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Dear :

This letter responds to a letter, dated June 23, 2003, 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 State 1 limited partnership classified as a partnership for federal income tax purposes. P's partners (Partners) are Z, the general partner, a State 1 limited liability company that owns a z% interest in P; and several institutional investors that collectively own a y% interest in P.

On Date 1, P received PLR 109362-98, and on Date 2, P received PLR 114506-99, both of which rule on issues similar to those addressed by this letter.

P through wholly-owned State 1 limited liability companies which are disregarded for federal tax purposes operates the A Facility, the B Facility, the C Facility, and the D Facility (Facility or Facilities) for the production of solid synthetic fuel from coal. The C Facility and the D Facility were originally in Location 1. Subsequently, the C Facility was relocated to Location 2 and the D Facility was relocated to Location 3. As described in the request, P may relocate the A Facility, and may also wish to relocate the B Facility.

Each Facility uses a chemical process to convert coal into a synthetic fuel. The chemical reagent consists of a commercially available asphalt as carrier, with quinoline added.

Synthetic fuel is made by mixing the quinoline-based chemical reagent with the feedstock coal in a pug mixer, after which the mixture passes through a pellet mill. In the pellet mill, three rotating cylinders force the synthetic fuel through a stationary cylindrical die. P does not produce pellets, briquettes or any other formed product; its customers do not desire such formed products and are not willing to pay additional amounts for product formation. All of the synthetic fuel produced by P, however, passes through the pellet mills before exiting the plant.

P has entered into a number of agreements with parties unrelated to P and its Partners with respect to the operation of synthetic fuel production at the Facilities. These agreements have been provided and described in detail in the ruling request.

E was originally hired by P to conduct independent analyses of chemical changes in coal. Since E's death, P has been testing its synthetic fuel production based both upon E's analytical method and upon the methods used by F. P expects to continue to regularly test the synthetic fuel production from the Facilities for chemical change, using the methodology specified in the reports from F.

F, a recognized expert in combustion, coal, and chemical analysis has performed tests on the coal used at the Facilities and the synthetic fuel produced at the Facilities, and has submitted reports on fuel produced from coal using the process described above. The expert has concluded in each case that a significant chemical change takes place with the application of the process using the chemical reagent.

The rulings requested by P are:

1. Each Facility, with the use of the chemical reagent in the process described herein, will produce a “qualified fuel” within the meaning of section 29(c)(1)(C), notwithstanding the use of F's methods rather than those of the late E to determine whether the requisite chemical change has taken place.

2. The production of qualified fuel from the Facilities will be attributable solely to P within the meaning of section 29(a)(2)(B), and thus P will be entitled to the credit under section 29(a) of the Code on the qualified fuel sold to unrelated persons, provided the Facilities were placed in service by the deadline in section 29(g) (June 30, 1998).

3. The section 29 credit attributable to P may be allocated among the Partners in accordance with their respective interests in P when the credit arises, which will be determined based on a valid allocation of the receipts from the sale of the qualified fuel.

4. If the Facilities were “placed in service” prior to July 1, 1998 within the meaning of section 29(g)(1), relocation of the Facilities to a different location after June 30, 1998, or replacement of part of the Facilities after that date, will not result in a new placed-in-service date for the Facilities for purposes of section 29 provided the fair market value of the original property is more than 20 percent of the Facilities’ total fair market value at the time of relocation or replacement.

RULING REQUESTS 1 AND 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). Under this rule, if a solid synthetic fuel produced from coal, such as synthetic fuel, differs significantly in chemical composition from its parent coal feedstock, the solid synthetic fuel is a "qualified fuel" within the meaning of section 29(c)(1)(C).

Based on the information supplied by P and P's authorized representative, including the test results submitted by P, we agree that the fuel produced in the Facilities using the process described in P's ruling request will result in a significant chemical change to the coal, transforming the coal into a solid synthetic fuel from coal. Because P owns the Facilities, we conclude P will be entitled to the section 29 credit for the production of the qualified fuel from the Facilities that is sold to an unrelated person.

RULING REQUEST 3

Under section 7701(a)(14), the term "taxpayer" means any person subject to any internal revenue tax. Section 7701(a)(1) provides that the term "person" includes an individual, trust, estate, partnership, association, company, or corporation. Accordingly, P should be treated as the "taxpayer" for purposes of the section 29 credit.

