



Dear :

This letter responds to your June 24, 2004 request, submitted on behalf of Taxpayer, for rulings under § 29 of the Internal Revenue Code.

On Date 1, Taxpayer received PLR-107568-99 (Private Letter Ruling), which ruled on similar issues addressed by this letter. Taxpayer seeks a confirmation of the rulings in light of certain changed circumstances, including the use of a different chemical reagent in Taxpayer's three synthetic fuel facilities (Facilities), and the purchase of interests in Taxpayer by Partner E and Partner F, all as described in the ruling request.

Taxpayer is a State limited liability limited partnership, classified as a partnership for federal tax purposes. Immediately prior to the consummation of the transactions described below, all of the interests in Taxpayer were owned by Partner A, Partner B, Partner C, and Partner D.

Taxpayer is the assignee of three contracts dated Date 2 for the construction of the Facilities that produce a solid synthetic fuel from coal (Product) using the process described below. Each of the Facilities consists of a single production line comprised of a twin roll briquetter, which is fed by its associated mixing and blending equipment. Taxpayer has owned and operated the Facilities in the same location since the time each Facility was first placed in service. During that period, Taxpayer has repaired and replaced certain parts in the Facilities as part of the regular upkeep and maintenance of the Facilities.

Taxpayer has entered into a contract with Partner D pursuant to which such company has agreed to procure coal feedstock on behalf of Taxpayer as necessary to satisfy its requirements to produce Product. In exchange, Taxpayer will pay a fee under that contract that is determined by reference to the tons of coal feedstock so procured, together with reimbursements for certain costs incurred in connection with procuring and transporting such coal feedstock.

Taxpayer has also entered into agreements with Partner D pursuant to which such company will be responsible for the day-to-day operation and maintenance of the Facilities and will act as an exclusive agent to market Product to unrelated parties on behalf of Taxpayer. As compensation for such services, Taxpayer will pay fees under such agreements determined by reference to the tons of Product produced and sold from the Facilities, together with reimbursements for certain expenditures incurred in connection therewith.

Taxpayer has supplied a detailed description of the process employed at the Facilities (Process) and the chemical reagents used in the Process for the production of Product. As described, the Facilities and the Process implemented in the Facilities, including the Primary Chemical Reagent and Alternative Chemical Reagents, meet the requirements of Rev. Proc. 2001-34, 2001-22 I.R.B. 1293. Further, recognized experts in coal combustion chemistry and analysis performed numerous tests on the coal used at the Facilities and have submitted reports concluding that significant chemical changes take place with the application of the Process and the chemical reagents described in Taxpayer's ruling request to the coal.

On Date 4, Partner E and Partner F purchased separate interests in Taxpayer from Partner D pursuant to purchase agreements. Pursuant to those agreements, Partner E and Partner F will make fixed and contingent payments to Partner D. Taxpayer represents that, based on the estimated annual production of x tons of Product per year and applying the discount rate of y%, the net present value of the contingent payments to be made to Partner D under each purchase agreement will be less than 50 percent of the total payments made to Partner D under each purchase agreement.

The partnership agreement of Taxpayer was amended and restated to reflect these transactions and certain agreements among the partners. Pursuant to the partnership agreement, each of the partners will make periodic capital contributions to enable Taxpayer to pay its operating costs and other obligations. The partnership agreement sets forth each partner's percentage interest in gross income the sale of synthetic fuel, and establishes a ceiling on the amount of capital contributions that Partner E and Partner F are required to make to the Taxpayer. The ceiling on capital contributions will not affect the percentage interests of the partners.

The rulings issued in the Private Letter Ruling that you wish to be reconfirmed in this private letter ruling are as follows:

1. Taxpayer, with the use of the Process and reagents described in Taxpayer's ruling request, including the Alternative Chemical Reagents, will produce a "qualified fuel" within the meaning of § 29(c)(1)(C).
2. Production of qualified fuel from the Facilities will be attributable solely to Taxpayer within the meaning of § 29(a)(2)(B), entitling Taxpayer to the § 29 credit for qualified fuel from the Facilities that is sold to an unrelated person.
3. The § 29 credit attributable to Taxpayer may be allocated to the partners of Taxpayer in accordance with the partners' interest in Taxpayer when the credit arises. For the § 29 credit, a partner's interest in Taxpayer is determined based on a valid allocation of the receipts from the sale of the § 29 qualified fuel.
4. Because the Facilities were "placed in service" prior to July 1, 1998, within the meaning of § 29(g)(1), relocation of a Facility to a different location after June 30, 1998, or replacement of parts of any Facility after that date, will not result in a

new placed in service date for that Facility for purposes of § 29 provided that the fair market value of the original property is more than twenty percent of such Facility's total fair market value immediately following the relocation or replacement.

5. Any termination of the Taxpayer under § 708(b)(1)(B) will not preclude the reconstituted partnership from claiming the § 29 credit on the production and sale of synthetic fuel to unrelated persons.

The changes in facts since the issuance of the Private Letter Ruling include the use of different chemical reagents and the separate purchases of interests in Taxpayer by each of Partner E and Partner F. The above rulings are not affected by the changed facts.

