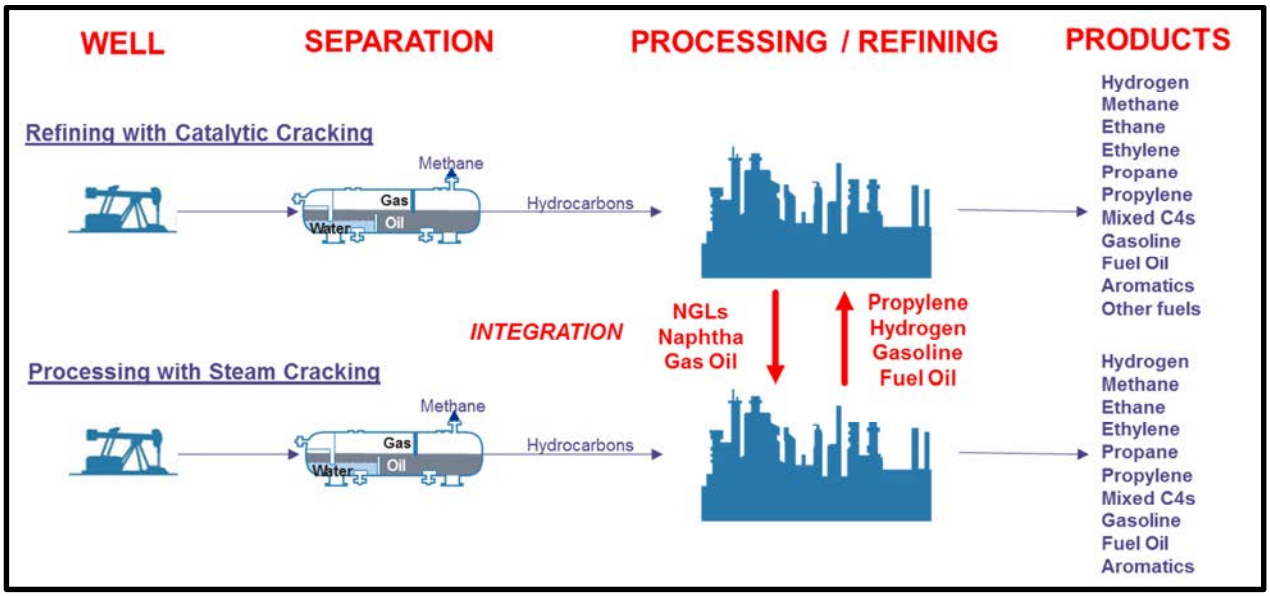
Figure 7. Propylene is produced both in refineries and in steam crackers processing NGLs.
Source: IHS



Refineries are a major source of propylene in the US. US refineries account for more than 60% of the propylene, with steam crackers accounting for the majority of the remaining supply.

In addition, there is considerable integration between crude oil refineries and steam crackers processing NGLs. See Figure 8. In other words, the refinery and the steam cracker are physically integrated or otherwise operate as one integrated unit. Most significantly, a long the chain of processes that occur within each facility, various hydrocarbons are sent from the refinery to the steam cracker and vice versa. Ethane, propane, butane, natural gasoline and gas oil can be sent from a refinery to a steam cracker for processing. Likewise, olefins, raw gasoline, fuel oil and aromatics can be sent from a steam cracker to a crude oil refinery for further processing, refining or blending with other products. Some facilities share the same utility infrastructure (e.g., electricity, steam, water, fire, cooling) and can be operated in a coordinated fashion (e.g., concurrent unit shutdowns for maintenance and utilization of the same personnel). This type of integration is not new; by 1987, when section 7704 was enacted, a significant amount of all ethylene production capacity in the United States was associated with refinery operations.

Figure 8. Crude oil refineries and steam crackers processing NGLs are integrated. ***Source: IHS***



In summary, catalytic cracking and steam cracking apply essentially the same processes to hydrocarbon feedstocks and produce the same products. In many cases, refineries contain both catalytic and steam crackers and there is considerable integration between crude oil refineries and steam crackers processing NGLs. Inexplicably, under the Proposed Regulations, the processing of NGLs into olefins (such as ethylene) through steam cracking does not generate qualifying income while the processing of crude oil through catalytic cracking into various components (again, such as ethylene) does give rise to qualifying income. As described in detail above, we believe this result is inconsistent with section 7704 and the legislative history as well as the reasonable expectation that Congress would seek to treat similarly-situated taxpayers in the same manner.

