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Dear Mr.           :

This letter responds to a letter, dated September 6, 2002, and subsequent correspondence submitted on behalf of P and A jointly by their authorized representative, requesting rulings under sections 29 and 702 of the Internal Revenue Code.

The facts as represented by P and P's authorized representative are as follows. P is a limited liability company formed for the purpose of acquiring, relocating and operating three separate facilities for the production of solid synthetic fuel from coal. P acquired and relocated one synthetic fuel facility (Facility) to the x site. On Date 1, P received PLR-121906-00, which rules on issues similar to those addressed by this letter. P seeks a confirmation of the rulings in light of the relocation of the Facility from the x site to the v site, the operation of the Facility at the v site, and P's plan to transfer the Facility to A and to distribute its entire membership interest in A to certain of its members, as described in the ruling request and subsequent correspondence by P's authorized representative. It is possible that P may not make the transfer or distribution noted in the prior sentence.

P is classified as a partnership for federal tax purposes. The original members of P were B and C. B holds a cc percent interest in P and is the managing member. B and C are corporations that are wholly-owned subsidiaries of D. D is engaged in a number of businesses, directly and through affiliates, including investments in the energy sector. D is a wholly-owned subsidiary of E. On Date 2, C sold its dd percent non-managing membership interest in P to affiliated corporations F (y percent), G (z percent), H (aa percent) and I (bb percent) for cash. On Date 7, H and I merged into G.

A is a limited liability company that is wholly-owned by P. A has not elected to be classified as a corporation for federal income tax purposes and therefore is disregarded as an entity separate from P. Following receipt by P of this private letter ruling,

P intends to transfer the Facility and related contracts to A and to distribute its entire membership interest in A to B, F, and G, after which time A will be classified as a partnership for federal income tax purposes whose partners are B, F, and G.

J entered into a construction contract on Date 4 with a general contracting firm to build the Facility. The construction contract was for a synthetic fuel production facility for producing solid synthetic fuel that was a "qualified fuel" within the meaning of section 29(c)(1)(C). P has provided an opinion of counsel that the construction contract was a legal, valid and binding obligation of J under applicable state law as of Date 4. In addition, the construction contract (i) provided for liquidated damages of at least five percent of the contract price, (ii) included a description of the Facility to be constructed, (iii) provided for a completion date and (iv) provided for a maximum price. P represents that the Facility was placed in service within the meaning of section 29(g)(1)(A) before July 1, 1998.

As described in the ruling request and subsequent correspondence from P's authorized representative, the Facility consists of a high-speed mixer, a ribbon blender and two pellet mills. In the process by which synthetic fuel is produced in the Facility, coal feedstock and a chemical reagent are mixed in the high-speed mixer and transported by gravity feed to the ribbon blender. The ribbon blender provides additional blending and then distributes the mixture to the two pellet mills for final processing and delivery to the finished product conveyor belt.

The coal-based synthetic fuel originally produced in the Facility (and other synthetic fuel facilities) by J was not commercially viable. As a result, J began using different chemical reagents to produce marketable synthetic fuels.

On Date 3, J sold the Facility to P for a fixed dollar amount, paid in full in cash at closing. The initial members of P, B, and C made capital contributions in cash to P in accordance with their ownership interests in an amount required to acquire and relocate the Facility to the x site. The members of P have made (and will continue to make) periodic cash capital contributions to P to pay operating costs.

With respect to the relocation and operation of the Facility at the x site, P entered into a number of auxiliary agreements with K, L, M and N. K, L, M, and N are unrelated to P.

P contracted with K to reassemble the Facility at the x site. P has represented that, following the relocation of the Facility to the x site, the fair market value of the original property of the Facility was more than 20 percent of the Facility's total fair market value (the cost of the new property plus the value of the original property). L, the owner of the x site, granted to P a lease at the x site to enable P to reassemble and operate the Facility at the x site. Under the lease agreement, P agreed to pay L a fixed monthly rent.

P entered into an agreement with L for the operation and maintenance of the Facility. L was subject to the direction and control of P, which had the sole authority to set production levels and make other strategic decisions. L was paid a fixed fee (which was reduced above a certain level of production) per ton of synthetic fuel produced, subject to a minimum annual operating fee and possible inflation adjustments every two years. Any capital costs associated with the Facility were paid by P and were required to be authorized by P.