#### RULING REQUEST #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 § 48(l) and its regulations are 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).

Consistent with its private letter ruling practice that began in the mid 1990's, the Service, in Rev. Proc. 2001-30, provided that taxpayers must satisfy certain conditions in order to obtain a letter ruling that a solid fuel (other than coke) produced from coal is a qualified fuel under § 29(c)(1)(C). Rev. Proc. 2001-30, as modified by Rev. Proc. 2001-34, 2001-1 C.B. 1293. The revenue procedure requires taxpayers to present evidence that all, or substantially all, of the coal used as feedstock undergoes a significant chemical change. To meet this requirement and obtain favorable private letter rulings, taxpayers provided expert reports asserting that their processes resulted in a significant chemical change.

In Announcement 2003-46, 2003-30 I.R.B. 222, the Service announced that it was reviewing the scientific validity of test procedures and results presented of significant chemical change in expert reports. In Announcement 2003-70, 2003- I.R.B. 1090, the Service announced that it had determined that the test procedures and results used by taxpayers were scientifically valid if the procedures were applied in a consistent and unbiased manner. However, the Service concluded that the processes approved under its long standing ruling practice and as set forth in Rev. Proc. 2001-30 did not produce the level of chemical change required by § 29(c)(1)(C). Nevertheless, the Service announced that it recognized that many taxpayers and their investors have relied on its long standing ruling practice to make investments. Therefore, the Service announced that it would continue to issue rulings on significant chemical change, but only under the guidelines set forth in Rev. Proc. 2001-30, as modified by Rev. Proc. 2001-34.

This ruling is provided to Taxpayer and its partners consistent with Announcement 2003-70 and the Service's long standing ruling practice. Accordingly, based on the expert test results submitted by Taxpayer and its partners, we conclude that the synthetic fuel produced at the Facilities using the described process and specified chemical reagents, including the Alternative Chemical Reagents, is a solid synthetic fuel produced from coal constituting a "qualified fuel" within the meaning of § 29(c)(1)(C). Because Taxpayer will own the Facilities and operate and maintain the Facilities through its agent, we conclude that Taxpayer will be entitled to the § 29 credit for the production of the qualified fuel from the Facilities that is sold to an unrelated person.

### RULING REQUEST #3

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 the § 29 credit attributable to Taxpayer may be allocated to the partners of Taxpayer in accordance with the partners' interests in Taxpayer when the credit arises. For the allocation of the § 29 credit, a partner's interest in Taxpayer is determined based on a valid allocation of the receipts from the sale of the § 29 qualified fuel.

#### RULING REQUEST #4

To qualify for the § 29 credit, Taxpayer's facilities 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. Section 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.

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 included in the facility plus the value of the used property).

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 § 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 a 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 briquetters 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 briquetters 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 § 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.

Consistent with the holding in Rev. Rul. 94-31, because Taxpayer's Facilities were "placed in service" prior to July 1, 1998, within the meaning of § 29(g)(1), relocation of a Facility to a different location, or replacement of part of a Facility after June 30, 1998, 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 (the cost of the new equipment included in the Facility plus the value of the used property).

#### RULING REQUEST #5

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)(4) 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)(4) 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 a termination of Taxpayer under § 708(b)(1)(B) will not preclude the reconstituted partnership from claiming the § 29 credit on the production and sale of synthetic fuel to unrelated persons.

#### CONCLUSIONS

Accordingly, we conclude as follows:

1. Taxpayer, with the use of the Process and reagents described in Taxpayer's ruling request, including the Alternative Chemical Reagents, will produce a "qualified fuel" within the meaning of § 29(c)(1)(C).
2. Production of qualified fuel from the Facilities will be attributable solely to Taxpayer within the meaning of § 29(a)(2)(B), entitling Taxpayer to the § 29 credit for qualified fuel from the Facilities that is sold to an unrelated person.
3. The § 29 credit attributable to Taxpayer may be allocated to the partners of Taxpayer in accordance with the partners' interest in Taxpayer when the credit



arises. For the § 29 credit, a partner's interest in Taxpayer is determined based on a valid allocation of the receipts from the sale of the § 29 qualified fuel.

4. Because the Facilities were "placed in service" prior to July 1, 1998, within the meaning of § 29(g)(1), relocation of a Facility to a different location after June 30, 1998, or replacement of parts of any Facility after that date, will not result in a new placed in service date for that Facility for purposes of § 29 provided that the fair market value of the original property is more than twenty percent of such Facility's total fair market value immediately following the relocation or replacement.
5. Any termination of the Taxpayer under § 708(b)(1)(B) will not preclude the reconstituted partnership from claiming the § 29 credit on the production and sale of synthetic fuel to unrelated persons.

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 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. 2004-1, 2004-1 I.R.B. 1. However, when the criteria in section 12.05 of Rev. Proc. 2004-1 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 Taxpayer.

Sincerely,

*/s/*  
Joseph H. Makurath

PLR-134671-04

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Senior Technician Reviewer, Branch 7  
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cc: