



August 4, 2015

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

RE: Comments on REG-132634-4 Qualifying Income from Activities of Publicly Traded Partnerships with Respect to Minerals or Natural Resources

Dear Sir/Madam:

ZeoGas LLC ("ZeoGas") appreciates the opportunity to submit this letter to the U.S. Department of Treasury ("Treasury") and the Internal Revenue Service ("IRS") in response to the request for comments on the proposed amendments to the Income Tax Regulations (26 CFR part 1) under section 7704(d)(1)(E) of the Internal Revenue Code of 1986, as amended (the "Code") regarding qualifying income from certain activities with respect to minerals or natural resources (REG-132634—14) ("Proposed Regulations").

ZeoGas is a pre-revenue, development-stage company which intends to develop and build a natural gas conversion facility that will co-locate and integrate three reactions: natural gas to syngas, syngas to methanol, and methanol to gasoline, followed by some conventional refining steps, such as distillation and hydro-treating, to produce zero-sulfur, low benzene, RON 92 gasoline and liquefied petroleum gases (LPGs), primarily propane and isobutane.

ZeoGas is neither a publicly traded partnership nor a partner of one, and we believe that natural gas processing using non-traditional conversion technology to produce fuel and other products which are historically the output of conventional crude refining, such as the gasoline ZeoGas intends to produce, is an activity squarely within the universe of qualifying activities described in the Proposed Regulations.

ZeoGas is submitting this comment to the Proposed Regulations for two reasons. First, it seeks clarification that the drafters' insertion into section 1.7704-4(c)(5)(ii) of the phrase, "in one integrated conversion" into the sentence "Convert methane...into liquid fuels that are otherwise produced from petroleum" is not intended to exclude natural gas processing using multi-step conversion techniques to produce gasoline and other LPGs from treatment as a qualifying "processing" activity. Second, it wishes to express specific and general concerns with regard to certain concepts and definitions of "refining" and "processing" which are included in the Proposed Regulations.

Multi-Step Conversion Processes are qualifying activities.

We believe that the specific reference in section 1.7704-4(c)(5)(ii) of the Proposed Regulations to include natural gas “conversion to liquid fuels otherwise produced from petroleum” as a qualifying activity demonstrates the drafters’ intention to include non-traditional natural gas conversion processes.

Our belief is supported by language in three private letter rulings (“PLRs”) issued to others by IRS in 2012 and 2013 stating that natural gas to liquid fuel conversion processes are qualifying activities.¹ A fourth PLR issued by IRS in November 2013 stated that conversion of natural gas to methanol was a qualifying activity, although as provided in Example 3 of the IRS’ May 26 Bulletin regarding the Proposed Regulations, methanol production would no longer be considered a qualifying activity because it is an intermediate product, not a fuel.²

ZeoGas understands that the referenced PLRs are not binding or even applicable to it, but they are instructive with regard to the stages of actual conversion processing techniques and could explain the specific inclusion of “conversion to liquid fuels” as a qualifying processing activity in the Proposed Regulations. The PLRs highlight two key issues within the concept that ZeoGas wishes to address. First, the text of each of the four PLRs cited above refers to a process of converting “natural gas,” not “methane” to fuel or methanol. Second, each of the “non-methanol-qualifying” PLRs also describe the qualifying activity as the conversion of natural gas through a “three-step integrated process.”

We do not understand why “methane” is used in section 1.7704-4(c)(5)(ii)(C) instead of natural gas, and believe it raises a question of whether it implies a preliminary processing step before “conversion” takes place—particularly since that section’s use of the word “methane” immediately follows the statement in the preceding section (1.7704-4(c)(5)(ii)(B)) that “methane” is a constituent of natural gas. ZeoGas urges the Treasury and IRS to explain the reason the Proposed Regulations define qualifying natural gas conversion processing as beginning with methane, or simply replace “methane” with “natural gas” in section 1.7704-4(c)(5)(ii) to mitigate ambiguity.

