SunCoke Energy™

SunCoke Energy, Inc.
1011 Warrenville Rd
Suite 600
Lisle, IL 60532

June 16, 2015

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

SunCoke Energy Partners, L.P. ("***SunCoke***") and SunCoke Energy, Inc. welcome 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 commend the efforts of the Department of the Treasury ("***Treasury***") and the Internal Revenue Service (the "***Service***") to implement a comprehensive definition of qualifying income as it relates to minerals and natural resources. We believe that input from participants in the mineral and natural resources industries will result in improved final Treasury Regulations.

1. Executive Summary

Our comments principally address the scope of activities that the Proposed Regulations treat as processing of ores and minerals. We believe that the Proposed Regulations ignore the plain meaning of the word "mining" set forth in the Code and the existing Treasury Regulations and effectively write "processing" of ores and minerals as an independent activity under section 7704(d)(1)(E) out of the statute. This result could not have been intended by Congress or the Treasury. Fortunately, it is an error that can be easily corrected by making it clear that "processing" of ores and minerals includes those nonmining processes described in Treasury Regulation § 1.613-4(g)(1).

Section 7704(d)(1)(E) identifies seven activities with respect to minerals or natural resources that produce qualifying income. The first five of those activities – exploration, development, mining or production, processing, and refining – reflect a comprehensive upstream-to-downstream progression of different activities that are performed on minerals or natural resources and which ultimately result in a refined product. Each of these separate activities when applied to a mineral or nature resource generates qualifying income.

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

Each of the words of the statute must be given its plain meaning. The word "mining" is defined in section 613(c)(2) and Treasury Regulation § 1.613-4(f)(1) to include not only the excavation of the ore or mineral but also specifically defined "mining processes." These mining processes are described in Treas. Reg. § 1.613-4(f)(2) as "ordinary treatment processes normally applied by mine owners or operators in order to obtain the [first] commercially marketable product…"

Inexplicably, the Proposed Regulations define the independent section 7704(d)(1)(E) activity of "processing" to include only the "mining processes" described in Treas. Reg. §1.613-4(f)(1)(ii). By doing this, the Proposed Regulations ignore the well-established and long-standing definition of "mining" set forth in the Code and Treasury Regulations and effectively eliminate the word "processing" of ores and minerals from the statute. This violates the bedrock principle of statutory construction that effect must be given to the plain meaning of all of the words of a statute.

As a result, under the Proposed Regulations as currently drafted, the listed "mining processes" generate qualifying income and the "refining" of ores generates qualifying income, but the processes that in fact occur between "mining" and "refining" do not. Thus, the Proposed Regulations would exclude from qualifying activities numerous mineral processing activities, including coking of coal and smelting iron ores, that purify, separate or eliminate impurities from ores and minerals and that necessarily must take place before "refining" as defined in the Proposed Regulations can occur. This definition would produce the certainly unintended and illogical result that a publicly traded partnership may refine a partially processed mineral, but may not carry out the processing activities necessary to prepare the mineral for refining. Given the well-established meaning of "mining" (which includes "mining processes"), "nonmining processes," and "refining" with respect to ores and minerals, and the structure and plain meaning of the words of section 7704(d)(1)(E), one can only conclude that Congress intended "processing" to include those nonmining processes that occur after "mining" and before "refining."

2. SunCoke's Business

SunCoke is a publicly traded partnership that is primarily engaged in the business of processing metallurgical coal into coke.[2] SunCoke owns interests in and operates three cokemaking facilities. SunCoke produces coke using a heat recovery process commonly referred to as thermal distillation or destructive distillation. In this process, pulverized metallurgical coal is heated to a temperature of 1100 degrees Celsius in an oxygen-restricted refractory oven, significantly reducing the percentage of volatile matter. The resulting coke product is a relatively porous mass of nearly pure carbon containing between 87 and 93 percent fixed carbon and less than 1% volatile matter. SunCoke sells the coke for use as a principal raw material in the blast furnace steelmaking process.