3. The Proposed Regulations Are Not Administrable

A number of existing MLPs engage in the processing, transportation, storage and/or marketing of NGLs, olefins and/or refined products. If the Proposed Regulations are finalized with unequal treatment of the same products based on their method of production, MLPs that are engaged in the transportation, storage and marketing of NGLs, olefins and refined products would have the virtually impossible task of trying to identify the exact source of the fungible products they handle in order to somehow segregate qualifying products from non-qualifying products and calculate income generated from each source. Congress could not have intended that result.

D. Fundamental Inconsistencies of the Proposed Regulations' Definitions

1. Refining NGLs — Applicable Treasury Regulations

Existing Treasury Regulations have defined "refining" in the context of NGLs and crude oil. The Treasury Regulations regarding the depletion of crude oil define "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."[19] For this purpose, "crude oil" is defined to include a "[n]atural gas liquid recovered from gas well effluent in lease separators or field facilities before any conversion process has been applied to such production."[20] In sum, existing Treasury Regulations define "refining" of NGLs broadly to include any transformative process, including chemical and physical changes, with certain limited exceptions to recognize activities treated as part of production of oil or gas. This is consistent with the plain meaning of "refining" discussed above.

The Proposed Regulations rely to some extent on the existing depletion regulations to define "processing or refining" of ores and minerals,[21] but ignore the definition of "refining" of crude oil and NGLs in the oil and gas depletion regulations. The Proposed Regulations should eliminate this inconsistency by incorporating the meaning of "refining" of crude oil, which includes NGLs, from the existing depletion regulations as well.

2. Refining NGLs — The Internal Revenue Manual

The Internal Revenue Service has included a general description of petroleum refining in Section 4.41.1.6 of its Oil & Gas Handbook, contained in the Internal Revenue Manual (the "IRM").[22] The most recent version of the description of a "refinery process" in the IRM was published on December 3, 2013. This use of petroleum "refining" is not couched in any technical context, but is merely a factual description of petroleum refining.[23]

The IRM states that modern refining processes involve the "breaking down, restructuring and recombining of hydrocarbon molecules."[24] The IRM further states that a "refinery process" includes converting petroleum into petrochemical feedstocks through a cracking process that converts paraffins into olefins.[25] More specifically, the description of "refinery process" includes "the removal of hydrogen to produce highly reactive hydrocarbons with double or triple bonds."[26] The descriptions in the IRM are consistent with existing Treasury Regulations,

[19] Treas. Reg. § 1.613A-7(s) (emphasis added). The operations excepted from refining are those regarded as part of "production," and the value added to the product thereby is subject to percentage depletion.

[20] Treas. Reg. § 1.613A-7(g)(3).

[21] *See* Prop. Treas. Reg. §1.7704-4(c)(5)(iv),

[22] IRM 4.41.1.6.

[23] Although the IRM is not generally considered legally binding authority, the Supreme Court has relied upon the IRM when interpreting the definition of a term appearing in the Treasury Regulations. *See United States v. Boyle*, 469 U.S. 241, 243 (1985) (citing the IRM, in favor of the taxpayer, as creating a list of circumstances that constitute "reasonable cause" for filing late returns even though no other authority listed such circumstances).

[24] IRM 4.41.1.6.1(2).

[25] IRM 4.41.1.6.1.1(2).

[26] IRM 4.41.1.6.1.1(5). Moreover, while discussing the various processes that constitute petroleum refining, the IRM repeatedly contemplates that such processes may produce products that can be sold as petrochemical feedstock and suggests that producing such feedstocks is a valid reason for performing a particular "refining process." IRM 4.41.1.6.1.1.

described above, which already have defined refining to be the process of causing a physical or chemical change to the substance being refined.

NGL cracking is entirely consistent with the definition of "refining" in existing Treasury Regulations and the descriptions in the IRM. A steam cracker processing ethane converts the ethane into ethylene by using heat (steam) to remove hydrogen and thereby create a double-bond between the two carbon atoms in ethane; a steam cracker processing propane works similarly.

In sum, the well-developed definitions of "refining" as reflected in commonly-accepted definitions of the term, as well as in the existing depletion regulations and the IRM quoted above, should be applied to interpret the meaning of "refining" in section 7704. The Proposed Regulations substantially limit the accepted meaning of "refining" to generally exclude chemical or physical changes, which are essential and intrinsic to the meaning of "refining" in common usage as well as under Treasury's and the IRS's own interpretations. This truncation is not merited, and we find nothing in the legislative history to suggest that the drafters intended such a restrictive meaning. Applying the long-accepted meaning of the term "refining," the cracking of a Qualifying Natural Resource such as an NGL in a steam cracker should be treated as a "refining" activity under section 7704(d)(1)(E).[27] Such a reading is consistent with the plain meaning of "refining," as well as with the reasoning contained in Westlake's PLR.

3. Contrary to Treasury's Suggestion, the Proposed Regulations Are Not Consistent with Existing Depletion Regulations

The preamble to the Proposed Regulations suggests that the exclusion of activities that cause a substantial physical or chemical change in a mineral or natural resource from processing and refining is consistent with definitions found elsewhere in the Code and regulations, citing Treas. Reg. § 1.613-4(g)(5) as an example. The purpose of that regulation is to list "transformation processes" which are not mining processes, and therefore cannot add value to a mineral or ore for purposes of computing percentage depletion. That such "transformation processes" are not mining processes does not mean that they are not processing or refining activities for purposes of section 7704(d)(1)(E). In fact, as "mining processes" are considered part of "mining",[28] the cited regulation is more consistent with the conclusion that transformation processes that are not mining processes, and therefore not part of mining, must necessarily fall into section 7704(d)(1)(E)'s Qualifying Activity continuum *after* mining or production, i.e., as processing or refining.

In any event, the definition of qualifying income cannot be determined by the line drawn in the depletion regulations. The line drawn in the depletion regulations separates production or mining activities from other activities – such as processing and refining. In this connection, the legislative history to section 7704 specifically provides that "whether income is taken into

[27] NGL cracking would also constitute "processing," which, as contemplated in the IRM, is a broader term than "refining."

[28] *See* I.R.C. §§ 613(c)(2), (4).

account in determining percentage depletion under section 613 is not necessarily relevant in determining whether such income is qualifying income under section 7704(d)."[29]

Viewed in this light, the term "processing" must mean, like refining, processes applied to depletable natural resources *after* mining or production processes (treated as a component part of mining or production under section 613), subject only to the limitation that any petroleum derivative produced must not be a Remote Derivative. Thus, gasoline, ethylene, propylene and similar clearly-identifiable natural resource products should qualify as products of processing or refining, but Remote Derivatives like plastics, rubbers and other more complex derivatives should not.

E. The Fuel Production Requirement Is Unsupportable

Beyond separation and the elimination of impurities, the Proposed Regulations appear to limit the term "refining" as applied to hydrocarbon natural resources to be only those activities the primary purpose of which is to produce fuel, and permit qualifying income to be generated by any coproduct only so long as its production is necessary for the economic production of fuel. It is inappropriate to limit the use of the term "refining" to the production of fuel, because no such limitation exists in the statute or in the legislative history. In fact, the legislative history recognized that lubricating oils are products of a refinery. Moreover, for the broader purposes of the statute, the term "refining" is not so limited. The term "refining," as used in section 7704(d)(1)(E), applies to all Qualifying Natural Resources — not simply those natural resources that can produce fuel. The statute and legislative history support that NGLs can be processed and refined in a manner directly and mechanically analogous to activities taking place in a crude oil refinery and that such activities are Qualifying Activities that produce qualifying income.

Finally, we note that each of ethylene, propylene and, more generally, petrochemical feedstocks are typical products of a refinery; nowhere, other than in the Proposed Regulations, is it suggested that these products are refinery products only if produced incidentally in the production of fuel. In addition, as discussed above, ethylene and propylene are not "plastics or similar derivatives" — they are gases that are very different from plastics. If these products, when produced in a refinery that also produces fuel, are not "plastics or similar petroleum derivatives," they cannot somehow become "plastics or similar petroleum derivatives" simply because they are not being produced incidentally to fuel production. Modern refineries are complex facilities with the ability to adjust their processes based on the available feedstocks (e.g., crude oil, NGLs, etc.) to produce the highest margin products, whether or not fuel, and refineries often intentionally produce ethylene and propylene as non-fuel products.[30]

F. The MACRS Limitation Is Inappropriate

Even in situations where a taxpayer engages in a processing or refining activity that meets the first two prongs of the Proposed Processing and Refining Test, the final prong of the Proposed Processing or Refining Test would deny qualifying income status to income derived

[29] Identical language is found in the reports from both the House of Representatives and the Senate to the Miscellaneous Revenue Act of 1988. H.R. REP. NO. 100-795, at 400 (1988); S. REP. NO. 100-445, at 424 (1988).

[30] We note that ethylene from refinery fuel processes is the same as ethylene from steam cracking.

from that activity if the taxpayer fails to use "an appropriate" MACRS class life for purposes of depreciation of the assets used in that activity. This rule would apparently apply even if the taxpayer's failure were reasonable, inadvertent, isolated, or the result of the IRS's refusal to grant consent to change to an appropriate depreciation method.[31]

The insertion of a MACRS class life requirement into any definition of processing or refining is inconsistent with the statutory language of section 7704(d)(1)(E). Regardless of the precise interpretation of the statutory terms "processing" and "refining," a processing or refining activity cannot become something else merely because a taxpayer uses a specific depreciation method or uses a different asset to accomplish the same result. Under the Proposed Regulations, two taxpayers who do exactly the same things for exactly the same reasons in exactly the same manner could be treated as performing different activities based on the depreciation method they might elect.

The simpler and more appropriate approach is to determine whether a taxpayer's activity is processing or refining for purposes of section 7704(d)(1)(E) without regard to how the taxpayer's assets are depreciated. It is not necessary to interject regulation of MACRS issues into the qualifying income regulations.

G. Relying on NAICS Codes Is Inappropriate

The Preamble to the Proposed Regulations provides that, with respect to natural gas activities, "[i]t is generally anticipated that activities that create the products listed in [the most recent version] of North American Industry Classification System (NAICS) code 211112 concerning natural gas liquid extraction will be qualifying activities." Similarly, with respect to crude oil refining, the Preamble states that "[i]t is generally anticipated that activities within a refinery that create the products that are listed in [the most recent version] of NAICS code 324110 concerning petroleum refineries will be qualifying activities, if those products are refinery grade products that are obtained in the steps required to make fuels, lubricating base oils, waxes, and similar products." However, the Preamble does *not* provide any express guidance regarding the treatment of any other NAICS codes, such as NAICS code 325110 concerning petrochemical manufacturing.

Use of the NAICS codes to define Qualifying Activities is unnecessary. As we have discussed above, taxpayers' activities can be characterized by reference to the common understanding of the terms "processing" and "refining." While we support the effort to use the NAICS codes as a safe harbor, it would be inappropriate to deny qualifying income status to taxpayers who do not self-assign NAICS code 211112 for natural gas activities or 324110 for crude oil refining activities.

NAICS is a system of classifying U.S. industries, designed and developed for statistical purposes.[32] According to the U.S. Census Bureau, there is "no central government agency with

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[31] *See* Treas. Reg. § 1.446-1(e)(2)(iii), Example 14 (requiring IRS consent to change the MACRS class life for an asset).

[32] *See North American Industry Classification System: Frequently Asked Questions,* U.S. CENSUS BUREAU, http://www.census.gov/eos/www/naics/faqs/faqs.html (last visited July 27, 2015).

the role of assigning, monitoring, or approving NAICS codes for establishments."[33] The U.S. Census Bureau expressly acknowledges that "[i]ndividual establishments are assigned NAICS codes by various agencies for various purposes using a variety of methods."[34]

Unsurprisingly given their purpose, the NAICS codes do not match up with the statutory language of section 7704(d)(1)(E). For example, there is no NAICS code labeled "processing" and certainly no separate NAICS codes for processing NGLs and refining NGLs. The two NAICS codes mentioned in the Preamble, by their terms, cover only "extraction" of NGLs and "refin[ing]" crude petroleum. Clearly, then, these two NAICS codes cannot comprise the full range of qualifying processing and refining activities.

