Dominion
MIDSTREAM PARTNERS

July 31, 2015

Submitted via Federal eRulemaking Portal
CC:PA:LPD:PR (REG-132634-14)
Room 5203
Internal Revenue Service
1111 Constitution Ave NW
Washington, D.C. 20224

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

Ladies and Gentlemen:

Dominion Midstream Partners, L.P. ("***DM***") 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 are writing to request clarification of the treatment of the following three activities: (1) the conversion of natural gas[2] from its gaseous form to a liquid form commonly referred to as "liquefied natural gas" or "LNG" ("***Liquefaction***"), (2) returning natural gas from liquid form to gaseous form ("***Regasification***"), and (3) the transportation of natural gas that has undergone Regasification ("***Subsequent Transportation***").

I. Executive Summary

The Proposed Regulations purport to provide an exclusive list of activities with respect to minerals or natural resources that will produce qualifying income under section 7704(d)(1)(E) (referred to in the Proposed Regulations as "***Section 7704(d)(1)(E) activities***").[3] For purposes of the Proposed Regulations, the term "mineral or natural resource" does not include, among other things, fuels described in sections 6426(b) through (e); those fuels include LNG.[4] The preamble

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[1] Unless otherwise stated, all "section" references herein are to the Internal Revenue Code of 1986, as amended, and the Treasury Regulations promulgated thereunder.

[2] In this letter, unless otherwise noted, we use the term "natural gas" to refer to methane that has been separated from the constituent components of a raw natural gas stream, either in a field separation unit or at a natural gas processing plant. Additional discussion of the LNG supply chain is provided below.

[3] Prop. Reg. § 1.7704-4(c)(1).

[4] Prop. Reg. § 1.7704-4(b) provides that, "[f]or purposes of this section, the term mineral or natural resource does not include … fuels described in sections 6426(b) through (e)." Liquefied natural gas is listed in section 6426(d)(2)(C).

to the Proposed Regulations expressly notes that the transportation and storage of fuels described in sections 6426(b) through (e) are not addressed, and requests "comments concerning whether guidance is also needed with respect to those activities and, if so, the specific issues such guidance should address."

It is indisputable that natural gas is a natural resource for purposes of section 7704(d)(1)(E). LNG is simply natural gas that has been super-cooled and converted to liquid form to facilitate its transportation and storage; it retains its chemical composition and thus remains a natural resource. In addition, Liquefaction, Regasification and Subsequent Transportation are all critical components of the international transportation of natural gas. Accordingly, we are writing to request that, if final regulations retain the "exclusive list" approach of the Proposed Regulations, those final regulations (1) treat LNG (including Regasified LNG) as a natural resource, and (2) treat Liquefaction, Regasification and Subsequent Transportation as Section 7704(d)(1)(E) transportation activities. Alternatively, we request that any final regulations address the transportation and storage of LNG and treat Liquefaction, Regasification and Subsequent Transportation activities as transportation of LNG for purposes of applying section 7704(d)(1)(E).[5]

II. DM's Cove Point LNG Operations

DM is a Delaware limited partnership. Limited partner interests in DM are traded on the New York Stock Exchange under the symbol "DM." As a result, DM is a publicly traded partnership within the meaning of section 7704(b).

A. DM's LNG Import and Pipeline Facilities

DM owns an equity interest in Dominion Cove Point LNG, LP, a Delaware limited partnership ("***Cove Point***"). Cove Point is the owner and operator of an LNG import Regasification facility and storage facility located on the Chesapeake Bay in Lusby, Maryland (the "***Cove Point LNG Facility***"). DM also owns and operates approximately 136 miles of natural gas pipeline that connect the Cove Point LNG Facility to interstate natural gas pipelines (the "***Cove Point Pipeline***"). The Cove Point LNG Facility currently includes an offshore pier, LNG storage tanks, Regasification facilities and associated equipment designed to (i) receive imports of LNG from tanker ships, (ii) store LNG in storage tanks, (iii) Regasify LNG, and (iv) deliver Regasified LNG to the Cove Point Pipeline.

B. DM's LNG Export Facilities

Cove Point is currently constructing additional assets at the Cove Point LNG Facility (the "***Liquefaction Project***"). When the Liquefaction Project is completed, pipeline-quality natural

[5] As discussed in detail below, section 7704(d)(1)(E), as amended by the Energy Improvement and Extension Act of 2008 (P.L. 110-343), includes within the definition of "qualifying income" income derived from the transportation or storage of any fuel described in section 6426(d), which, as noted above, includes LNG. While we believe that Liquefaction, Regasification and Subsequent Transportation are most appropriately treated as qualifying income because they involve the transportation of a natural resource, guidance specifically treating those activities as transportation of LNG would be equally effective in clarifying their status as activities generating qualifying income.

gas will be (i) transported from interstate pipelines through the Cove Point Pipeline to the Cove Point LNG Facility, (ii) Liquefied, (iii) stored in existing storage tanks at the Cove Point LNG Facility, and (iv) transferred to tanker ships owned by third parties for export.