[2] Coke produced from metallurgical coal is sometimes referred to as metallurgical coke, or met coke, to distinguish it from petroleum coke, or pet coke, which is produced in crude oil refineries from the bottom fractions of the crude oil fractionation process.

SunCoke also owns and operates a coal logistics facility and is contemplating expanding its business to include additional mineral processing activities. To that end, SunCoke has recently received two private letter rulings from the Service concluding that producing iron ore pellets and direct reduced iron produce qualifying income.[3]

3. Detailed Discussion

a. Section 7704(d)(1)(E) Treats "Processing" as an Independent Activity

The Proposed Regulations are intended to provide guidance on what constitutes "qualifying income" from minerals or natural resources under section 7701(d)(1)(E) of the Code, which defines qualifying income, in relevant 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 7704(d)(1)(E) identifies each of "mining or production," "processing" and "refining" as a separate activity, separated by commas. The only activities not separated by commas are "mining or production." The combination of "mining or production" correctly reflects that ores and minerals are mined, while oil and gas are produced. In contrast, section 7704(d)(1)(E) treats "processing" and "refining" as separate activities. Thus, section 7704(d)(1)(E) must be interpreted to give each term a separate meaning. The Supreme Court has made this a fundamental tenet of statutory construction. *Montclair v. Ramsdell*, 107 U.S. 147, 152 (1883); *Astoria Federal Savings & Loan Ass'n v. Solimino*, 501 U.S. 104, 112 (1991); *Bailey v. United States*, 516 U.S. 137, 146 (1995). As discussed below, in violation of this principle the Proposed Regulations both ignore the plain meaning of "mining" and effectively write "processing" out of section 7704(d)(1)(E).

Section 7704(d)(1)(E) defines "mineral or natural resource" as any product of a character with respect to which a deduction for depletion is allowable under section 611. Section 611 provides depletion deductions for mines, wells and other natural deposits. In an integrated mining operation, the producer is entitled to claim percentage depletion on the value of the mineral or natural resource after the completion of all mining processes. This point is referred to as the "depletion cut-off point." The legislative history to section 7704(d)(1)(E) makes clear that the reference to depletion was intended only to identify the minerals and natural resources and was not intended to suggest that qualifying income must itself be income that would qualify for percentage depletion.[4] However, as applied to processing of ores and minerals, the Proposed Regulations in effect, and inappropriately, cut off qualifying income at the depletion cutoff point.

---

[3] PLR 201351009 (Dec. 20, 2013) (PLR-117185-13) (beneficiating and pelletizing iron ore using a bentonite binder); PLR 201448019 (Nov. 27, 2014) (PLR-14673-13) (production of direct reduced iron by combining iron ore or iron ore pellets with synthesis gas in the presence of heat to yield iron, with water and carbon dioxide as byproducts).

[4] S. Rep. No. 445, 100th Cong., 2d Sess. 424 (1988) ("The reference in the bill to products for which a depletion deduction is allowed is intended only to identify the minerals or natural resources and not to identify what income from them is treated as qualifying income. Consequently, whether income is taken into account in determining percentage depletion under section 613 does not necessarily determine whether such income is qualifying income.").

b. The Proposed Regulations – Definition of "Processing or Refining" of Ores and Minerals

The Proposed Regulations use the term "qualifying activities" to describe activities relating to minerals and natural resources that would produce qualifying income. Under the Proposed Regulations, qualifying activities include only "section 7704(d)(1)(E) activities" and activities that are "intrinsic" to section 7704(d)(1)(E) activities. Section 1.7704-4(c) of the Proposed Regulations limits the scope of qualifying activities to an exclusive list of activities, and specifically states that "[n]o other activities qualify as section 7704(d)(1)(E) activities."

