BOARDWALK PIPELINE PARTNERS®

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Via Federal eRulemaking Portal

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

Re: Comments on REG-132634-14, Qualifying Income from Activities of Publicly Traded Partnerships With Respect to Minerals or Natural Resources

Boardwalk Pipeline Partners, LP ("***Boardwalk***") welcomes the opportunity to provide comments on recently issued proposed regulations (REG-132634-14) (the "***Proposed Regulations***") addressing the scope of activities relating to minerals and natural resources that produce qualifying income under Section 7704(d)(1)(E) of the Internal Revenue Code of 1986, as amended (the "***Code***").[1] We recognize the efforts of the Department of the Treasury ("***Treasury***") and the Internal Revenue Service (the "***Service***") to provide regulatory guidance regarding the scope of qualifying income as it relates to minerals and natural resources. However, we do not believe it is feasible or necessary to create an "exclusive list" of activities in this context. Moreover, in some cases, the Proposed Regulations represent a departure from common interpretations of the statute and lead to conclusions that are inconsistent with industry practices, creating uncertainty regarding the treatment of income where no uncertainty should exist. We believe that input from Boardwalk and other participants in the mineral and natural resources industries will result in improved final regulations.

I. Summary of Comments

Our comments address a number of issues with the Proposed Regulations and suggest appropriate changes that are necessary to achieve legislative intent and facilitate common industry practices. We believe that the final regulations should reflect that (i) olefins are natural resources under Section 7704 regardless of the hydrocarbon feedstock or the activity from which they are produced, (ii) any standard adopted for the activities of processing and refining cannot reasonably exclude activities that result in a chemical change or include a preference for products that are produced incidental to fuel production and, as a result, processing natural gas liquids ("***NGLs***") into olefins is a qualifying activity, and (iii) transportation activities that commonly

[1] Unless otherwise stated, all references herein to "section" or "§" are to the Code or the Treasury regulations.

include, and may be required to include, activities such as building interconnections to third party (non-customer) pipelines and similar activities are qualifying activities.

II. Boardwalk's Business and 2013 Private Letter Ruling

Boardwalk is a Delaware limited partnership formed in 2005 operating in the midstream portion of the natural gas and NGLs industry. Boardwalk's common units are traded under the symbol "BWP" on the New York Stock Exchange.

Boardwalk's business consists of integrated natural gas and NGL pipeline transportation and storage and natural gas gathering and processing services for those natural resources. Among Boardwalk's assets are 317 miles of pipelines and underground storage facilities dedicated to providing transportation and storage services for NGLs and olefins (including ethylene and propylene). Boardwalk also provides fractionation services for NGLs.

At the time of Boardwalk's initial acquisition of its NGL and olefins assets, Boardwalk filed a private letter ruling request with the Service in order to confirm the proper treatment of its activities with respect to such assets under Section 7704. On May 30, 2013, the Service issued to Boardwalk a ruling (the "***Boardwalk Ruling***," Priv. Ltr. Rul. 2013-37-014) concluding that income derived from the refining and processing of Feedstocks (as defined below) into olefins and from the transportation, storage and marketing of olefins constitutes "qualifying income" within the meaning of Section 7704(d)(1)(E). For the reasons discussed herein, the Service's conclusion in the Boardwalk Ruling is consistent with the statutory language of Section 7704.

III. The Proposed Regulations

A. *Processing and Refining: Treatment of Olefins*

The Proposed Regulations are intended to provide guidance on what constitutes "qualifying income" under Section 7704(d)(1)(E), which defines qualifying income, in pertinent part, to mean "income and gains derived from the exploration, development, mining or production, processing, refining, transportation ... or the marketing of any mineral or natural resource."

Section 1.7704-4(c) of the Proposed Regulations contains a comprehensive definition of each of the activities listed in Section 7704(d)(1)(E). That definition limits the scope of exploration, development, mining or production, processing, refining, transportation, or marketing of minerals and natural resources to an exclusive list of qualifying activities, and specifically states that "[n]o other activities qualify as section 7704(d)(1)(E) activities."

Section 1.7704-4(c)(5)(i) of the Proposed Regulations defines "processing or refining," stating that "an activity is processing or refining if it is done to purify, separate, or eliminate impurities." Further, the Proposed Regulations provide that an activity will not qualify as processing or refining if the activity "causes a substantial physical or chemical change in a mineral or natural resource" or transforms such mineral or natural resource into "new or different mineral products or into manufactured products."

