Internal Revenue Service

Department of the Treasury

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Date:
November 23, 2001

Re: Section 29 Request for a Ruling: Credit for Producing Fuel from a Nonconventional Source

LEGEND:

P	=
P1	=
X	=
Y	=
A	=
B	=
C	=
D	=
E	=
F	=
G	=
Date 1	=
Date 2	=
$W	=
$X	=
$Y	=
$Z	=
Amount 1	=
Amount 2	=

Dear :

This letter responds to a letter dated July 7, 2000, and subsequent correspondence, submitted on behalf of P by its authorized representative, requesting rulings under section 29 of the Internal Revenue Code.

FACTS

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

P is a limited liability company, taxable as a partnership. X owns a 99.99 percent membership interest in P, and Y owns a 0.01 percent membership interest in P.

Pursuant to the transaction described below, P owns all of the membership interests in P1. P1 is disregarded as an entity separate from P. P1 owns a synthetic fuel facility (Facility) that produces a solid synthetic fuel from coal (Product).

P acquired all of the membership interests in P1 from B pursuant to a purchase agreement, as amended, entered into on Date 1. In consideration for the membership interests in P1, P will (i) make cash payments of $W and $X and deliver a promissory note in the original principal amount of $Y within 10 days of receipt of a favorable private letter ruling, (ii) make fixed quarterly payments totaling $Z per year, and (iii) make contingent quarterly cash payments based on the production of the Facility in excess of Amount 1.

The Facility was constructed pursuant to a construction contract entered into by C with D on Date 2. The construction contract is for a synthetic fuel production facility for producing solid synthetic fuel using A's patented process. The construction contract provides for a fixed price and a completion date. The construction contract does not provide for the payment of liquidated damages. P has provided an opinion of counsel that the construction contact constituted a binding written contract under applicable state laws prior to January 1, 1997, and at all times thereafter through the completion of the contract.

The Facility's modular equipment, some of which is bolted onto a concrete pad, can be unbolted, disassembled and readily moved to another site. Thus, the Facility can be moved to a new site to take advantage of a supply of coal or for other business reasons. The Facility's equipment includes (1) a motor control center; (2) various belt conveyors; (3) a fluid mixing tank station with associated pumps; (4) a binder mixer that mixes coal with binder; (5) belt conveyors that feed the coal into the roll briquetters for processing; (6) four roll briquetters; and (7) finished product collection and stacking conveyors.

The Facility is currently located on property owned by E. As part of the transaction, P1 assumed B's rights and obligations under the site lease agreement with E. Under the site lease agreement, as amended, P1 agreed to pay E a fixed monthly rent for the use of the site.

P1 also assumed B's rights and obligations with E under an agreement for the supply of coal to the Facility and a sales agency agreement with E for the sale of the Product to unrelated purchasers. The coal supply agreement, as amended, allows P1 to purchase coal from outside sources under certain circumstances.

Also as part of the transaction, P1 assumed B's rights and obligations under an operation and maintenance agreement with F regarding the Facility. Under the operations and maintenance agreement, as amended, F's compensation is an amount equal to a percentage of certain costs of operating the Facility. P1 will pay all operating costs set forth in the annual budget. In addition, any capital costs associated with the Facility will be paid by P1 and must be authorized by P1.

P1 entered into a sublicense agreement with G and A granting to P1 the right to use A's technology, trade secrets, and other intellectual property for producing synthetic fuel from coal. The sublicense agreement, as amended, provides that P1 will pay G and A an initial royalty fee for the first Amount 1 tons of Product produced at the Facility. In addition, P1 will pay G an earned royalty fee for production above Amount 2 in any calendar year. P1 will pay G a reduced earned royalty fee for production above Amount 2 in any calendar year. P1 will pay G a reduced earned royalty fee for production above Amount 1 in any calendar year. Under the sublicense agreement, as amended, A is obligated to sell to P1 all of P1's requirements of chemical reagent for the Facility.

P1 entered into a service agreement with E under which E agreed to provide certain services with respect to P1's preparation and handling of coal and the handling and delivery of the Product. Under the services agreement, E will earn a fee based on the tons of coal and Product handled.

P has supplied a detailed description of the process employed in the Facility for the production of Product. P also has proposed that, from time to time, one of three alternative chemical reagents may be used in the process for the production of Product. As described, the Facility and the process implemented in the Facility, including the three alternative chemical reagents, meet the requirements of Rev. Proc. 2001-34, 2001-22 I.R.B. 1293.

