Internal Revenue Service

Department of the Treasury

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CC:PSI:7-PLR- 104099-00
Date:
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LEGEND:

P =
New P =

Q =

R =

S =

T =

W =

X =

Y =

Z =

Agreement =

Date 1 =

Date 2 =

Date 3 =

Dear :

This letter responds to a letter dated February 2, 2000, and subsequent correspondence, submitted on behalf of P by its authorized representatives, requesting rulings under § 29 and § 702 of the Internal Revenue Code.

FACTS

The facts as represented by P and P's authorized representatives are as follows:

P is a limited liability company, taxable as a partnership. X and Y were the initial members in P. W is the sole member of X. Because X is disregarded as an entity for federal income tax purposes, W is treated as owning X's member interest in P. Y is a wholly-owned subsidiary of W. Z is the indirect parent corporation of W. On Date 3, X sold a 90% member interest in P to R pursuant to a Purchase and Sale Agreement, dated as of Date 3, between R and X. P represents that a termination of P under § 708(b)(1)(B) occurred as a result of such sale. The reconstituted partnership following the termination of P under § 708(b)(1)(B) is referred to as New P.

P acquired the Facility from Q pursuant to an Agreement dated as of Date 2. Q was the original owner of the Facility, which was constructed pursuant to a construction contract, dated Date 1, that was assigned to Q. The construction contract does not provide for liquidated damages or any other limitation on the maximum amount of damages available should either party fail to perform. The construction contract includes a description of the facility to be constructed, a completion date and a price. P provided an opinion of counsel that the construction contract constituted a binding written contract under applicable state laws prior to January 1, 1997, and at all times thereafter through completion of the contract.

The Facility is a movable facility that can be moved from one site to another depending on the availability, price and location of coal feedstock. Subsequent to the purchase, P relocated the Facility to a site owned by an indirect subsidiary of W. Following the relocation, the fair market value of the original property was more than 20 percent of the Facility's total value (the cost of the new property plus the value of the original property).

P operated and maintained the Facility. P purchased coal feedstocks for the Facility from a variety of sources. The feedstock coal was thoroughly mixed with a chemical reagent in a pugmill. After leaving the pugmill, the mixture was carried by conveyor belt to a conveyor from which it was distributed to one of three briquetters by an arrangement of diverters and chutes. Each briquetter was equipped with a short conveyor belt running under it that received the resulting solid synthetic fuel product and carried it to a common collection belt and then out of the Facility to a storage area. In P and New P's production process, the combination of the chemically reactive agent, the mixing process, the retention time, and the compression pressure used in the roll briquetter process results in the formation of a solid synthetic fuel product. The synthetic fuel produced by P was sold to third party utilities and industrial users. The Facility utilized coal feedstock and chemical reagents that meet the requirements of Rev. Proc. 2001-34, 2001-22 I.R.B. 1293.

The Facility has used various feedstock sources, chemical reagents and chemical reagent concentrations as described in P's letter ruling request. P has had recognized experts in coal and chemical analysis conduct numerous tests on synthetic fuel samples produced by P using each reagent identified in the request for rulings. These tests are described in detail in P's letter ruling request and subsequent correspondence from P's authorized representatives. Based on this testing of the reagents, the experts have concluded that there was a measurable, significant change in the chemical composition of the resulting synthetic fuel compared to the unreacted coal feedstocks and chemical reagent.

P's Amended and Restated Limited Liability Company Agreement allocated receipts from the sale of synthetic fuel among its members in accordance with their membership interests.

The rulings requested by P are as follows:

(1) P, with use of the process, produces a "qualified fuel" within the meaning of § 29(c)(1)(C).

(2) The contract for construction of the Facility constitutes a "binding written contract" in effect before January 1, 1997 for purposes of § 29(g)(1)(A).

(3) The Facility is "placed in service" for purposes of § 29(g)(1) on the date that the Facility was first placed in a condition or state of readiness and availability to produce qualified fuel, as provided in §§ 1.46-3(d)(1)(ii) and 1.167(a)-11(e)(1)(i).

(4) Production of qualified fuel from the Facility will be attributable solely to P within the meaning of § 29(a)(2)(B) of the Code and P will be entitled to the § 29 credit for qualified fuel from the Facility that is sold to unrelated persons.