III. The LNG Supply Chain

The Liquefaction of natural gas, transportation of LNG by tanker ship, terminalling and storage of LNG, Regasification, and Subsequent Transportation of LNG are all integral and necessary steps in the international transportation of natural gas. The steps involved in the "LNG Supply Chain" are described more fully below.

A. Production, Gathering and Processing

Raw natural gas produced from an oil well or from a natural gas well typically consists primarily of methane (CH_4). It may also contain varying amounts of:

- ethane (C_2H_6), propane (C_3H_8), normal butane (n-C_4H_{10}), isobutene (i-C_4H_{10}) (collectively referred to as natural gas liquids or "***NGLs***");
- carbon dioxide (CO_2), hydrogen sulfide (H_2S), methyl mercaptan or MeSH (CH_3SH), and ethyl mercaptan or EtSH (CH_3CH_2SH) (collectively referred to as "***acid gases***");
- nitrogen (N_2) and helium (He) (collectively referred to as "***other gases***");
- water vapor and liquid water; and
- natural gasoline and/or crude oil (collectively referred to as "***liquid hydrocarbons***").

Raw natural gas is typically treated at or near the wellhead for removal of liquid water and liquid hydrocarbons. In some cases, methane is separated from NGLs, acid gases and other gases in field separation units at or near the wellhead, and then transported by pipeline, as discussed below. In other cases, raw natural gas (following the removal of water and liquid hydrocarbons) is transported via gathering systems to natural gas processing plants where methane is separated from NGLs, acid gases and other gases, and then transported by pipeline, as discussed below.

B. Pipeline Transportation

Natural gas, consisting primarily of methane, is transported by pipeline to Liquefaction facilities located along the coast of the producing country.

C. Liquefaction

Natural gas (again consisting primarily of methane) is super-cooled, through various means, to a temperature of minus 260 degrees Fahrenheit, transforming the gas into a liquid with approximately $1/600^{th}$ the volume it occupies in its gaseous state. The chemical composition of

the natural gas is not changed by Liquefaction; it remains primarily methane (CH_4). The volumetric reduction resulting from Liquefaction permits the cost-effective transportation of natural gas by ocean-going tanker ships.

D. Shipping and Storage

LNG is loaded onto specially designed, double-hulled LNG tanker ships and transported overseas to a receiving LNG facility, where it is off-loaded and stored in specially designed storage tanks.

E. Regasification and Delivery to Pipelines for Subsequent Transportation

Regasification is the process whereby LNG is heated and returned to its gaseous state. Regasified LNG is, like the natural gas that went through the Liquefaction process, composed principally of methane (CH_4). The natural gas is then delivered into pipelines, where it is transported together with natural gas that has not been through Liquefaction and Regasification. Natural gas that results from Regasification is fungible with natural gas that has not been Liquefied and Regasified.

IV. Discussion

A. Liquefaction, Regasification and Subsequent Transportation are Transportation of a Natural Resource for Purposes of Section 7704(d)(1)(E).

As originally enacted in 1987, section 7704(d)(1)(E) provided that the term "qualifying income" means—

> 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 (including fertilizer, geothermal energy, and timber).

The 1987 legislative history to section 7704(d)(1)(E) states that "[n]atural 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, <u>methane</u>, butane, propane and similar products which are recovered from petroleum refineries or field facilities" (emphasis added).[6] Section 7704(d)(1) was amended in 1988 with the addition of a final sentence providing that—

> For purposes of paragraph (E), the term "mineral or natural resource" means any product <u>of a character</u> with respect to which a deduction for depletion is allowable under section 611; except that such term shall not include any product described in subparagraph (A) or (B) of section 613(b)(7).

[6] H.R. Rep. No 495, 100th Cong., 1st Sess. At 947 (1987).

Methane is the principal component of raw natural gas produced from a well. It is clearly a product of a character with respect to which a deduction for depletion is allowable under section 611, and is thus a "natural resource" as defined in the statute. It is also specifically described as a natural resource in the relevant legislative history. As a result, the transportation of methane (whether separated from a raw natural gas stream in a field separator or at a natural gas processing plant) generates qualifying income. LNG is simply methane that has been super-cooled, transforming it from a gas to a liquid to facilitate its transportation and storage. Its chemical composition is unchanged by the cooling process; it remains CH_4 (methane). Similarly, Regasified LNG is also methane; it has the same chemical and physical characteristics as it did when separated from the raw natural gas stream. As discussed above, Liquefaction and Regasification are crucial elements in the transportation of natural gas.[7] As a result, income derived from Liquefaction, Regasification and/or Subsequent Transportation is qualifying income because those activities are the transportation of a natural resource.

Section 7704(d)(1)(E) was amended in 2008, with the addition of the following language—

> [or] industrial source carbon dioxide, or the transportation or storage of any fuel described in subsection (b), (c), (d), or (e) of section 6426, or any alcohol fuel described in section 6426(b)(4)(A) or any biodiesel fuel as defined in section 40A(d)(1) (the "2008 Amendment").