A recognized expert in combustion, coal, and chemical analysis has performed numerous tests on the fuel produced from coal using the process, including the alternative chemical reagents, that will be used at the Facility and has submitted a report in which the expert concludes that significant chemical changes take place with the application of the process to the coal.

RULING REQUESTS #1 & #2

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 section 48(l) and its regulations are relevant to the interpretation of the term under section 29(c)(1)(C). Former section 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 section 29 and former section 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 section 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 section 1.48-9(c)(2)(i).

Based on the representations of P and P's authorized representative, including the preponderance of the test results, we agree that the fuel to be produced in P's Facility using the described process on the coal, including the use of alternative chemical reagents, will result in a significant chemical change to the coal, transforming the coal into a solid synthetic fuel from coal. Because P will own the Facility and operate and maintain the Facility through its agent, we conclude P will be entitled to the section 29 credit for the production of the qualified fuel from the Facility that is sold to an unrelated person.

RULING REQUEST #3

Sections 29(f)(1)(B) and (f)(2) provide that section 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 section 29(f) in the case of a facility producing qualified fuels described in section 29(c)(1)(C). Section 29(g)(1)(A) provides that for purposes of section 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, section 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, includes such essential features as a description of the facility to be constructed, a completion date, and a maximum price. In addition, the contract does not limit damages to a specified amount. P provided an opinion of counsel that the contract is binding under applicable state law. Therefore, we conclude that the Facility was constructed pursuant to a binding written contract for purposes of section 29(g)(1)(A).

RULING REQUEST #4

Sections 29(f)(1)(B) and (f)(2) of the Code provide that section 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 section 29(f) in the case of a facility producing qualified fuels described in section 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 section 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, section 29(f)(2) is to be applied by substituting for the date therein January 1, 2008.

To qualify for the section 29 credit, P's Facility must be placed in service before July 1, 1998, pursuant to a binding written contract in effect before January 1, 1997. While section 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. Section 1.167(a)-11(e)(1)(i) and section 1.46-3(d)(1)(ii) of the 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.

Rev. Rul. 94-31, 1994-1 C.B. 16, concerns section 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 section 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, if P's Facility was "placed in service" prior to July 1, 1998, within the meaning of section 29(g)(1), relocation of P's Facility 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 section 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. When property is placed in service is a factual determination, and we express no opinion on when P's Facility was placed in service.

RULING REQUEST #5

The section 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 section 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 which first began production after January 1, 1980.

The section 29 credit has been extended by Congress four times. The placed-in-service deadline and the period for claiming the section 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).

If section 29(f)(1)(B) were read as requiring facilities producing qualified fuels to be placed in service by the taxpayer, facilities placed in service before 1980 that are sold or transferred to a new taxpayer after 1979 would not entitle the purchaser/transferee to claim the section 29 credit. It is clear from the legislative history of section 44D that Congress intended the credit to apply to facilities placed in service after 1979, and that the placed-in-service deadline in section 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 sections 29(f) and 29(g) focus on the facility, and not the owner of the facility. The legislative history of section 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 section 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 section 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 P's Facility was "placed in service" prior to July 1, 1998 within the meaning of section 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 section 29 for the new owner. When property is placed in service is a factual determination, and we express no opinion on when P's Facility was placed in service.

RULING REQUEST #6

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 section 708(b)(1)(B) occurring on or after May 9, 1997.

As discussed above, the placed-in-service deadline in sections 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 sections 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 sections 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 a termination of P under section 708(b)(1)(B) will not preclude the reconstituted partnership from claiming the section 29 credit on the production and sale of synthetic fuel to unrelated persons.

CONCLUSIONS

Accordingly, based on the representations of P and P's authorized representative, we conclude as follows:

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

(2) The production of the qualified fuel from the Facility will be attributable solely to P, entitling P to the section 29 credit for qualified fuel sold to unrelated persons.

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

(4) If the Facility was "placed in service" prior to July 1, 1998 within the meaning of section 29(g)(1), relocation of the Facility 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 section 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 (we express no opinion on when P's Facility was placed in service).

(5) If P's Facility was "placed in service" prior to July 1, 1998 within the meaning of section 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 section 29 for the new owner (we

express no opinion on when P's Facility was placed in service).

(6) A termination of P under section 708(b)(1)(B) will not preclude the reconstituted partnership from claiming the section 29 credit on 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 P's Facility was placed in service for purposes of section 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 section 12.04 of Rev. Proc. 2001-1, 2001-1 I.R.B. 1, 46. However, when the criteria in section 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.

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

Enclosure:
Copy for section 6110 purposes