In addition, the official descriptions of the NAICS codes contain imprecise terminology, revealing that the NAICS codes are not sophisticated or clear enough to substitute for thoughtful regulatory guidance in this area. For example, the NAICS codes at various times equate "manufacturing" with "smelting/refining"[35] or with "processing (i.e., beyond basic preparation),"[36] and the codes include "petroleum refineries" under the "manufacturing" umbrella as well.[37] The NAICS codes explain that the "Chemical Manufacturing" subsector (which includes NAICS code 325110) includes "the production of basic chemicals" as well as "the production of intermediate and end products produced by *further processing* of basic chemicals" while acknowledging that some other "chemical processing" occurs "during mining operations."[38] Particularly given how the NAICS codes intermix the terms refining, processing, manufacturing, and even mining, the NAICS codes do not provide suitable guidance regarding the meaning of the distinct statutory terms in section 7704(d)(1)(E).

To further highlight the difficulties in using the NAICS codes as a proxy for comprehensive regulations, use of a different method of categorization in the context of refining and processing activities could give disparate results. Processes that generate the products listed in NAICS codes 211112 and 324110 may also fit within other NAICS codes — such as 325110 — potentially creating a situation in which a taxpayer has a legitimate choice between alternative

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[33] *Id.* at Question 10.

[34] *Id.*

[35] *See 2012 NAICS Definition of Sector 21*, U.S. CENSUS BUREAU, http://www.census.gov/cgi-bin/sssd/naics/naicsrch?code=21&search=2012%20NAICS%20Search (last visited July 27, 2015).

[36] *See 2012 NAICS Definition of Sector 21 – Mining, Quarrying, and Oil and Gas Extraction: 21232 Sand, Gravel, Clay, and Ceramic and Refractory Minerals Mining and Quarrying*, U.S. CENSUS BUREAU, http://www.census.gov/cgi-bin/sssd/naics/naicsrch?code=21232&search=2012%20NAICS%20Search (last visited July 27, 2015); *see also 2012 NAICS Definition of Sector 31-33 -- Manufacturing*, U.S. CENSUS BUREAU, http://www.census.gov/cgi-bin/sssd/naics/naicsrch?code=31&search=2012%20NAICS%20Search (last visited July 27, 2015) ("Manufacturing establishments may process materials or may contract with other establishments to process their materials for them. Both types of establishments are included in manufacturing.").

[37] *See 2012 NAICS Definition of Sector 31-33 – Manufacturing: 32411 Petroleum Refining*, U.S. CENSUS BUREAU, http://www.census.gov/cgi-bin/sssd/naics/naicsrch?code=32411&search=2012%20NAICS%20Search (last visited July 27, 2015).

[38] *See 2012 NAICS Definition of Sector 31-33 Manufacturing: 325 Chemical Manufacturing*, U.S. CENSUS BUREAU, http://www.census.gov/cgi-bin/sssd/naics/naicsrch?code=325&search=2012%20NAICS%20Search (last visited July 27, 2015) (emphasis added).

NAICS codes for the same activity. Nothing in section 7704 or its history suggests the use of NAICS codes to determine qualifying income. As such, we recommend clarification that the language in the preamble was not meant to limit qualifying income based on a taxpayer's NAICS codes.

V. Proposed Regulatory Standard

The most appropriate test to be applied to determine whether an activity is processing or refining that creates qualifying income for purposes of section 7704(d)(1)(E) is the test provided in the statute: whether the activity takes a Qualifying Natural Resource as an input and applies an operation that meets the plain definition of "processing" or "refining." That is all that is required under the statute. The steam cracking of NGLs to create olefins generates qualifying income under this standard.

In the specific context of Qualifying Natural Resources that are oil and gas, we recognize Treasury's need to draw a line that stops short of Remote Derivatives under the legislative history. A potentially helpful consideration is to include an additional requirement for Qualifying Natural Resources that are oil and gas: the output of the activity must be a product of a type that is produced in a crude oil refinery.[39] Products of the type that are produced in a crude oil refinery are very different from Remote Derivatives (i.e., plastics and similar petroleum derivatives), and include olefins such as ethylene and propylene.[40] Products of the type that are produced in a crude oil refinery are by definition products that are produced by the type of processing that occurs in petroleum refineries.

Under this standard, qualifying income would result from an operation that (1) takes an oil and gas Qualifying Natural Resource as an input and (2) produces, through a Qualifying Activity, a product of a type that is produced in a crude oil refinery. The process need not actually take place in a crude oil refinery — it would simply need to produce one of the same outputs that a crude oil refinery would produce.

We believe this formulation is consistent with the statute and its legislative history, as well as with the approach the Service has previously applied in issuing private letter rulings. In particular, this approach gives effect to the legislative history's concern that oil and gas products necessitating processing beyond the type of processing that takes place in petroleum refineries should not give rise to qualifying income. In other words, this proposed standard safeguards against qualification of activities that produce petroleum derivatives similar to plastics — Remote Derivatives — which is the only limitation focused on processing or refining supported by the legislative history.

In addition, this approach solves the problems discussed above: it eliminates the disparate treatment of similarly-situated taxpayers, it eliminates any distinction based on the

[39] We make this suggestion understanding that the statute looks only to inputs and not outputs. However, we believe this suggested language will help draw a clear line between the output from refining and processing of Qualifying Natural Resources and Remote Derivatives.

[40] A list of products that are produced in a crude oil refinery can be found on the U.S. Energy Information Administration website at http://www.eia.gov/dnav/pet/pet_pnp_refp2_dc_nus_mbbl_m.htm.

geographic location in which the processing of the natural resource occurs, and, for MLPs that engage in the transportation, storage and/or marketing of olefins and/or refined products, it eliminates the need to identify the exact source of the fungible products they handle (which would be virtually impossible).

Under this standard, the steam cracking of ethane and propane to produce ethylene and propylene in facilities that do not also produce fuels, such as WLKP's, would be Qualifying Activities and produce qualifying income because (i) ethane and propane are natural resources of a character with respect to which a deduction for depletion is allowable under section 611 that are not described in section 613(b)(7)(A) or (B), and (ii) ethylene and propylene are exactly the same as the corresponding products that have historically been and currently are produced by crude oil refineries.

VI. Application of the Proposed Regulations to Taxpayers with PLRs

The Proposed Regulations generally would apply to income earned by a partnership in a taxable year beginning on or after the date that final regulations are issued. However, under one part of a proposed transition rule, a partnership that received a private letter ruling from the IRS to the effect that income from a particular activity is qualifying income may continue to treat such income as qualifying income through a period that ends ten years after the publication of final regulations (the "Transition Rule").

For over a quarter of a century since section 7704(d)(1)(E) was enacted, taxpayers have been operating without regulatory guidance regarding qualifying income. During that time, the IRS responded to the need for certainty in this area by issuing private letter rulings. We believe that the IRS's rulings reflect a measured approach that is consistent with section 7704(d)(1)(E) and its legislative history. We also believe that the IRS carefully considered each ruling request knowing that businesses and their investors would rely on the IRS's rulings indefinitely. We welcome and understand the need for comprehensive regulatory guidance to give taxpayers certainty without the need to go through the time-consuming private letter ruling process. However, to use such guidance to revoke prior rulings, even after a transition period, would be unfair and would pronounce to both businesses and their investors that they are no longer able to rely on IRS guidance when making long-term business and investment decisions.

Treasury and IRS officials have indicated that the Transition Rule was adopted by reference to the similar 10-year transition period afforded to publicly traded partnerships upon the enactment of section 7704. However, the situation faced by publicly traded partnerships existing at the time of the enactment of section 7704, and the transition relief accorded by statute in that case, are not analogous (beyond the use of a 10-year period in each case) to the situation faced by publicly traded partnerships that have received qualifying income rulings from the IRS. Specifically, transition relief was extended in 1987 to mitigate the effects of a statutory change, not a changed interpretation of the statute by a regulatory body.

Under these circumstances, the Proposed Regulations operate essentially to revoke the PLR issued to WLKP. An MLP is formed because it has certain tax characteristics, the consequences of which are understood and expected by businesses and investors. The Proposed Regulations, if finalized, would fundamentally change the nature of WLKP, which was formed

as an MLP in reliance on a PLR, resulting in something else that neither the company nor its investors contemplated: a limited-life MLP. Because the revocation of WLKP's PLR would change the fundamental nature of the security that has been sold in the market, we believe that it is appropriate here to extend permanent relief by applying the rules that the IRS would otherwise apply under section 7805(b) and the regulations thereunder with respect to rulings issued for particular transactions. Thus, we believe that fairness dictates that permanent relief should be extended to an MLP if (i) there was no misstatement or omission of material facts in the PLR request, (ii) the facts subsequently developed are not materially different from the facts on which the ruling was based, (iii) there has been no change in the applicable statute, (iv) the ruling was originally issued with respect to a prospective or proposed formation of an MLP, and (v) the taxpayer directly involved in the ruling acted in good faith in reliance upon the ruling and the failure to grant relief would be to his detriment.[41] All of these factors are met in WLKP's case.

