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Dear

This letter responds to a letter dated June 22, 1999, and subsequent correspondence, submitted on behalf of P by its authorized representative, requesting rulings under sections 29 and 702 of the Internal Revenue Code.

FACTS

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

P is a Delaware limited liability company formed in 1998 for the purpose of constructing and operating facilities for the production of a solid synthetic fuel from coal. P is (and will continue to be) classified as a partnership for federal income tax purposes. The initial members of P were A and B (collectively, the "Sellers").

Currently, the members of P are C and D (collectively, the "New Members"). C is a single member limited liability company that is wholly owned by E; as such, C will be disregarded for federal income tax purposes. D is a single member limited liability company that is wholly owned by F; as such, D will be disregarded for federal income tax purposes. Both E and F join in the consolidated federal income tax return filed by G.

G is the common parent of an affiliated group of numerous subsidiaries engaged in a variety of businesses. G will guarantee certain of the financial obligations of the New Members.

The Sellers capitalized P with a certain amount of capital contributions and provided additional funds through loans for the construction of the facility and its operations. (The loans are evidenced by promissory notes from P to the Sellers.)

The New Members acquired the Sellers' membership interests in P pursuant to the Purchase and Sale Agreement dated Date 1. This agreement requires the New Members to make payments to the Sellers directly and to make capital contributions to P that should permit P to repay the loans made by the Sellers. On Date 1, the New Members made payments to the Sellers as well as capital contributions to P. The New Members also made available to P new financing from an affiliate of G.

The New Members have agreed to contribute to P an amount sufficient to allow P to repay in full the notes payable to the Sellers (including accrued interest through the date of the payment). This contribution is due within 15 days following the later of (i) the date on which P has achieved a monthly average production of a certain quantity of MMBtu of qualified fuel within certain specified periods, and (ii) the earlier of Date 2 or the date on which all of the following requirements are satisfied: (A) receipt of a favorable private letter ruling, (B) receipt of a pre-filing determination from the relevant District Office that the facility was placed in service for purposes of section 29 on or before June 30, 1998, or the satisfactory completion of an audit of P's 1998 federal income tax return, and (C) (unless waived by the New Members) J or its parent corporation has contracted for, used, and approved for use in their electrical generating plants in State X solid synthetic fuel made with petroleum-based binders and has not issued requirements that make P's production ineligible for sale to their plants. (J and

its affiliates generate more than 90 percent of the electricity generated within the immediate vicinity of P's facility, and thus represent unusually important customers to P.) It is currently expected that these payments and contributions by the New Members (collectively the "Down Payment") will exceed the amounts paid to construct the facility.

In addition to the Down Payment, the New Members are required to make additional quarterly payments to the Sellers (the "Installment Payments"). The Installment Payments are payable quarterly in arrears based on the energy content of synthetic fuel produced and sold to unrelated parties during the preceding calendar quarter, adjusted to remove the energy content of the binder material. The amount thus payable will be based on a schedule of rates, subject to a maximum weighted average price per MMBtu, depending on the total energy content of synthetic fuel produced and sold during the quarter. These rates were based on the 1997 credit rates as announced in Notice 98-28 and will be adjusted for inflation. The Installment Payments are reduced by amounts designed to permit funding of operating and reclamation reserves for P; by pre-closing obligations of P; by any payments to R for use of its technology; by payments on the assignments of the construction contracts; and by certain specified yearly amounts (not adjusted for inflation) per ton of synthetic fuel produced.

The Installment Payments are subordinated to the extent there is any cash operating deficit or required addition to reserves with respect to the synthetic fuel facility in excess of the per ton amounts specified in the last sentence. Any Installment Payment thus subordinated would be payable out of operating cash flow of P in later periods. (Thus, each Installment Payment will become fixed in amount in the quarter that synthetic fuel is produced and sold, but may be paid over time.) Amounts subordinated will be represented by a promissory note and are unconditionally payable in Date 3, regardless of cash availability.

According to P's authorized representative, when measured on a present value basis using an a percent discount rate, the Down Payment amounts to approximately b percent of the purchase price, and the Installment Payments amount to approximately c percent of the purchase price.

The Sellers have an option to reacquire their interests in P at a fair market value price in certain limited circumstances.

P has entered into a number of auxiliary agreements. P has entered into a site lease agreement with I for the site of the facility and land used for coal storage for an initial term equal to five years and five days. P has the right to extend the term of this lease for two consecutive five year periods. The lease also includes various licenses and rights of access necessary for P to carry on its business.

P also has entered into an agreement with E for the marketing of its production.