Specifically with respect to natural gas, Section 1.7704-4(c)(5)(ii) of the Proposed Regulations provides that "processing" of natural gas includes (i) purifying natural gas, (ii) separating natural gas into its constituents, or (iii) converting methane to liquid fuels otherwise produced from petroleum in one integrated conversion. The preamble to the Proposed Regulations further explains that it is generally anticipated that the activities that create the products listed in the North American Industry Classification System ("***NAICS***") code 211112 concerning natural gas liquid extraction will be qualifying activities.

Finally, the Proposed Regulations treat crude oil and natural gas refining and processing activities differently, even where such processes may create the same products, such as olefins. Section 1.7704-4(e), Example 1 of the Proposed Regulations describes a publicly traded partnership that chemically converts the components of natural gas, including ethane and propane, into "ethylene, propylene, and other gases" with the use of a steam cracker. Section 1.7704-4(e), Example 2 of the Proposed Regulations describes a publicly traded partnership that owns a petroleum refinery at which it produces "refinery-grade ethylene" as a byproduct of the catalytic cracking of the components of crude oil. The disparate treatment of ethylene produced in the process of crude oil refining in Example 2 (resulting in qualifying income) versus ethylene produced from natural gas processing in Example 1 (not resulting in qualifying income) illustrates the application of the Proposed Regulations' differing definitions of refining and processing which depend on the natural resource hydrocarbon source being processed or refined.

B. *Transportation Related to Interconnect Agreements*

Section 1.7704-4(c)(6) of the Proposed Regulations provide that "transportation is the movement of minerals or natural resources and products produced [by qualifying mining or production or refining or processing activities], including by pipeline, barge, rail, or truck..." Construction of pipeline connection qualifies as transportation "only to the extent that a pipe is run to connect a producer or refiner to a preexisting interstate or intrastate line owned by the publicly traded partnership (interconnect agreements)."[2]

IV. Discussion

A. *Olefins are Natural Resources*

1. *The statute and its legislative history treat "oil, gas, and products thereof" as natural resources.*

Section 7704(d)(1)(E) provides that the term "qualifying income" includes "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

[2] Prop. Treas. Reg. 1.7704-4(c)(6)(v).

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

> [N]atural resources include…oil, gas or products thereof….[O]il, gas, or products thereof means gasoline, kerosene, number 2 fuel oil, refined lubricating oils, diesel fuel, methane, butane, propane, and similar products which are recovered from petroleum refineries or field facilities. Oil, gas, or products thereof are not intended to encompass oil or gas products that are produced by additional processing beyond that of petroleum refineries or field facilities, such as plastics or similar petroleum derivatives.[3]

In this manner, the statute and its legislative history provide a non-exclusive list of "oil, gas and products thereof" that are treated as natural resources for the purpose of Section 7704(d)(1)(E). The list also refers to "similar products which are recovered from petroleum refineries or field facilities," indicating that Congress intended the list to be expansive rather than restrictive, with the only limit being that the list of natural resources would not include "plastics or similar petroleum derivatives."

Olefins are hydrocarbons derived from crude oil, natural gas and NGLs. The most common feedstocks used to produce olefins are naphtha, gas oil, ethane, propane, and butane (collectively, the "***Feedstocks***").[4] NGLs, including ethane, propane and butane, are naturally occurring components of crude oil and natural gas at the point at which depletion is calculated. As such, NGLs are products of a character with respect to which a deduction for depletion is allowable. Further, naphtha and gas oil are each directly produced in crude oil refining. Accordingly, there can be no doubt that the Feedstocks for olefins are natural resources for purposes of Section 7704.