Pursuant to a coal feedstock purchase agency agreement, M agreed to act as P's exclusive agent to arrange for the purchase by P of coal feedstock from third party suppliers. Under a synthetic fuel purchase agreement, M agreed to purchase all of the synthetic fuel produced in the Facility each year. Under the terms of the coal feedstock purchase agency agreement and synthetic fuel purchase agreement, if M did not arrange for the delivery of the entire supply of coal feedstock that it was required to arrange or did not purchase any portion of the synthetic fuel it was required to purchase, P was entitled to obtain coal feedstock from or sell synthetic fuel to third parties. Pursuant to a separate agency agreement with N, P could request that N act as its agent to arrange for the supply of any coal feedstock that M failed to deliver or arrange for the marketing of any synthetic fuel that M failed to purchase in exchange for a fixed fee per ton of coal feedstock purchased or synthetic fuel sold.

On Date 5, P terminated the coal feedstock purchase agency and synthetic fuel purchase agreements with M and, pursuant to the agency agreement between N and P, requested that N arrange on P's behalf for the purchase of coal feedstock for use in the Facility and the sale of synthetic fuel produced in the Facility. P purchased coal feedstock and sold synthetic fuel through N as its agent until Date 6, when it entered into new agreements with O.

Pursuant to a coal feedstock purchase agency agreement between P and O, O agreed to act as P's exclusive agent to arrange for the purchase by P of coal feedstock from third party suppliers. Under a synthetic fuel purchase agreement, O agreed to purchase a specified amount of the synthetic fuel produced in the Facility each year. Under the terms of the coal feedstock purchase agency agreement and synthetic fuel purchase agreement, if O did not arrange for the delivery of the entire supply of coal feedstock that it was required to arrange or failed to purchase any portion of the synthetic fuel it was required to purchase, P could have obtained coal feedstock from or sold synthetic fuel to third parties. Both agreements between P and O expired on Date 7.

P has relocated the Facility from the x site to the v site. With respect to the reassembly and operation of the Facility at the v site, P has entered into a number of auxiliary agreements with K, U, and Q, which are unrelated to P. P plans to assign its

rights under these agreements to A effective upon the transfer of the Facility from P to A.

P contracted with K to reassemble the Facility at the v site. P has represented that, following the relocation of the Facility at the v site, the fair market value of the original property of the Facility will be more than 20 percent of the Facility's total fair market value (the cost of the new property plus the value of the original property). Q owns v and has granted to P a lease at the site of v to enable P to reassemble and operate the Facility. Under the lease agreement, P agreed to pay Q a fixed monthly rent. P will also pay Q a fee for assistance provided by Q with respect to sales of synthetic fuel to third parties.

Pursuant to a coal feedstock purchase agency agreement, Q has agreed to act as P's exclusive agent to arrange for the purchase by P of coal feedstock from third party suppliers. Under a synthetic fuel purchase agreement, Q agreed to purchase the synthetic fuel produced in the Facility up to a fixed amount each year. Under the terms of the coal feedstock purchase agency agreement and synthetic fuel purchase agreement, if Q does not arrange for the delivery of the entire supply of coal feedstock that it is required to arrange or fails to purchase any portion of the synthetic fuel it is required to purchase, P may obtain coal feedstock from or sell synthetic fuel to third parties.

P entered into an agreement with U for the operation and maintenance of the Facility at the v site. U is subject to the direction and control of P, which has the sole authority to set production levels and make other strategic decisions. U is paid a fixed fee (adjusted pursuant to a cost escalation provision) per ton of synthetic fuel produced in the Facility. Any capital costs associated with the Facility will be paid by P and must be authorized by P. P has represented that all sales of synthetic fuel will be to unrelated persons.

P has supplied a detailed description of the process employed at the Facility. P also has indicated that from time to time several alternative chemical reagents identified in P's submissions may be used in the process. As described, the Facility and the process implemented in the Facility and the alternative chemical reagents used in the process meet the requirements of Rev. Proc. 2001-34, 2001-22 I.R.B. 1293.

Recognized experts in coal combustion chemistry conducted numerous tests on the fuel produced from coal feedstock using the process with each chemical reagent that was used in the Facility at the x site or, after relocation to the v site, is (or may be) used at the v site, and have submitted multiple reports in which the experts conclude that significant chemical changes take place with the application of the process to the coal.