As compensation for its marketing efforts, E will receive a commission on all sales based on a percentage of net sales proceeds (subject to a minimum based on the tonnage of synthetic fuel sold), plus a bonus based on a percentage of the amount by which the sales price exceeds an index adjusted based on changes in coal prices at three local power plants. In its capacity as the exclusive sales representative for P's output, E may also arrange for transportation of the output. E also has a right of first refusal for it or F to broker coal-based feedstock to P.

P also has entered into an Asphalt Binder Supply Agreement with H, a wholly-owned subsidiary of G. Under this agreement, H will be the exclusive provider to P of the needed petroleum-based binder material (consisting of asphalt cement, chemicals and other additives). The price for the asphalt cement component of the binder is adjusted monthly to reflect changes in the average posted price for asphalt cement at an appropriate location with agreed quality factors as reported in an industry weekly.

P and A have entered into a Facilities Operating Agreement under which A will serve as contract operator and provide manpower for the facility. As contract operator, A will be subject to the direction and control of P, which will have sole authority to set overall production levels and to make other strategic decisions. This agreement has an initial term ending on Date 4 (or, if earlier, the last date on which solid synthetic fuel qualifying for tax credits may be produced at the facility). A's compensation for serving as contract operator will be limited to recovery of costs plus a fixed fee, adjusted for inflation.

Following the purchase, the New Members own all of the membership interests in P, and the Sellers have no voting rights with respect to P. C serves as the managing member of P, and is responsible for all major operational decisions of P.

Under the Limited Liability Company Agreement of P, all items of income, gain, loss, and deduction will be shared, and all cash distributions made, in proportion to the members' ownership percentages.

In connection with the purchase, the New Members determined that the future operations of P could involve using feedstock from a wide variety of sources and using varying concentrations of binder, adjusted over time in accordance with the demands of the marketplace for synthetic fuel as well as the costs of the feedstock and binder. P commissioned studies on various feedstock sources and binder concentrations. Experts have conducted numerous tests on synthetic fuel samples produced from such types of feedstock and such binder concentrations . These tests are described in detail in P's letter ruling request. By the preponderance of the test results, the experts have concluded that there was a measurable, significant change in the chemical composition of the resulting fuel compared to the corresponding coal-based feedstock.

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).

Based on the representations of P and P's authorized representative, including the preponderance of P's test results, we agree that the fuel to be produced in P's facilities using the process on the coal feedstock will result from a significant chemical change in coal, transforming the coal feedstock into a solid synthetic fuel from coal. Because P will own the facilities and because A on behalf of P will operate and maintain the facilities, we conclude that 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

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 section 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 section 704 and section 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 are not reflected by adjustments to the partners' capital accounts (except to the extent that adjustments to the adjusted tax basis of partnership section 38 property in respect of tax credits and tax credit recapture give rise to capital account adjustments under section 1.704-1(b)(2)(iv)(j)). 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. 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 section 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, assuming the solid synthetic fuel produced qualifies for the section 29 credit, the credit will be allowed to P and the credit may be passed through to and allocated to the partners of P under the principles of section 702(a)(7) in accordance with each partner's interest in P as of the time the tax credit arises. We express no opinion, however, regarding how the partners' interests in P are determined.

RULING REQUEST #4

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.

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.

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 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.

RULING REQUEST #5

To qualify for the section 29 credit, P’s facilities 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. Sections 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. When property is placed in service is a factual determination, and we express no opinion on when P’s facilities were placed in service.

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, the relocation of any of P's facilities after June 30, 1998, will not prevent the relocated facility from continuing to be treated as originally placed in service prior to July 1, 1998, for purposes of section 29 provided the fair market value of the used property is more than 20 percent of the relocated facility's total fair market value at the time of the relocation.

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) 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;

(3) the credit allowed under section 29 may be passed through to and allocated among the partners in P in accordance with the principles of section 702(a)(7);

(4) any termination of P under section 708(b)(1)(B) arising from prior sales or exchanges of interests in P will not preclude P from taking the section 29 credit for the production of the qualified fuel from the facilities that is sold to an unrelated person; and

(5) if a 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, 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 used property is more than 20 percent of the relocated facility's total fair market value at the time of the relocation.

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 facilities were 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. 2000-1, 2000-1 I.R.B. 4, 46. However, when the criteria in section 12.05 of Rev. Proc. 2000-1 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,

CHARLES B. RAMSEY
Branch Chief, Branch 6
Office of Assistant Chief Counsel
(Passthroughs and Special Industries)

Enclosure:
Copy for section 6110 purposes