Similarly, olefins are natural resources for the purposes of Section 7704(d)(1)(E). Although not specifically enumerated by the legislative history, olefins, like number 2 fuel oil, refined lubricating oils, and diesel fuel, are commonly "recovered from petroleum refineries or field facilities." In fact, the U.S. Energy Information Administration ("***EIA***") defines ethylene, propylene, and other olefins as "olefinic hydrocarbon[s] recovered from refinery processes or petrochemical processes."[5] EIA data illustrates that thousands of barrels of olefins are produced each month within U.S. refineries.[6] Further, there is no question that olefins such as ethylene and propylene are not equivalent to plastics. Ethylene and propylene are simply "building

[3] H.R. Rep. No. 100-495, at 947 (Conf. Rep.).
[4] In North America in 2009, ethane accounted for 65% of ethylene production, butane and propane accounted for 19%, and naphtha and gas oil accounted for 16%. Bernstein Black Book, North American E&Ps: Manifest Destiny & the Unconventional Resource; Nov. 2011, at 105. Globally, however, naphtha is the feedstock for over half of all ethylene production. *Id.*
[5] *See* http://www.eia.gov/dnav/pet/TblDefs/pet_pnp_refp2_tbldef2.asp.
[6] *See* http://www.eia.gov/dnav/pet/pet_pnp_refp2_a_EPLLEY_ypy_mbbl_m.htm.

blocks" for further processing. Olefins may be used for further refinery operations or they may be used as petrochemical feedstocks, but they are not finished products similar to plastics. Plastics are products that result from many processes and combinations of products that are neither produced in nor common in petroleum refineries. See Exhibit A for an example that clearly illustrates the differentiation between ethylene on the one hand, and the many downstream products that could be excluded from treatment as a natural resource on the other.

2. *There is no basis for differentiating between hydrocarbon sources for olefins or activities producing olefins.*

Because olefins are natural resources for purposes of Section 7704, olefins should be treated as natural resources without regard to their source. The legislative history's explanation regarding natural resources illustrates only the types of products that should be treated as natural resources for purposes of Section 7704, rather than limiting the manner in which such products may be produced, whether they are produced from oil or natural gas, or the type of facility from which they are produced.

It is possible to produce many of the products listed in the legislative history from any number of hydrocarbon sources. For example, liquid fuels and lubricating oils may be produced from natural gas, crude oil, and even coal. Because (i) these resulting products are listed as natural resources and (ii) their source is a mineral or natural resource subject to depletion, there is no doubt that their production generates qualifying income. Prior to the release of the Proposed Regulations and the uncertainty that they have caused, being listed or falling within the description of a natural resource in the legislative history was conclusive as to the nature of a product. The Service has concluded similarly for several taxpayers that their gas-to-liquids activities generate qualifying income.[7] In the same manner, as described above, olefins may be produced from multiple natural resource Feedstocks and should be treated as a natural resource regardless of source.

The Proposed Regulations' varying treatment of olefins and other "oil, gas and products thereof" appears to be based on a preference in the Proposed Regulations for activities relating to fuel production. Neither the statute nor its legislative history includes any indication that products of oil or gas must be derived incident to the production of fuel. The only limitation is related to resulting finished products that are plastics or similar petroleum derivatives. The Proposed Regulations' fuel production limitation is far more restrictive than is necessary to exclude the production of plastics and similar petroleum derivatives. Thus, we can find no justification for a preference for activities that produce fuel or the disparate treatment of olefins and other oil, gas and products thereof.

The Proposed Regulations can better serve the intent of Section 7704(d)(1)(E) by simply providing a non-exclusive list, similar to that in Section 1.7704-4(c)(5)(iii)(B) of the Proposed Regulations, of end products that are plastics or similar petroleum derivatives that are not natural

[7] *See* Priv. Ltr. Rul. 2013-24-002 (February 21, 2013); Priv. Ltr. Rul. 2013-15-005 (January 3, 2013); Priv. Ltr. Rul. 2013-14-038 (December 12, 2012).

resources and do not result from activities that qualify as refining or processing of oil, gas or products thereof. For example: the list could include plastics, polymers, polyethylene, ethylene dichloride, ethylene oxide, ethylene glycol, vinyl acetate, polyester, polyvinyl chloride and polypropylene. Such an approach would be consistent with the existing private letter rulings on qualifying activities with respect to natural resources such as olefins, while also providing guidance regarding specific end products, the refining, processing, transportation or marketing of which would not generate qualifying income.

3. *Differentiating between hydrocarbon sources for olefins or activities producing olefins is impractical for pipelines.*

Example 1 and Example 2 of the Proposed Regulations treat olefins differently depending on their source.[8] However, as a practical matter, olefins transported by pipelines must be fungible products. As fungible products, each type of olefin has the same molecular structure regardless of whether such olefin is produced from processing or refining natural gas or crude oil.