The Proposed Regulations combine the terms "processing and refining" and then define them collectively as activities that are "done to purify, separate, or eliminate impurities." This combined definition includes two caveats. First, the partnership's designation of assets used in the activity under the modified accelerated cost recovery system ("***MACRS***") must be consistent with processing or refining of a natural resource. Second, under the Proposed Regulations "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 the extracted mineral or natural resource into new or different mineral products or into manufactured products." As described below, there is nothing in the statute or in its legislative history to support this combined, three-pronged definition of "processing or refining" in the Proposed Regulations and in fact it is contrary to the plain meaning of the words "mining" and "processing."

c. The Definitions of Mining, Processing and Refining Should Be Consistent With Section 613 and the Treasury Regulations Thereunder

Section 7704(d)(1)(E) does not contain new, section 7704(d)(1)(E)-specific, definitions for mining, processing or refining. There was no reason for Congress to define those terms in section 7704(d)(1)(E). At the time this provision was enacted, section 613 and the Treasury Regulations that had been issued thereunder already contained definitions of several of the terms used in section 7704(d)(1)(E). These included "mining," which encompasses "mining processes," and "nonmining processes." "Nonmining processes" in turn includes "refining." The purpose of these definitions is to clarify what processes take place before and after the depletion cut-off point.

Under general principles of statutory construction, where Congress uses similar words and phrases in different Code provisions, those terms have the same meaning in each provision.[5] As section 7704(d)(1)(E) specifically references the depletion rules, the definitions of terms in section 613 and the associated Treasury Regulations should provide the touchstone for defining the same or similar terms used in section 7704(d)(1)(E). In fact, the Proposed Regulations do rely on the Treasury Regulations under section 613 to define the terms "processing" and "refining." Unfortunately, the drafters of the Proposed Regulations fail to apply the definitions in the manner intended by Congress.

---

[5] *E.g., Commissioner v. Keystone Consolidated Industries,* 508 U.S. 152, 159 (1993); *Seaman v. Commissioner,* 29 T.C.M (CCH) 1331, 1333 (1970), *aff'd,* 479 F.2d 336 (9th Cir. 1973).

Mining and Mining Processes. Section 613(c) provides a detailed definition of mining, which includes:

> not merely the extraction of the ores and minerals from the ground but also the treatment processes considered as mining described in paragraph (4) (and the treatment processes necessary or incidental thereto) and so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills where such treatment processes are applied thereto as are not in excess of 50 miles....

Section 1.613-4(f)(1) of the Treasury Regulations implements this definition by defining "mining" to include both (i) the extraction of ores or minerals from the ground, and (ii) "mining processes" described in paragraphs (2) through (6). In general, these processes, which include, for example, cleaning, breaking, dust allaying, and treating to prevent freezing (for coal) and sorting, concentrating, sintering and substantially equivalent processes (for ores such as iron ore), are "ordinary treatment processes normally applied by mine owners or operators to obtain the [first] commercially marketable product or products." For ores and minerals that are not customarily sold in crude form, section 1.613-4(f) treats additional processes as mining processes.

It is difficult to understand why the Proposed Regulations do not adopt the definition of "mining" from section 613. Instead, the Proposed Regulations omit "mining processes" from the definition of "mining" and effectively narrow the term "mining" to include only "[o]perating equipment to extract natural resources from mines and wells" and "[o]perating equipment to convert raw mined products ... to substances that can be readily transported or stored."

Nonmining Processes. Section 613(c)(5) provides a list of nonmining processes, *i.e.*, processes that are performed after mining processes are completed. Those processes include (among others) electrolytic deposition, roasting, calcining, thermal or electric smelting refining, polishing, fine pulverization, blending with other materials, treatment effecting a chemical change, and thermal action.[6]

A number of the listed nonmining processes eliminate impurities from ores or minerals, thus falling within the general definition of processing in the Proposed Regulations. For example, section 1.613-4(g)(6)(ii) of the Treasury Regulations defines "thermal smelting" as "processes which reduce, separate, or remove impurities from ores or minerals by the application of heat." Examples of such processes include "the furnacing of copper concentrates" and "the heating of iron ores, concentrates or pellets in a blast furnace to produce pig iron." Similarly, section 1.613-4(g)(6)(i) defines calcining to mean "processes used to expel the volatile portions of a mineral by the application of heat." Another such process, "thermal action," means "processes which involve the application of artificial heat to ores and minerals, such as ... the coking of coal." Treas. Reg. § 1.613-4(g)(6)(viii). Roasting is a further example of a process performed to remove impurities in ores or minerals. *See* Treas. Reg. § 1.613-4(g)(2).