(5) If the Facility was "placed in service" prior to July 1, 1998, within the meaning of § 29(g)(1), relocation of the Facility to a different location after June 30, 1998, or replacement of parts of the Facility after that date, will not result in a new placed in service date for the Facility for purposes of § 29 provided the fair market value of the original property is more than 20 percent of the Facility's total fair market value at the time of relocation or replacement.

(6) The credit allowed under § 29 may be passed through to and allocated among all the members in P in accordance with the principles of § 702(a)(7).

(7) If the Facility was "placed in service" prior to July 1, 1998, within the meaning of § 29(g)(1), the Facility will continue to be treated as placed in service before July 1, 1998 if sold to a new owner after such date.

(8) The termination of P and any termination of New P under § 708(b)(1)(B) will not preclude the reconstituted partnership from claiming the § 29 credit for the production and sale of synthetic fuel to unrelated persons.

RULING REQUEST #1

Section 29(a) allows a credit for qualified fuels sold by the taxpayer to an unrelated person during the taxable year, the production of which is attributable to the taxpayer. The credit for the taxable year is an amount equal to $3.00 (adjusted for inflation) multiplied by the barrel-of-oil equivalent of qualified fuels sold.

Section 29(c)(1)(C) defines "qualified fuels" to include liquid, gaseous, or solid synthetic fuels produced from coal (including lignite), including such fuels when used as feedstocks.

In Rev. Rul. 86-100, 1986-2 C.B. 3, the Internal Revenue Service ruled that the definition of the term "synthetic fuel" under § 48(l) and its regulations is relevant to the interpretation of the term under § 29(c)(1)(C). Former § 48(l)(3)(A)(iii) provided a credit for the cost of equipment used for converting an alternate substance into a synthetic liquid, gaseous, or solid fuel. Rev. Rul. 86-100 notes that both § 29 and former § 48(l) contain almost identical language and have the same overall congressional intent, namely to encourage energy conservation and aid development of domestic energy production. Under § 1.48-9(c)(5)(ii) of the Income Tax Regulations, a synthetic fuel "differs significantly in chemical composition," as opposed to physical composition, from the alternate substance used to produce it. Coal is an alternate substance under § 1.48-9(c)(2)(i) of the Income Tax Regulations.

In Rev. Proc. 2001-30, 2001-19 I.R.B. 1163, the Service announced that it will resume issuance of rulings under § 29(c)(1)(C) for processes that do not go beyond the processes approved in the rulings issued prior to 2000.

Section 3 of Rev. Proc. 2001-34 provides that the Service will issue rulings that a solid fuel (other than coke) produced from coal is a qualified fuel under § 29(c)(1)(C) if the conditions set forth below are satisfied and evidence is presented that all, or substantially all, of the coal used as feedstock undergoes a significant chemical change. The conditions are that:

1. The feedstock coal consists of coal fines or crushed coal comprised of particles the majority of which, by weight, are no larger than 3/8 inch;

2. The feedstock coal is thoroughly mixed in a mixer: (a) with styrene or other monomers, (b) with quinoline (C_9H_7N) or other organic resin and left to cure for several days, (c) with ultra heavy hydrocarbons, or (d) with an aluminum and/or magnesium silicate binder following heating to a minimum temperature of 500 degrees Fahrenheit; and

3. The treated feedstock is subjected to elevated temperature and pressure that results in briquettes, pellets, or an extruded fuel product, or the taxpayer represents that the omission of this procedure will not significantly increase the production of the facility over the remainder of the period during which the § 29 credit is allowable.

Based on the representations of P and P's authorized representatives, including the test results submitted by P, we conclude that the conditions of Rev. Proc. 2001-34 are met and that the process and reagents used in the Facility as described in P's ruling request and subsequent correspondence produced a significant chemical change to the coal, transforming the coal feedstock into a solid synthetic fuel from coal.

RULING REQUEST #2

Sections 29(f)(1)(B) and (f)(2) provide that § 29 applies with respect to qualified fuels which are produced in a facility placed in service after December 31, 1979, and before January 1, 1993, and which are sold before January 1, 2003.

Section 29(g)(1) modifies § 29(f) in the case of a facility producing qualified fuels described in § 29(c)(1)(C). Section 29(g)(1)(A) provides that for purposes of § 29(f)(1)(B), a facility shall be treated as placed in service before January 1, 1993, if the facility is placed in service before July 1, 1998, pursuant to a binding written contract in effect before January 1, 1997. Section 29(g)(1)(B) provides that if the facility is originally placed in service after December 31, 1992, § 29(f)(2) shall be applied by substituting "January 1, 2008" for "January 1, 2003".