The commercial realities of the pipeline transportation business are such that products to be transported may be gathered by the shipper from multiple producers at a central gathering point, via another pipeline, from central storage facilities, or directly at a source. Accordingly, it may be impossible for a publicly traded partnership providing pipeline transportation and storage services to distinguish between olefins produced at a crude oil refinery and those that are not. Therefore, the Proposed Regulations' distinction between refinery and non-refinery produced olefins creates a practical impossibility in the context of pipeline transportation and storage activities. Left unresolved, this impossibility frustrates the Congressional intent of Section 7704(d)(1)(E). Under the Proposed Regulations, absent positive proof of source, publicly traded partnerships providing transportation and storage would be forced to treat all activities with regard to olefins as non-qualifying. The best solution to this issue is to clarify that olefins are natural resources, an approach that is supported by common usage, the statute, the legislative history and the Service's prior ruling practice. An alternative solution is to provide a safe harbor permitting publicly traded partnerships to treat income from the transportation and storage of certain products of oil and gas such as olefins as qualifying income unless the publicly traded partnership has knowledge that such products result from processes that the Proposed Regulations do not treat as qualifying activities.

B. ***Processing and Refining***

We agree that activities that eliminate impurities from natural gas and separate natural gas into its constituent parts constitute "processing or refining" within the meaning of Section 7704. However, as discussed in detail below, the restrictions on what kinds of activities can qualify as refining and processing have the result of excluding many common processing or refining activities from the definition of qualifying activities. For example, natural gas and crude oil are both hydrocarbon resources from which many of the same products can be produced

[8] *See* Prop. Reg. Section 1.7704-4(e).

using similar methods, and the current Proposed Regulations would treat such activities as qualifying with respect to crude oil, but not with respect to natural gas. We believe that the distinctions drawn between crude oil and natural gas processing and refining activities are inconsistent with the language of Section 7704(d)(1)(E). As suggested above, the Proposed Regulations can better serve the intent of Section 7704(d)(1)(E) by providing a non-exclusive list of end products that are plastics or similar petroleum derivatives that are not natural resources and do not result from activities that qualify as refining or processing of oil, gas or products thereof.

1. *Processing and refining are separate activities.*

Section 7704 does not define any of the activities listed in Section 7704(d)(1)(E). However, Section 7704(d)(1)(E) clearly identifies processing and refining as separate activities that may be applied to any natural resource. Congress, by including the term "processing" in addition to the term "refining," clearly intended that some activities other than refining would generate qualifying income. The Proposed Regulations nevertheless treat "processing" and "refining" as a single activity and attempt to apply different meanings for that activity with respect to different natural resources. We find no support in the statute or the legislative history for that position. Moreover, with respect to hydrocarbons from oil or gas, such treatment is clearly not consistent with legislative intent. Long-established principles of statutory interpretation require that to the extent possible, effect should be given "to every clause and word of a statute."[9] Recent cases affirm such principles, stating that statutes should be construed "so as to avoid rendering superfluous" any language of a statute.[10] Finally, where Congress has used two terms in a statute, the Supreme Court has stated "we assume that Congress used two terms because it intended each term to have a particular, nonsuperfluous meaning."[11] Accordingly, "processing" and "refining" should each be interpreted as having an independent meaning.

While "processing" has never been defined by the Treasury or the Service for purposes of section 7704, dictionary definitions of "processing" include "the act or process of treating or preparing something by a special method"[12] and "[p]erform a series of mechanical or chemical operations on (something) in order to change or preserve it."[13] Nothing in Section 7704 or its legislative history suggests that the word "processing" was intended to have a specific meaning or serve as a limitation on the types of activities that generate qualifying income. Rather, the legislative history seems to indicate the opposite by providing that "products of" oil and gas are still natural resources. Logically, the processes similar to those applied in crude oil refineries would be qualifying activities. The Service has confirmed this in issuing private letter rulings.[14]

[9] *Montclair v. Ramsdell*, 107 U.S. 147, 152 (1883).
[10] *Astoria Federal Savings & Loan Ass'n v. Solimino*, 501 U.S. 104, 112 (1991).
[11] *Bailey v. United States*, 516 U.S. 137, 146 (1995).
[12] Collins English Dictionary
[13] Oxford English Dictionary
[14] *See, e.g.*, Priv. Ltr. Rul. 1996-39-011 (May 20, 1996) (natural gas processing), Priv. Ltr. Rul. (May 30, 2013) (NGL processing or refining); 2013-37-014; Priv. Ltr. Rul. 2012-41-004 (July 2, 2012) (NGL processing); Priv. Ltr. Rul. 2012-36-005 (June 5, 2012) (NGL processing via hydrogenation and catalytic cracking); Priv. Ltr. Rul. 2007-18-005 (May 4, 2007) (processing of highly refined lubricating oils).