WLKP would be irreparably harmed by the issuance of final regulations that correspond to the Proposed Regulations, as it has been harmed by the mere issuance of the Proposed Regulations, notwithstanding the facts that the Proposed Regulations are not effective and the proposed 10-year transition period has not even started to run. From the completion of the initial public offering ("IPO") of WLKP units on August 4, 2014, until the publication of the Proposed Regulations, WLKP units have traded as high as $34 but never below the original $24 IPO price. Within two days of the publication of the Proposed Regulations, WLKP's units lost approximately 30 percent of their trading value, trading as low as $19.62, and WLKP lost more than $200 million in market capitalization. In addition, over that period, Westlake's corporate market capitalization fell by more than $1 billion. In the aggregate, losses to the equity value of Westlake and WLKP exceeded $1.2 billion. These losses were directly attributable to language in the Proposed Regulations effectively revoking WLKP's private letter ruling. No other events can explain this market reaction.

Accordingly, if the Proposed Regulations are finalized in any form that would disqualify the activities of any MLP which received a PLR, we believe the finalized regulations should expressly grant any MLP with an existing PLR the right to continue generating qualifying income under any and all of the conclusions of that PLR so long as the facts examined in the PLR have not materially changed (and so long as section 7704(d)(1)(E) is not itself amended to prevent this result).

In other contexts, Treasury has expressly granted permanent "grandfather" relief for taxpayers who made business decisions in reliance on prior guidance, even when those decisions have ongoing tax effects. For example, under Treas. Reg. §§ 1.1471-2(b) and 1.1471-2T(b)(2)(i)(A)(1), Treasury permanently exempted from new FATCA withholding requirements any obligation outstanding on July 1, 2014. Similarly, under Treas. Reg. § 1.61-22(j), Treasury permanently exempted from new split-dollar life insurance rules any such arrangement entered into before September 17, 2003. Such rules recognize that taxpayers making current business decisions should not be subjected to uncertainty regarding future changes in the tax law — in other words, once a business decision is made in reliance on the tax rules at the time, the tax

[41] *See* Treas. Reg. § 601.201(*l*)(5); *see also* Treas. Reg. § 601.201(*l*)(6) (providing that the application of a ruling to a transaction will not be affected by the subsequent issuance of regulations (either temporary or final), if the conditions specified in Treas. Reg. § 601.201(*l*)(5) are met).

consequences flowing directly from that business decision should remain constant. The IRS has applied this same concept in its rulings.[42]

The decision to form an MLP and launch a publicly traded enterprise is an extremely significant business decision — one that has long-term consequences both for the shareholders in the sponsor company as well as for the unitholders of the MLP. With acute awareness of the long-term significance of this decision, Westlake sought and received interpretive guidance from the Service (in the form of the Westlake PLR) to provide certainty of the tax consequences flowing from that decision. Unitholders were informed of the ruling and undoubtedly relied upon its validity in making their investment decisions. Under the circumstances, Westlake and the WLKP unitholders should be allowed to rely permanently on that guidance absent an actual amendment to section 7704 or a material change in the facts underlying the PLR. To promulgate regulations that reverse explicit guidance provided by the IRS would frustrate reliance on IRS guidance in the many areas that still lack Treasury Regulations, and would be unfair even with a transition period.

We appreciate the opportunity to comment on this very important matter and welcome further discussions. Please contact me at (713) 585-2643 if you have any questions.

Sincerely,

M. Steven Bender
Senior Vice President, Chief Financial Officer and Treasurer
Westlake Chemical Partners LP

[42] *See, e.g.*, Rev. Rul. 2008-13, 2008-1 C.B. 518 (exempting plans in effect prior to release of the ruling from its interpretation of qualified performance-based compensation); Rev. Rul. 2004-75, 2004-2 C.B. 109 (exempting any payments made under annuity contracts in effect before publication of the ruling from its conclusion that certain such payments would be U.S.-source income).