---

[6] Treas. Reg. § 1.613-4(g)(1).

However, most of those nonmining processes effect a physical or chemical change and thus likely fail the third prong of the definition of "processing or refining" in the Proposed Regulations. Moreover, the Proposed Regulations go further, defining "processing" of ores and minerals to mean only the mining processes described in Treasury Regulation § 1.613-4(f)(1)(ii). This eliminates any nonmining process from the definition of "processing or refining," including those that purify and yet do not cause a substantial physical or chemical change. This definition misapplies the definition of "mining" in both the Code and the Treasury Regulations and by doing so, effectively eliminates processing of ores and minerals from section 7704(d)(1)(E).

Despite the principle included in the Proposed Regulations that an activity constitutes processing or refining of a natural resource if it eliminates impurities from natural resources, the Proposed Regulations as currently drafted would limit processing of ores and minerals to activities that generate depletable income and would exclude any activity that might cause a substantial physical or chemical change, even though Congress made clear that qualification of an income stream as depletable is not necessary to the qualification of the income as qualifying income.[7]

Refining. Section 1.613-4(g)(6)(iii) defines "refining" to refer to non-mining processes "used to eliminate impurities or foreign matter from smelted or partially processed metallic and nonmetallic ores and minerals, as, for example, the refining of blister copper." That paragraph further states that, "[i]n general, a refining process is designed to achieve a high degree of purity by removing relatively small amounts of impurities or foreign matter from smelted or partially processed ores or minerals." The Proposed Regulations appropriately look to section 1.613-4(g)(6)(iii) of the Treasury Regulations for the definition of "refining" but neglect to apply those regulations to define "mining" and "processing."

d. Congress Intended "Processing" of Ores and Minerals to Include "Nonmining Processes" Described in Section 1.613-4(g)

Given the well-established meaning of "mining" under section 613 and the Treasury Regulations thereunder, for purposes of section 7704(d)(1)(E) Congress must have intended processing to mean the nonmining processes listed in section 613(c)(5) that are carried out after mining processes have been completed and before refining begins. For example, before copper can be refined, concentrated copper ores (a mixture of copper sulfide, iron sulfide and other metals) must be smelted in a furnace to yield blister copper, which is then refined in an anode furnace to yield pure copper.[8] Similarly, to reduce the iron oxide in iron ore to relatively pure iron, the iron ore must be pulverized and smelted.

The fact that the definition of refining in the Proposed Regulations refers to partially processed minerals further indicates that nonmining processes, such as smelting, that are preparatory to refining should constitute "processing." Otherwise, the Proposed Regulations would mean that refining a smelted mineral, such as blister copper, generates qualifying income, but that the predecessor smelting process does not generate qualifying income. The Proposed

---

[7] S. Rep. No. 445, 100th Cong., 2d Sess. 424 (1988).

[8] United States Environmental Protection Agency, Metallurgical Industry, AP 42, ch. 12.3, "Primary Copper Smelting" (1986).

Regulations as drafted apparently compel this result, however, even though smelting accomplishes precisely the result – removing impurities from ores or minerals – that the Proposed Regulations define as processing or refining. The Proposed Regulations seem to ignore this inconsistency.