Moreover, the Service has recognized that "processing" has a broader meaning than refining, explaining in a 2008 private letter ruling, that "processing in the energy industry means a specific type of downstream activity encompassing refining and certain petrochemical activities."[15]

Though few definitions of "processing" exist, the Service has defined "refining" in other contexts. 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 crude oil products."[16] For this purpose, "crude oil" is defined to include "natural gas liquid recovered from gas well effluent in lease separators or field facilities before any conversion process has been applied to such production."[17] NGLs include ethane, propane, normal butane, isobutane, and natural gasoline.

In addition, the Internal Revenue Manual (the ***"IRM"***) states that a modern refinery involves the "breaking down, restructuring and recombining of hydrocarbon molecules" in Section 4.41.1.6.1. IRM Sections 4.41.1.6.1.1(2) and 4.41.1.6.1.1(4) further state that a "refinery process" includes converting petroleum feedstocks through a cracking process where olefins, among other hydrocarbons, are produced and that cracking produces both saturated and unsaturated hydrocarbons.[18]

2. *The "substantial chemical or physical change" and "production of fuel" restrictions are inconsistent with legislative intent.*

Unfortunately, the Proposed Regulations adopt an extremely narrow definition for refining and processing activities, in part, by imposing a limitation that chemically converting a product of oil or gas will not constitute a qualifying activity unless the feedstock is petroleum and the conversion is necessary to the production of fuels. The Proposed Regulations state that unless specifically provided otherwise, an activity would not qualify as processing or refining if the activity causes a "substantial physical or chemical change in a mineral or natural resource, or transforms the extracted mineral or natural resource into new or different mineral products or into manufactured products." The Proposed Regulations then have an exception to treat as qualifying income certain chemical conversion processes that are "necessary to the cost effective production of gasoline or other fuels."

This limitation is surprising because it is inconsistent with many common activities that are generally considered processing and refining, and there is no basis for the determination that processes that cause a substantial physical or chemical change should not generate qualifying income under Section 7704. As discussed above, each of processing and refining is a broad

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[15] Priv. Ltr. Rul. 2008-21-021 (Feb. 19, 2008).
[16] Treas. Reg. § 1.613A-7(s)(3).
[17] Treas. Reg. § 1.617A-7(g)(3).
[18] I.R.M. exhibit 4.41.1-11 lists ethylene (C_2H_4), propylene (C_3H_6) and butylene (C_4H_8) as olefins, or ethylene series unsaturated hydrocarbons.

category of activities, and both categories would typically include activities that cause a physical or chemical change. Congress, by including the refining of crude oil among the activities that are considered qualifying activities under Section 7704, and by making references to products other than fuels as "products thereof" clearly contemplated that processes which cause substantial physical or chemical change to a natural resource would generate qualifying income. Crude oil refining includes numerous processes that result in chemical changes that are not incident to fuel production, but are instead focused on refining and processing the portions of crude oil that are better suited for the production of other products, such as lubricating oils, waxes, asphalts, solvents and olefins.

Neither the language of Section 7704 nor its legislative history suggests that refining or processing should be limited to activities that do not cause a physical or chemical change, nor do they provide any evidence of a preference for activities that produce fuels over other refined products. The only evidence of any limit found the legislative history is that "plastics and similar petroleum derivatives" are not treated as natural resources. It may follow that the production of such products should not be treated as qualifying processing or refining activities. However, the adoption of a standard which excludes refining and processing activities that cause physical or chemical change is far too restrictive to accomplish such a goal, and is inconsistent with Congress' intent in enacting Section 7704.