A contract is binding only if it is enforceable under local law against a taxpayer, and does not limit damages to a specified amount, e.g., by use of a liquidated damages provision. A contract provision limiting damages to an amount equal to at least five percent of the total contract price, for example, should be treated as not limiting damages. The construction contract, executed prior to January 1, 1997, does not provide for liquidated damages and includes such essential features as a description of the facility to be constructed, a completion date, and a price. P provided an opinion of counsel that the construction contract constituted a binding written contract under applicable state laws prior to January 1, 1997, and at all times thereafter through completion of the contract. Therefore, we conclude that the construction contract is a binding written contract for purposes of § 29(g)(1)(A).

RULING REQUESTS #3 and #5

Sections 29(f)(1)(B) and (f)(2) of the Code provide that § 29 applies with respect to qualified fuels which are produced in a facility placed in service after December 31, 1979, and before January 1, 1993, and which are sold before January 1, 2003.

Section 29(g)(1) of the Code modifies § 29(f) in the case of a facility producing qualified fuels described in § 29(c)(1)(C), which qualified fuels include solid synthetic fuels produced from coal or lignite. Section 29(g)(1)(A) provides that for purposes of § 29(f)(1)(B), such a facility is to be treated as placed in service before January 1, 1993, if the facility is placed in service before July 1, 1998, pursuant to a binding, written contract in effect before January 1, 1997. Section 29(g)(1)(B) provides that if the facility is originally placed in service after December 31, 1992, § 29(f)(2) is to be applied by substituting for the date therein January 1, 2008.

To qualify for the § 29 credit, the facility must be placed in service before July 1, 1998, pursuant to a binding written contract in effect before January 1, 1997. While

§ 29 does not define "placed in service," the term has been defined for purposes of the deduction for depreciation and the investment tax credit. Property is "placed in service" in the taxable year the property is placed in a condition or state of readiness and availability for a specifically assigned function. Sections 1.167(a)-11(e)(1)(i) and 1.46-3(d)(1)(ii) of the Income Tax Regulations. "Placed in service" has consistently been construed as having the same meaning for purposes of the deduction for depreciation and the investment tax credit. See Rev. Rul. 76-256, 1976-2 C.B. 46. When property is placed in service is a factual determination, and we express no opinion on when the Facility was placed in service.

Rev. Rul. 94-31, 1994-1 C.B. 16, concerns § 45, which provides a credit for electricity produced from certain renewable resources, including wind. The credit is based on the amount of electricity produced by the taxpayer at a qualified facility during the 10-year period beginning on the date the facility was originally placed in service, and sold by the taxpayer to an unrelated person during the taxable year. Rev. Rul. 94-31 holds that, for purposes of § 45, a facility qualifies as originally placed in service even though it contains some used property, provided the fair market value of the used property is not more than 20 percent of the facility's total value (the cost of the new property plus the value of the used property).

Rev. Rul. 94-31 concerns a factual context similar to the present situation. Consistent with the holding in Rev. Rul. 94-31, the relocation of the Facility after June 30, 1998, or replacement of parts of the Facility after that date, will not prevent the relocated Facility from continuing to be treated as originally placed in service prior to July 1, 1998 for purposes of § 29 if the fair market value of the original property is more than 20 percent of the Facility's total fair market value at the time of relocation or replacement.

RULING REQUEST #4

Section 29(a) allows a credit for qualified fuels sold by the taxpayer to an unrelated person during the taxable year, the production of which is attributable to the taxpayer.

Under § 7701(a)(14), "taxpayer" means any person subject to any internal revenue tax. Furthermore, § 7701(a)(1) provides that when used in title 26, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof, "person" will be construed to mean and include an individual, trust, estate, partnership, association, company, or corporation.

P is the taxpayer for purposes of § 29(a)(2)(B) of the Code because a limited liability company such as P may be treated for tax purposes as either a partnership or a corporation, either of which is a taxpayer under § 7701(a)(14). P owned and operated the Facility and produced and sold the resulting qualified fuel. All production of qualified fuels by the Facility therefore was attributable solely to P within the meaning of

§ 29(a)(2)(B) and P was entitled to the § 29 credit for the production of the qualified fuel from the Facility that was sold to unrelated persons.

RULING REQUEST #6

Section 29(a) allows a credit for qualified fuels sold by the taxpayer to an unrelated person during the taxable year, the production of which is attributable to the taxpayer.