With regard to the second issue highlighted by the PLRs, we do not understand why section 1.7704-4(c)(5)(ii)(C) of the Proposed Regulations uses the phrase “in one integrated conversion.” Each of the non-methanol PLRs cited above describes and refers to the same or similar non-traditional natural gas conversion processes as encompassing “a three step integrated process.” The non-methanol PLRs detail the multi-stage conversion process as: “[processing] natural gas into methanol and synthesis gas and that, with the addition of certain specialized refinery

¹ IRS Priv. Ltr. Rul. 2013-15-015 (April 12, 2013), IRS Priv. Ltr. Rul. 2013-24-002 (June 14, 2013), IRS Priv. Ltr. Rul. 2013-14-038 (April 5, 2013)

² IRS Priv. Ltr. Rul. 2013-46-007 (November 15, 2013). ZeoGas believes that methanol production from natural gas should qualify under the Proposed Regulations, but does not address that here.

components, will further process the methanol and synthesis gas into gasoline and liquefied petroleum gas (LPG).”³

The non-methanol PLRs describe the several steps in the conversion process with some specificity: “Gasoline and LPG are produced from natural gas through a *three step integrated process*; synthesis gas and methanol are produced in the first and second steps of this process, respectively. First, the natural gas enters a steam methane reformer where under high heat the natural gas is combined with steam to produce synthesis gas. Second, the synthesis gas is converted into methanol, hydrogen and water in the presence of a copper-based catalyst. Third and finally, the methanol is converted into a mixture of methanol, dimethyl ether and water, which is then passed over a catalyst to produce gasoline, LPG and water (which is recycled through the facility).” (*emphasis added*) Interestingly, it is the only the PLR regarding methanol production which refers to “an integrated process,” but even that PLR identifies at least two processing steps: “First, the natural gas enters a steam methane reformer where under high heat the natural gas is combined with steam to produce synthesis gas. Second, the synthesis gas is converted into methanol, hydrogen and water in the presence of a copper-based catalyst....”

ZeoGas urges Treasury and IRS to revise the phrase, “in one integrated conversion” in section 1.7704-4(c)(5)(ii) of the Proposed Regulations to clarify that qualifying natural gas processing includes multi-stage conversion processes used in natural gas to liquid fuel conversion. We suggest the following alternative language to address the ambiguity around beginning the conversion process with processed natural gas, (i.e. methane) and use of multi-stage conversion processing: “(iii) Converting natural gas to liquid fuels otherwise produced from petroleum in an integrated conversion process occurring within a single facility.”

Processes that cause physical and chemical changes to natural gas are qualifying activities.

ZeoGas does not disagree that natural gas processing includes activities which “purify, separate or eliminate impurities” from natural gas, but we do not believe that should be the exclusive list of qualifying processing activities. Such a limitation would drastically limit or exclude almost all downstream natural gas conversion processing activities. We also believe, for the same reasons, that it is inappropriate to exclude processes which cause a transformative physical or chemical change to natural gas. We are concerned that non-traditional conversion from natural gas to gasoline, for example, could be excluded under either limitation, as would many traditional crude processing and refining processes.

³ IRS Priv. Ltr. Rul. 2013-24-002 (June 14, 2013)

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“Refining” and “Processing” should not be treated differently depending on whether the feedstock is natural gas or crude.

While we are concerned with the specific activities directly related to the natural gas conversion process described above, we also have general concerns about the approach used in the Proposed Regulations which restrict the kinds of activities that can qualify as refining and processing depending on whether the feedstock is natural gas or crude, because we believe such restrictions may result in excluding many traditional processing or refining activities and non-traditional conversion processes which would otherwise be qualifying activities. We do not think it is appropriate, and believe it is inconsistent with the language of section 7704(d)(1)(E) to treat certain activities as qualifying with respect to crude oil, but not with respect to natural gas.

NCAIS and MACRS designations should not create barriers to qualifying activities.

Finally, ZeoGas is concerned with the introduction of a requirement that qualifying activities that create the products listed in the 2012 version of NAICS code 211112 concerning natural gas liquids extraction or code 324110 concerning refineries. While the processes described in the PLRs produce products which may be listed in either of the NAICS codes, the products are not created by using the same processes. The reference to NAICS could be instructive, and helpful, but should not be a gating factor.

Similarly, ZeoGas does not believe that it is appropriate to require a certain designation of a Modified Accelerated Cost Recovery System (MACRS) class life for assets used in the activity ...” As with the issue of introducing a requirement of a certain NAICS designation, introducing a certain MACRS recovery period as a bar to an otherwise qualifying activity seems onerous. Natural gas conversion processing assets which produce gasoline and other LPGs traditionally produced in a crude refinery are not interchangeable, and if required of natural gas conversion processing facilities, the provision would create uncertainty and unnecessary administrative burdens.

We appreciate the effort of Treasury and the IRS to address issues around qualifying income for publicly traded partnerships, and the opportunity to comment. If you have any questions or would like to discuss these comments, please feel free to contact me at (713) 751-9138.

Respectfully Submitted,

ZeoGas LLC

Jeri P. Wechsler
General Counsel