3. *Olefins are products of crude oil and natural gas refining or processing.*

As discussed above, olefins are natural resources for purposes of Section 7704. Olefins are principally produced through a "cracking" process, which is common in petroleum refineries. The cracking process creates olefins by removing hydrogen atoms to decrease the size of the hydrocarbon molecules. When ethane is cracked, only minimal co-products are formed.[19] When naphtha, gas oil, propane or butane is used for ethylene cracking, propylene and other co-products are also produced.[20] The resulting olefins are then sold to third parties who use the olefins as a feedstock for further processing.[21]

As described above, the Treasury regulations and the IRM define "refining" as the process of causing a physical or chemical change to the molecular structure of a product. Additionally, the IRM specifically states that converting petroleum feedstocks through a cracking process to produce olefins meets the definition of "refining." Further, the processing of Feedstocks into olefins does not convert the hydrocarbons into functionally different products, such that they lose their identity as natural resources. Rather, the resulting olefins are still hydrocarbon feedstocks for further processing activities performed by Boardwalk's customers.

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[19] *See Jenkins, supra* note 4, at 18.

[20] *See Bernstein, supra* note 3, at 105. Other hydrocarbon products produced are benzene, other aromatics, and heavy alkenes. *Id.*

[21] Ethylene is one of the most common feedstocks for chemical and manufacturing plants across the world. Scott Jenkins, Shale Gas Ushers in Ethylene Feed Shifts, *Chemical Engineering*, Oct. 2012, at 17. Propylene has also experienced recent rapid growth in production. *See* R. Mao, N. Vu, N. Al-Yassir, N. François, and J. Monnier, The Thermocatalytic Cracking Process for the Production of Light Olefins and Transportation Fuels from Gas Oils, *Topics in Catalysis* Vol. 37, Nos. 2-4, April 2006.

Finally, there is nothing in the legislative history of Section 7704 that suggests that processes that cause a substantial physical or chemical change should not be qualifying activities. Therefore, the conversion of natural resource Feedstocks into olefins constitutes refining or processing of a natural resource for the purposes of Section 7704(d)(1)(E).

For the above stated reasons, we believe that distinctions drawn with respect to crude oil and natural gas processing and refining activities are inconsistent with the language of Section 7704(d)(1)(E).

4. *The NAICS Codes may provide a safe harbor, but should not be treated as determinative.*

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."

To the extent that these statements are meant to provide an informal safe harbor, we support that effort. However, to the extent that these statements are used to deny qualifying activity status to taxpayers who do not self-assign NAICS code 211112 for natural gas activities or 324110 for crude oil refining activities, this is inappropriate.

NAICS is a system of classifying U.S. industries, designed and developed for statistical purposes.[22] According to the U.S. Census Bureau, there is "no central government agency with the role of assigning, monitoring, or approving NAICS codes for establishments."[23] 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."[24]

Use of a different method of categorization in the context of refining and processing activities could give disparate results. Many processes that generate the products listed in NAICS codes 211112 and 324110 may also fit within other NAICS codes, potentially creating a situation in which a taxpayer has a legitimate choice between alternative NAICS codes for the same activity. Nothing in section 7704 or its history suggests that a taxpayer should be bound by its choice of a categorization for statistical purposes. Relying on NAICS codes to determine qualifying income would do just that.

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[22] *See* United States Census Bureau, North American Industry Classification System Frequently Asked Questions, *available at* www.census.gov/eos/www/naics/faqs/faqs.html.
[23] *Id.*
[24] *Id.*

Moreover, NAICS was adopted in 1997; Congress clearly did not have NAICS in mind when it passed section 7704(d)(1)(E).[25] In fact, no references to NAICS or its predecessor, the SIC, appear anywhere in the Code. Although the Treasury regulations occasionally reference NAICS codes, they are used for illustrative purposes, for administrative convenience, or to define a safe harbor – they are not used in a restrictive manner.[26] For example, Treas. Reg. Section 1.1031(a)-2 references NAICS codes in defining "product classes" for purposes of the like-kind exchange rules. Allowing non-recognition treatment under Section 1031 to apply to "like class" items is a taxpayer-friendly way to meet the statute's "like kind" requirement. Further, the Service has made it clear in rulings issued under section 1031 that properties of the same nature and character can be like-kind properties even if they do not fit within the same product class.[27] Meanwhile, Rev. Proc. 2015-14 uses NAICS codes for administrative simplicity when it lists industries eligible to obtain automatic consent for an accounting method change, and Treas. Reg. Section 1.936-11(b)(2)(ii) uses NAICS codes to define a safe harbor. In no instances do the NAICS codes provide a determinative standard for interpreting the Code, nor should they, for the reasons stated above.