Section 7701(a)(14) provides that "taxpayer" means any person subject to any internal revenue tax. Generally, under § 7701(a)(1), the term "person" includes an individual, a trust, estate, partnership, association, company, or corporation.

Section 702(a)(7) provides that each partner determines the partner's income tax by taking into account separately the partner's distributive share of the partnership's other items of income, gain, loss, deduction, or credit to the extent provided by regulations prescribed by the Secretary. Section 1.702-1(a) provides that the distributive share is determined as provided in § 704 and § 1.704-1.

Section 704(a) provides that a partner's distributive share of income, gain, loss, deduction, or credit is, except as otherwise provided in chapter 1 of subtitle A of title 26, determined by the partnership agreement. Section 704(b) provides that a partner's distributive share of income, gain, loss, deduction, or credit (or item thereof) is determined in accordance with the partner's interest in the partnership (determined by taking into account all facts and circumstances) if (1) the partnership agreement does not provide as to the partner's distributive share of income, gain, loss, deduction, or credit (or item thereof), or (2) the allocation to a partner under the agreement of income, gain, loss, deduction, or credit (or item thereof) does not have substantial economic effect.

Section 1.704-1 (b)(4)(ii) provides that allocations of tax credits and tax credit recapture (except for § 38 property) are not reflected by adjustments to the partners' capital accounts. Thus, these allocations cannot have economic effect under § 1.704-1(b)(2)(ii)(b)(1), and the tax credits and tax credit recapture must be allocated in accordance with the partners' interests in the partnership as of the time the tax credit or credit recapture arises. If a partnership expenditure (whether or not deductible) that gives rise to a tax credit in a partnership tax year also gives rise to valid allocations of partnership loss or deduction (or other downward capital account adjustments) for the year, then the partners' interests in the partnership with respect to such credit (or the cost giving rise to it) are in the same proportion as the partners' respective distributive shares of the loss or deduction (and adjustments). See § 1.704-1 (b)(5), example (11). Identical principles apply in determining the partners' interests in the partnership with respect to tax credits that arise from receipts of the partnership (whether or not taxable).

Based on the information submitted and the representations made, we conclude that, assuming the solid synthetic fuel produced and sold qualified for the § 29 credit, the credit was allowed to P and the credit may be passed through to and allocated to the members of P under the principles of § 702(a)(7) in accordance with each member's interest in P as of the time the tax credit arose. For the § 29 credit, a member's interest in P is determined based on a valid allocation of the receipts from the sale of the § 29 credit qualified fuel.

RULING REQUEST #7

The § 29 credit has always been a time sensitive credit in that eligibility for the credit is determined when facilities or wells producing qualified fuels are placed in service and when the qualifying fuels are produced and sold to unrelated persons. For example, the § 44D credit, as originally enacted in the Crude Oil Windfall Profit Tax Act of 1980, was generally available for the production and sale of alternative fuels after December 31, 1979, and before January 1, 1990, on property that first began production after January 1, 1980.

Congress has extended the § 29 credit four times. The placed-in-service deadline and the period for claiming the § 29 credit were extended in the Technical and Miscellaneous Revenue Act of 1988 (1991 for placed in service), Omnibus Budget Reconciliation Act of 1990 (1993 for placed in service and 2003 for the end of the credit period), Energy Policy Act of 1992 (1997 for placed in service and 2007 for the end of the credit period), and Small Business Job Protection Act of 1996 (June 30, 1998, for placed in service).

It is clear from the legislative history of § 44D that Congress intended the credit to apply to facilities placed in service after 1979, and that the placed-in-service deadline in § 29(f)(1)(B) must be read as applying to when the facility is first placed in service within the applicable dates. The placed-in-service deadlines contained in §§ 29(f) and 29(g) focus on the facility, and not the owner of the facility. The legislative history of § 44D clearly shows that Congress wanted to encourage the production of new alternative fuels from facilities first placed in service after 1979, and not provide tax incentive for production capacity in service before 1980.

Section 29(g)(2) demonstrates that Congress knows how to preclude transferees of facilities from claiming the § 29 credit. That provision provides that extension of the period for placing facilities in service after 1992 does not apply to any facility that produces coke or coke gas unless the original use of the facility commences with the taxpayer.