Viewed in this light, the term "processing" must include nonmining processes applied to depletable natural resources after production or mining processes and before refining. Accordingly, processes applied to ores and minerals up to and including processes that eliminate impurities from ores and minerals, such as smelting of ores and coking of coal, should be characterized as processing of ores and minerals which produce qualifying income.

e. The "Substantial Chemical Change" Limitation Is Inconsistent with Section 7704(d)(1)(E) and Congressional Intent

Under the Proposed Regulations, except as 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 preamble to the Proposed Regulations suggests that the source of this rule is section 1.613-4(g)(5) of the Treasury Regulations, which defines "transformation processes" to mean:

> Processes which effect a substantial physical or chemical change in a crude mineral product, or which transform a crude mineral product into new or different mineral products, or into refined or manufactured products, are nonmining processes except to the extent that such processes are specifically allowed as mining processes in section 613(c) or under paragraph (f) of this section.

While this definition is helpful in determining whether a process constitutes a mining process for which depletion is allowable, it was not intended to distinguish, nor is it helpful in distinguishing between activities that qualify as processing or refining of an ore or mineral, which produce qualifying income, and activities that constitute manufacturing, which do not produce qualifying income. This is clear from the fact that the definition in section 1.613-4(g)(5) treats refining, which the Proposed Regulations recognize as a qualifying activity, as a transformative process.

There is simply no basis in section 7704 or in the legislative history for imposing a blanket exclusion of any activity that results in a "substantial" physical or chemical change from the definition of processing or refining.

f. The MACRS Consistency Requirement Should Be Eliminated

Even if an activity otherwise is on the exclusive list of processing or refining activities, the Proposed Regulations would not treat the activity as a qualifying activity unless the MACRS class life used by the partnership for assets used in the activity is "consistent" with processing or refining under Rev. Proc. 87-56. Nothing whatsoever in section 7704(d)(1)(E) or its legislative history provides any support for this limitation.

The MACRS classifications for assets used in mineral processing and refining do not separate processing and refining activities from manufacturing activities, and thus are not even marginally helpful in determining whether the activity produces qualifying income. For example, SunCoke classifies its coke production assets under asset class 33.4, which includes "assets used in coke production." That category, however, also encompasses assets used in a broad array of processes generally relating to the steel industry, ranging from smelting and refining of iron ore to the manufacture of steel nails and spikes. Some of those activities, such as refining iron ore, clearly are qualifying activities under the Proposed Regulations but other activities, equally clearly, would not be qualifying activities. Accordingly, the MACRS limitation should be deleted from the final regulations.

4. Recommendations

We believe that the final regulations should be amended as follows:

1. The general definition of processing or refining in section 1.7704-4(c)(5)(i) of the Proposed Regulations should be amended to eliminate (i) the exclusion of activities involving a substantial physical or chemical change or the transformation of the mineral into a new and different product from the definition of refining or processing, and (ii) the MACRS consistency requirement.

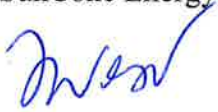
2. Section 1.7704-4(c)(5) of the Proposed Regulations should be amended to provide separate definitions for "processing" and "refining." The definition of "processing" should eliminate the reference to Treasury Regulation section 1.613-4(f)(1)(ii). Instead, the final regulations should define processing and refining of ores and minerals to include the nonmining processes listed in Treasury Regulation section 1.613-4(g)(1). In addition, the final regulations should clarify that any process that is undertaken to reduce impurities in the ore or mineral, such as calcining, thermal smelting of iron ore, the coking of coal, as well as any process necessary to carry out those activities, constitutes processing or refining within the meaning of section 7704(d)(1)(E).

3. Section 1.7704-4(c)(1) of the Proposed Regulations should be amended to eliminate the concept that qualifying activities are limited to those specifically identified in paragraph (c).

We believe that the foregoing changes will result in a clear and workable definition of "processing" that is consistent with the language of section 7704(d)(1)(E) and Congressional intent as expressed in the legislative history.

Sincerely,

SunCoke Energy Partners, L.P.



Fay West, Chief Financial Officer of General Partner

SunCoke Energy, Inc.

Fay West, Chief Financial Officer