Using an unregulated system that was developed and maintained for statistical, not regulatory, purposes to limit the meaning of statutory terms would be inappropriate. That does not appear to be Treasury's intention when it referenced NAICS codes in the Preamble to the Proposed Regulations. However, as stated above, the referenced codes could be used to provide an informal safe harbor. Furthermore, considering that natural gas and crude oil are both hydrocarbon resources from which many of the same products can be produced using similar methods, to the extent NAICS codes are used as a safe harbor, the codes should be considered to apply equally to the processing and refining of natural gas or crude oil. For example, isopentane should be a qualifying natural resource based on its inclusion under NAICS 211112 regardless of whether it comes from the processing or refining of natural gas or crude oil and regardless of whether such activity is conducted within a crude oil refinery.

C. *Interconnect Agreements under the Proposed Regulations*

The Proposed Regulations provide that the construction of a pipeline is a qualifying activity only to the extent that "a pipe is run to connect a producer or refiner to a preexisting interstate or intrastate line owned by the publicly traded partnership."[28] The Proposed Regulations further provide that development activities include "…constructing and installing gathering systems and custody transfer stations."[29] Proposed Regulations Section 1.7704-4(c)(6)(v) should be modified to broaden and clarify the activities that generate qualified income related to interconnect agreements. In particular, modifications are needed to accommodate activities associated with development and to recognize common industry practice.

[25] NAICS generally replaced the Standard Industrial Classification ("***SIC***") system, but Congress did not refer to SIC codes in the statute and the legislative history contains no reference to SIC codes as a potential source of guidance.

[26] The Treasury regulations issued under Sections 1031, 199, 936, and 1471 contain references to NAICS codes.

[27] *See* Priv. Ltr. Rul. 2009-12-004 (March 20, 2009); Tech. Adv. Mem. 200602034 (January 13, 2006).

[28] Prop. Treas. Reg. 1.7704-4(c)(6)(v).

[29] Prop. Treas. Reg. 1.7704-4(c)(3)(vi).

1. *Interconnect agreements should not be limited to refiners and producers.*

Many of Boardwalk's pipelines are regulated by the Federal Energy Regulatory Commission, which requires that pipelines cooperate and connect with other pipelines to facilitate the efficient movement of natural gas throughout the country. Similar rules apply to some intrastate and offshore pipelines. Consequently, the construction of interconnections is a common part of the pipeline transportation business.

Interconnect agreements often provide for payments to the pipeline company that will coordinate the interconnection to compensate it for the design, purchasing of material and construction or assembly of pipes, valves, meters, meter stations and other associated property, and the inspection or oversight of such work performed by third parties to assemble or construct the property owned by the pipeline and/or the connecting party. Depending on the arrangements and the anticipated relative benefit of the interconnection, compensation for managing or constructing the interconnection may be limited to partial or full cost reimbursement, which may include third-party costs as well as an allocation of direct and indirect costs such as overhead. Alternatively, the interconnect agreement may be structured with a flat fee or a cost-plus arrangement with the possibility that the pipeline company may earn a profit.

As the Proposed Regulations acknowledge, requests for interconnections, and the related payments, may be from transportation customers (such as producers and refiners), but may also be from other types of customers or a party that is not directly a transportation customer. For example, interconnection agreements may be with another pipeline, a gathering system, a utility, a power generation facility, a refinery, a local distribution company, or other commercial, industrial or governmental consumer. It is important to note that although the interconnection will normally provide access to new customers or provide existing customers with new destinations, the party requesting the interconnection may not be the transportation customer.

Therefore, the final regulations should be clarified to provide that any revenue realized by a pipeline transportation business from pipeline interconnections and related services is qualifying income, regardless of whether or not the reimbursements come directly from a transportation customer and regardless of the type of customer that the interconnection provides access to. Such revenue is derived from the business of transporting a mineral or natural resource or products thereof as required by Section 7704(d)(1)(E).