Section 702(a)(7) and the regulations thereunder require each partner to take into account separately the partner's distributive share of each class or item of the partnership's income, gain, loss, deduction, or credit. See Treas. Reg. § 1.702-1(a). Section 1.702-1(a)(8)(ii) requires each partner to take into account separately the partner's distributive share of any partnership item which if separately taken into account by any partner would result in an income tax liability different from that which would otherwise result. Under section 1.702-1(a), a partner's distributive share is determined as provided in section 704 and Treas. Reg. § 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 (i) the partnership agreement does not provide for the partner's distributive share of income, gain, loss, deduction, or credit (or item thereof) or (ii) the allocation to a partner under the agreement of income, gain, loss, deduction, or credit (or item thereof) lacks substantial economic effect.

Under section 1.704-1(b)(4)(ii), allocations of tax credits and tax credit recapture (except for section 38 property) do not result in any 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

tax credit recapture arises. The Regulations provide, however, that in determining the partners' interests in the partnership regarding tax credits that arise from receipts of the partnership (whether or not taxable), such as the section 29 credit, if that receipt also gives rise to a valid allocation of partnership income, the partners' interests in the partnership with respect to such item of credit will be in the same proportion as such partners' respective distributive shares of such income. Treas. Reg. § 1.704-1(b)(4)(ii).

Based on the information submitted, we conclude that the section 29 credit attributable to P may be passed through to, and allocated to, the Partners of P in accordance with each Partner's interest in P when the credit arises. For the section 29 credit, a Partner's interest in P is determined based on a valid allocation of the receipts from the sale of the section 29 qualified fuel.

RULING REQUEST 4

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.

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 included in the Facility 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 to a different location after June 30, 1998, or replacement of part of the Facility after that date, will not result in a new placed in service date for the Facility for purposes section 29 provided the fair market value of the property used at the original facility is more than 20 percent of the Facility's total fair market value at the time of relocation or replacement (the cost of the new equipment included in the Facility plus the value of the property used at the original facility).

Rev. Rul. 94-31 describes a windfarm that consists of an "array of wind turbines, towers, pads, transformers, roadways, fencing, on-site power collection systems, and monitoring and meteorological equipment." Notwithstanding that the windfarm consisted of all of these items, the ruling concludes that the "facility" for purposes of section 45 is confined to "the property on the windfarm necessary for the production of electricity from wind energy." (emphasis added.) The present situation is similar to Rev. Rul. 94-31. Thus, for purposes of determining the Facility's total fair market value at the time of relocation or replacement, the Facility consists of the process equipment directly

necessary for the production of the qualified fuel, starting at the immediate input of the coal and chemical reagents to the pug mills or mixers (including any coal hoppers and reagent tanks directly feeding the pug mills or mixers) through the output from the pellet mills or other forming equipment (including output hoppers, if any). Hence, the Facility's total fair market value includes the process equipment such as pugmills or mixers, the pellet mills or other forming equipment, the equipment necessary to interconnect such equipment, the electrical, instrumentation, control systems and auxiliaries related to such equipment (including the structures that house such electrical, instrumentation and control systems), the foundation platform(s) for the above-referenced equipment, and an appropriate allocation of the engineering, project management, overhead, and other costs assignable to the relocation of such equipment and construction. The Facility's total fair market value does not include costs associated with the purchase and installation of equipment that supports the operation of the Facility but is not directly necessary for the production of the qualified fuel, such as coal beneficiation, or preparation equipment (e.g., crushers, screens, dryers, or scales), other material handling or conveying equipment (e.g., stacking tubes, transfer towers, storage bunkers, mobile equipment, or conveyors), certain site improvements (e.g., fencing, lighting, earthwork, paving), separate office and bathhouse trailers for facility personnel, and buildings (if a “building” for purposes of section 168 of the Code).

Sampling and quality control are necessary for operational control of a production facility. However, a particular type of sampling equipment generally is not necessary for the production of qualified fuel. Thus, the costs of sampling equipment are excluded from the Facility's total fair market value unless the particular sampling equipment is necessary for operational control of the facility.

Accordingly, based on the facts and law discussed, and representations made by P and P's authorized representative, we issue the following rulings to P:

1. Each Facility, with the use of the chemical reagent in the process described herein, will produce a “qualified fuel” within the meaning of section 29(c)(1)(C), notwithstanding the use of F's methods rather than those of the late E to determine whether the requisite chemical change has taken place.

2. The production of qualified fuel from the Facilities will be attributable solely to P within the meaning of section 29(a)(2)(B), and thus P will be entitled to the credit under section 29(a) of the Code on the qualified fuel sold to unrelated persons, provided the Facilities were placed in service by the deadline in section 29(g) (June 30, 1998).

3. The section 29 credit attributable to P may be allocated among the Partners in accordance with their respective interests in P when the credit arises, which will be determined based on a valid allocation of the receipts from the sale of the qualified fuel.

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

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

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, 50. However, when the criteria in section 12.05 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 and P's second 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