The rulings issued in PLR-121906-00, which you wish to be reconfirmed in this private letter ruling, are as follows:

(1) P, both before and after its reconstitution, with the use of the process and the chemical reagents, will produce a “qualified fuel” within the meaning of section 29(c)(1)(C);

(2) Both before and after P’s reconstitution, the production of the qualified fuel from the Facility will be attributable solely to P, entitling P to the section 29 credit for the production of qualified fuel from the Facility that is sold to an unrelated person;

(3) The contract for the construction of the Facility constitutes a “binding written contract” in effect before January 1, 1997 for purposes of section 29(g)(1)(A);

(4) The section 29 credit attributable to P may be passed through to and allocated among the members of P, both before and after the reconstitution, in accordance with the principles of section 702(a)(7), in accordance with each member’s interest in P at the time the section 29 credit arises. For the section 29 credit, a member’s interest in P is determined based on a valid allocation of the receipts from the sale of the section 29 qualified fuel;

(5) The acquisition of the Facility by P will not affect the placed in service date of the Facility for purposes of section 29;

(6) Any termination of P under section 708(b)(1)(B) arising from sales or exchanges of interests in P (including the termination of P arising from the sale by C of its dd percent interest in P to F, G, H and I), will not preclude P as reconstituted from taking the section 29 credit for the production and sale of qualified fuel to unrelated persons; and

(7) If the Facility was “placed in service” prior to July 1, 1998, within the meaning of section 29(g)(1), the relocation of the Facility to the x site or other 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 section 29 provided the fair market value of the original property of the Facility is more than 20 percent of the Facility’s total fair market value at the time of the relocation or replacement.

The changes in facts since the issuance of PLR-121906-00 are: (i) the relocation of the Facility from the x site to the v site, (ii) the operation of the Facility at the v site as described above, and (iii) the plan to transfer the Facility to A and to distribute all of P’s interest in A to B, F, G, H and I, as described in the ruling request and subsequent correspondence by P’s authorized representative. The rulings set forth in PLR-121906-00 are not affected by these changed facts.

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

(1) Prior to any distribution by P of all the interests in A to B, F, and G, P, with the use of the process and the chemical reagents, produces a "qualified fuel" within the meaning of section 29(c)(1)(C);

(2) Prior to any distribution by P of all the interests in A to B, F, and G, the production of the qualified fuel from the Facility is attributable solely to P, entitling P to the section 29 credit for the production of qualified fuel from the Facility that is sold to an unrelated person;

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

(4) The section 29 credit attributable to P may be passed through to and allocated among the members of P in accordance with the principles of section 702(a)(7), in accordance with each member's interest in P at the time the section 29 credit arises. For the section 29 credit, a member's interest in P is determined based on a valid allocation of the receipts from the sale of the section 29 qualified fuel;

(5) The acquisition of the Facility by P, any transfer of the Facility by P to A, and any distribution by P of all the interests in A to B, F, and G, do not affect the placed in service date of the Facility for purposes of section 29;

(6) Any termination of P under section 708(b)(1)(B) arising from sales or exchanges of interests in P (including any termination arising from the sale by C of its dd percent interest in P to F, G, H, and I) does not preclude P as reconstituted from taking the section 29 credit for the production and sale of qualified fuel to unrelated persons; and

(7) If the Facility was "placed in service" prior to July 1, 1998, within the meaning of section 29(g)(1), the relocation of the Facility to the x site or other location, including the relocation of the Facility to the v site, after June 30, 1998, or replacement of parts of the Facility after that date, does 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 of the Facility is more than 20 percent of the Facility's total fair market value at the time of the relocation or replacement. We express no opinion on when the Facility was placed in service.

The conclusions drawn and rulings given in this letter are subject to the requirements that the taxpayer (i) maintain sampling and quality control procedures that conform to ASTM or other appropriate industry guidelines at the facility that is the subject of this letter, (ii) obtain regular reports from independent laboratories that have

analyzed the fuel produced in such facility to verify that the coal used to produce the fuel undergoes a significant chemical change, and (iii) maintain records and data underlying the reports that taxpayers obtain from independent laboratories including raw FTIR data and processed FTIR data sufficient to document the selection of absorption peaks and integration points.

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 or how the partners' interests in P are determined.

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. 2003-1, 2003-1 I.R.B. 1, 44. However, when the criteria in section 12.06 of Rev. Proc. 2003-1 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 section 6110 purposes

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