INTERNAL REVENUE SERVICE

Number: **200021034**
Release Date: 5/26/2000
Index No.: 40.00-00

CC:DOM:P&SI:8/PLR-117434-99

FEB 23, 2000

In re:

Legend:

Taxpayer =
General Partner =
Limited Partner =

Coop =

This responds to your October 13, 1999, request for a ruling concerning § 40 of the Internal Revenue Code. Specifically, you request the Service to rule that:

(1) Taxpayer is an eligible small ethanol producer under § 40(g)(1) whose production of ethanol may qualify for the small ethanol producer credit under § 40(a)(3) and (b)(4), provided Taxpayer at all times during the taxable year has a productive capacity not in excess of 30 million gallons for alcohol as defined under § 40(d)(1)(A) without regard to clauses (i) and (ii);

(2) Taxpayer is not required to reduce under § 40(c) any portion of the § 40(a)(3) credit to which Taxpayer is entitled by any benefit provided with respect to the alcohol solely by reason of the application of § 4081(c); and

(3) Taxpayer, as an eligible small ethanol producer, receives the entire § 40(a)(3) credit available, which is passed through to and allocated only among the partners of Taxpayer under the principles of § 702(a)(7) in accordance with each partner's ownership interest in Taxpayer as of the time the credit arises.

The information submitted states that Taxpayer is a limited partnership formed by General Partner and Limited Partner for the purpose of acquiring and operating a plant (the Plant) for processing corn into ethanol fuel. Taxpayer leases the Plant from General Partner and produces the ethanol from corn acquired from General Partner and the members of General Partner. Taxpayer anticipates selling the ethanol to gasohol blenders. The Plant has a productive capacity of 12 million gallons of alcohol per year. It has been represented that neither Taxpayer nor any of Taxpayer's partners

or members of Taxpayer's controlled group have an interest in any other alcohol production facility. The ethanol produced is at least 190 proof.

The parties entered into a number of agreements, including: Site Lease Agreement, regarding lease of the Plant and property from General Partner to Taxpayer; Operating and Maintenance Agreement, between General Partner and Taxpayer regarding day-to-day operation and maintenance of the Plant; and Corn Supply Agreement, among Taxpayer, COOP, and General Partner whereby Taxpayer will obtain a supply of corn at fair market prices and a technology license from General Partner. Taxpayer represents that all these agreements were negotiated at arm's length.

Taxpayer represents that, based upon reasonable business assumptions, Taxpayer may realize significant profits from the Plant during its lease renewal term. Therefore, Taxpayer represents that aside from any tax benefits it may receive, it has a reasonable profit expectation over the potential term of the transaction.

Section 40(a) provides that for purposes of § 38, the alcohol fuels credit includes the small ethanol producer credit (SEP Credit) for an eligible small ethanol producer (Eligible Producer).

Section 40(b)(4)(A) provides that the SEP Credit of any Eligible Producer for any taxable year is 10 cents for each gallon of qualified ethanol fuel production of such producer.

Section 40(b)(4)(B) provides, generally, that the term qualified ethanol fuel production (Qualified Production) includes any alcohol that is ethanol that is produced by an Eligible Producer and that is sold for use or used during the taxable year by the Eligible Producer in the production of a qualified mixture in a trade or business (other than casual off-farm production). Section 40(b)(1)(B) defines "qualified mixture" to include a mixture of alcohol and gasoline that is sold by the taxpayer producing that mixture to any person for use as a fuel, or is used as a fuel by the taxpayer producing that mixture.

Section 40(b)(4)(C) provides that the Qualified Production of any producer for any taxable year shall not exceed 15,000,000 gallons.

Section 40(c) provides that the amount of the credit determined under § 40 with respect to any alcohol shall be properly reduced to take into account any benefit provided with respect to the alcohol solely by reason of the application of the excise tax rate reductions allowed by § 4041(b)(2), (k), or (m), § 4081(c), or § 4091(c).

Section 40(d)(1)(A) provides that the term "alcohol" includes methanol and ethanol but does not include (i) alcohol produced from petroleum, natural gas, or coal (including peat), or (ii) alcohol with a proof of less than 150.

Section 40(g)(1) provides that an Eligible Producer is a person, that at all times during the taxable year, has a productive capacity for alcohol (as defined in § 40(d)(1)(A) without regard to clauses (i) and (ii)) not in excess of 30,000,000 gallons. Pursuant to § 40(g)(3), in the case of a partnership, the limitations contained in § 40(b)(4)(C) and in § 40(g)(1) shall be applied at the entity level and at the partner level.

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) of the Income Tax Regulations 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 determined by the partnership agreement, except as otherwise provided in chapter 1 of subtitle A of title 26.

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 section 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.

Based on the information submitted and the representations made, Taxpayer is an eligible small ethanol producer because Taxpayer, its partners, and its members have a productive capacity for alcohol not in excess of 30,000,000 gallons per year.

Accordingly, we conclude:

(1) Taxpayer is an eligible small ethanol producer under § 40(g)(1) whose production of ethanol may qualify for the small ethanol producer credit under § 40(a)(3) and (b)(4), provided Taxpayer, its partners, and its members at all times during the taxable year have a productive capacity not in excess of 30 million gallons of alcohol as defined under § 40(d)(1)(A) without regard to clauses (i) and (ii);

(2) Taxpayer is not required to reduce under § 40(c) any portion of the § 40(a)(3) credit to which Taxpayer is entitled by any benefit provided with respect to the alcohol solely by reason of the application of § 4081(c); and

(3) Taxpayer, as an eligible small ethanol producer, receives the entire § 40(a)(3) credit available, which is passed through to and allocated only among the partners of Taxpayer under the principles of § 702(a)(7) in accordance with each partner's ownership interest in Taxpayer as of the time the credit arises.

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under any other provision of the Code.

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.

Sincerely,
Assistant Chief Counsel
(Passthroughs and Special Industries)
By: Richard A. Kocak, Chief, Branch 8

Enclosures (2):
Copy of this letter
Copy for § 6110 purposes