Accordingly, the determination of whether a facility has satisfied the placed-in-service deadline under either § 29(f)(1)(B) or 29(g)(1)(A) is made by reference to when the facility is first placed in service, not when the facility is transferred or sold to a different taxpayer. Therefore, if the Facility was "placed in service" prior to July 1, 1998 within the meaning of § 29(g)(1), the sale of the Facility after June 30, 1998, will not result in a new placed in service date for the Facility for purposes of § 29 for the new owner.

RULING REQUEST #8

Section 708(b)(1)(B) provides that a partnership shall be considered as terminated if within a twelve-month period there is a sale or exchange of 50 percent or more of the total interest in partnership capital and profits.

Section 1.708-1(b)(1)(iv) provides that if a partnership is terminated by a sale or exchange of an interest, the following is deemed to occur: The partnership contributes all of its assets and liabilities to a new partnership in exchange for an interest in the new partnership; and, immediately thereafter, the terminated partnership distributes interests in the new partnership to the purchasing partner and the other remaining partners in proportion to their respective interests in the terminated partnership in liquidation of the terminated partnership, either for the continuation of the business by the new partnership or for its dissolution and winding up. Section 1.708-1(b)(1)(iv) applies to terminations of partnerships under § 708(b)(1)(B) occurring on or after May 9, 1997.

As discussed above, the placed-in-service deadline in §§ 29(f)(1)(B) and 29(g)(1)(A) must be read as applying to when the facility is first placed in service within the applicable dates. The placed-in-service deadlines contained in §§ 29(f)(1)(B) and 29(g)(1)(A) focus on the facility, and not the taxpayer owning the facility.

Accordingly, the determination of whether a facility has satisfied the placed-in-service deadline under §§ 29(f)(1)(B) and 29(g)(1)(A) is made by reference to when the facility is first placed in service, not when the facility is placed in service by a transferee taxpayer. Therefore, we conclude that the termination of P under § 708(b)(1)(B) on R's purchase of its interest will not preclude New P from claiming the § 29 credit on the production and sale of synthetic fuel to unrelated persons.

CONCLUSIONS

Accordingly, based on the representations of P and Ps authorized representatives, we conclude as follows:

(1) P, with use of the process and reagents described in the request for rulings, produced a "qualified fuel" within the meaning of § 29(c)(1)(C).

(2) The contract for construction of the Facility constitutes a "binding written contract" within the meaning of § 29(g)(1)(A).

(3) The Facility is "placed in service" for purposes of § 29(g)(1) on the date that the Facility was first placed in a condition or state of readiness and availability to produce qualified fuel, as provided in §§ 1.46-3(d)(1)(ii) and 1.167(a)-11(e)(1)(i) (we express no opinion on when the Facility was placed in service).

(4) Production of qualified fuel from the Facility was attributable solely to P within the meaning of § 29(a)(2)(B) of the Code and P was entitled to the § 29 credit for qualified fuel from the Facility that was sold to unrelated persons.

(5) If the Facility was "placed in service" prior to July 1, 1998, within the meaning of § 29(g)(1), relocation of the Facility to a different location after June 30, 1998, or replacement of parts of the Facility after that date, did not result in a new placed in service date for the Facility for purposes of § 29 provided the fair market value of the original property was more than 20 percent of the Facility's total fair market value at the time of relocation or replacement.

(6) The credit allowed under § 29 may be passed through to and allocated among all the members in P in accordance with the principles of § 702(a)(7).

(7) If the Facility was "placed in service" prior to July 1, 1998, within the meaning of § 29(g)(1), the Facility will continue to be treated as placed in service before July 1, 1998 if sold to a new owner after such date.

(8) The termination of P under § 708(b)(1)(B) will not preclude New P from claiming the § 29 credit for the production and sale of synthetic fuel to unrelated persons.

Except as specifically ruled upon above, we express no opinion concerning the federal income tax consequences of the transaction described above. Specifically, we express no opinion on when the Facility was placed in service for purposes of § 29.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent. Temporary or final regulations pertaining to one or more of the issues addressed in this ruling have not yet been adopted. Therefore, this ruling may be modified or revoked by the adoption of temporary or final regulations to the extent the regulations are inconsistent with any conclusion in this ruling. See § 12.04 of Rev. Proc. 2001-1, 2001-1 I.R.B. 1, 46. However, when the criteria in § 12.05 of Rev. Proc. 2001-1 are satisfied, a ruling is not revoked or modified retroactively, except in rare or unusual circumstances.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to P's authorized representative.

Sincerely yours,
Joseph H. Makurath
Senior Technician Reviewer, Branch 7
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure:
Copy for § 6110 purposes