Proposed Regulation Section 1.7704-4(a) provides that "[f]or purposes of section 7704(d)(1)(E), qualifying income includes only income and gains from qualifying activities with respect to minerals or natural resources as defined in paragraph (b) of this section" (emphasis added). Latching onto the 2008 Amendment, Proposed Regulation Section 1.7704-4(b) provides that "[f]or purposes of this section, the term mineral or natural resource does not include industrial source carbon dioxide, fuels described in section 6426(b) through (e), any alcohol fuel defined in section 6426(b)(4)(A) or any biodiesel fuel as defined in section 40A(d)(1)." LNG is listed in section 6426(d)(2)(C), and thus is not treated as a natural resource under the Proposed Regulations.

We agree that most of the fuels added to section 7704(d)(1)(E) by the 2008 Amendment are not natural resources and are properly excluded from the definition of "natural resource" by Proposed Regulation Section 1.7704-4(b). For the reasons described above, however, we believe that LNG is a natural resource and remains a natural resource following Regasification.[8] Quite simply, if Congress had intended the 2008 Amendment to exclude natural gas from the definition of natural resource, thereby creating a conflict with the statutory definition and the legislative

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[7] The Internal Revenue Service has issued a private letter ruling concluding that Liquefaction and Regasification give rise to qualifying income. *See* PLR 201224023 (June 15, 2012).

[8] We observe that liquefied petroleum gas and compressed natural gas, both also listed in section 6426(d), should also be treated as natural resources and should not be excluded from the definition of natural resource by the Proposed Regulations.

history, it would have said so.[9] It did not. As a result, the definition of natural resource used by the Proposed Regulations improperly excludes LNG from status as a natural resource.

If final regulations under section 7704(d)(1)(E) follow the approach and form of the Proposed Regulations, we request that the following changes to the Proposed Regulations be made to clarify that LNG (including Regasified LNG) is a natural resource and that Liquefaction, Regasification, and Subsequent Transportation are section 7704(d)(1)(E) transportation activities.

1. Proposed Regulation Section 1.7704-4(b)

The last sentence of Proposed Treasury Regulation Section 1.7704-(b) should be amended to read as follows (additional language is underlined):

> For purposes of this section, the term mineral or natural resource does not include industrial source carbon dioxide, fuels described in section 6426(b) through (c), any alcohol fuel defined in section 6426(b)(4)(A), or any biodiesel fuel as defined in section 40A(d)(1). <u>Notwithstanding the foregoing, liquefied natural gas ("LNG") and regasified LNG are treated as natural resources for purposes of this section</u>.

2. Proposed Regulation Section 1.7704-4(c)(6)

Proposed Regulation Section 1.7704-4(c)(6) should be amended to read as follows (additional language is underlined):

> Transportation is the movement of minerals or natural resources and products produced under paragraph (c)(4) or (5) of this section, including by pipeline, barge, rail or truck, except for transportation (not including pipeline transportation) to a place that sells or dispenses to retail customers. Retail customers do not include a person who acquires oil or gas for refining or processing, or a utility. The following activities qualify as transportation—
>
> (i) Providing storage services;
> (ii) Terminalling;
> (iii) Operating gathering systems and custody transfer stations;
> (iv) Operating pipelines, barges, rail or trucks;
> (v) Construction of a pipeline only to the extent that a pipe is run to connect a producer or refiner to a preexisting

[9] The apparent legislative purpose for the 2008 Amendment was to include certain income derived from activities with respect to alternative fuels as qualifying income in order to encourage additional investment in the infrastructure needed to support the use of those fuels. As a matter of drafting convenience, Congress simply used already available sections of the Code listing various alternative fuel sources without regard to whether such fuel sources were otherwise natural resources for purposes of section 7704.

interstate or intrastate line owned by the publicly traded partnership (interconnect agreements); and

(vi) liquefaction and regasification of natural gas.[10]

B. Liquefaction, Regasification and Subsequent Transportation are Transportation of LNG for Purposes of Section 7704(d)(1)(E)

Pursuant to the 2008 Amendment, income and gains derived from the transportation and storage of LNG constitute qualified income without regard to the status of LNG as a natural resource. Accordingly, if the proposals described immediately above are not adopted, we request that final regulations (or other guidance) be adopted expressly treating Liquefaction, Regasification, and Subsequent Transportation as the transportation of LNG for purposes of section 7704(d)(1)(E).[11]

Sincerely,

Dominion Midstream Partners, LP

Alma W. Showalter
Vice President – Tax

[10] As an alternative to this approach, Prop. Reg. § 1.7704-4(c)(5)(ii) could be amended to include Liquefaction and Regasification in the category of activities treated as processing of natural gas.

[11] Under Prop. Reg. § 1.7704 4(c)(5)(ii), neither Liquefaction nor Regasification are included as activities constituting the processing of natural gas. As a result, Subsequent Transportation may not qualify as transportation of a natural resource or product produced under Prop. Reg. § 1.7704-4(c)(5) if LNG is not treated as a natural resource. As a result, Subsequent Transportation would need to be treated as transportation of LNG if our first proposal is not adopted.