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

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

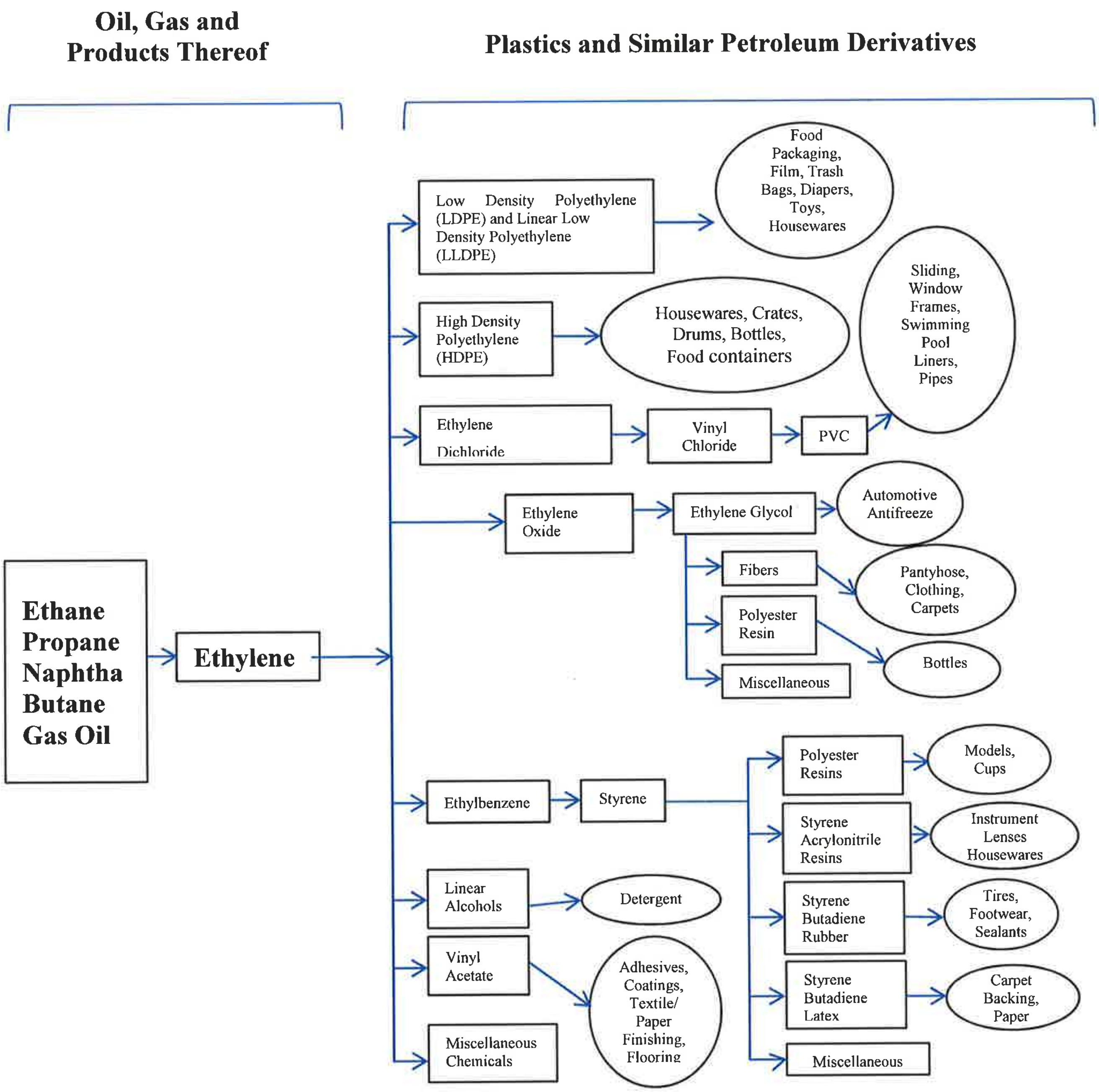
V. Conclusion

The final regulations should reflect that (i) olefins are natural resources under Section 7704 regardless of the hydrocarbon feedstock or the activity from which they are produced, (ii) any standard adopted for the activities of processing and refining cannot reasonably exclude activities that result in a chemical change or include a preference for products that are produced incidental to fuel production and, as a result, processing NGLs into olefins is a qualifying activity, and (iii) transportation activities that commonly include, and may be required to include, activities such as building interconnections to third party (non-customer) pipelines and similar activities are qualifying activities. We believe that these suggested changes to the Proposed Regulations are consistent with the plain meaning of Section 7704, as well as the Congressional intent underlying Section 7704, based on the analysis herein. In addition, we believe that such changes are necessary to facilitate common industry practices.

Thank you,

James Jones
Vice President of Tax
Boardwalk Pipeline Partners, LP

Exhibit A



This information is publicly available at http://www.americanchemistry.com/ethylene-chain.