**Internal Revenue Service**

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:B07-PLR-119833-01
Date:
September 14, 2001

DO:

Legend

P =

P1=
A =

B =

C =

V =
W =
Facility =

Date 1 =
Date 2 =
Date 3 =
Date 4 =
Amount 3 =

Dear

In a letter dated April 4, 2001 and a supplemental letter dated July 5, 2001 your representative requested rulings regarding your purchase of an interest in a facility designed to produce solid synthetic fuel from coal.

You have represented the facts to be as follows:

On Date 1, P1 received PLR 199904027, which rules on the similar issues addressed by this letter. P seeks a confirmation of the rulings given to P1 in light of the state-law merger of P and P1 and the sale by A and B to C of membership interests in P.

P is a Delaware limited liability company, taxable as a partnership. P is the surviving entity in a state-law merger with P1, which was undertaken to convert P1 from a West Virginia limited liability company to a Delaware limited liability company. Since P1 was disregarded as an entity until the merger occurred, and since as a result of the merger, A and B owned identical interests in the profits and capital of P as they had owned in P1, P is a continuation of P1 and the state-law merger is ignored for federal income tax purposes.

P1 constructed, and P now owns and operates, a facility for producing a solid synthetic fuel from coal using a process licensed to P by V. The Facility is a coal agglomeration facility consisting of two production lines located within a single metal building. The Facility was constructed pursuant to two written contracts (one for each production line) entered into by V with W on Date 2. V assigned those contracts to P1 as of Date 3.

The Facility was constructed and is operated on property held under lease by B and subleased to P under a Sublease (the "Site"). B has entered into a Feedstock Supply Agreement to supply coal feedstock to the Facility. The coal fines feedstock is currently supplied exclusively from B's coal preparation plant operations. B installed a recovery circuit and vertical filter as a part of its coal preparation plant to recover ultra-fine coal. The ultra-fine coal previously could not be recovered and was part of the waste stream discharge from the coal preparation plant. One production line will use the ultra-fine coal or a blend of the ultra-fine coal and other coal. The second production line will use coal feedstock that is at least 50 percent by weight less than 3/8 inch. The product produced by the second production line will not be processed through the extruders or the dryers at the Facility. The process flow for the first line will be modified to allow the product to be processed through either dryer.

P routinely has had experts conduct tests on fuel produced from coal using the process. Regardless of whether "extrusions" are formed, the experts have concluded that the coal feedstock used at the Facility undergoes a significant chemical change as a result of the process.

C acquired an interest in P pursuant to a Purchase and Sale Agreement ("Sale Agreement"). P has three separate classes of membership interests (Series A, B and C) that share in P's profits and losses based on annual production volumes. The Series A Interest is allocated 98% of the first Amount 3 of annual production ("Phase I") and 1% of the production in excess of Amount 3 per year ("Phase II"). The Series B Interest is allocated 1% of Phase I production and 98% of Phase II production. The Series C Interest participates in 1% of all production. The Series A, B, and C Interests are generally allocated income, gains, losses deductions and section 29 credits attributable to their respective percentage interest in Phase I and Phase II production. Cost recovery deductions are generally allocated 98% to the Series A Interest, 1% to the Series B Interest, and 1% to the Series C Interest. P has represented that allocation and distributions pursuant to the Sale Agreement will have substantial economic effect as required by section 1.704-1(b)(2) of the Income Tax Regulations.

Pursuant to the Sale Agreement, C purchased the Series A Interest from A and B and received an option to purchase the Series B Interest. In exchange for the Series A Interest, A and B received an amount of cash at closing, a fixed recourse promissory note, and a contingent promissory note.

The remaining facts are the same as stated in PLR 199904027.
The rulings issued in PLR 199904027, which you wish to be reconfirmed in this private letter ruling, are as follows (with P being substituted for P1):

1. P, with use of the process, produces a “qualified fuel” within the meaning of section 29(c)(1)(C) of the Internal Revenue Code.

2. Production of qualified fuel from the Facility is attributable to P within the meaning of section 29(a)(2)(B).

3. P is entitled to the section 29 credits for the production of the qualified fuel from the Facility that is sold to an unrelated person.

4. Each of the contracts for construction of the Facility constitute a “binding written contract” within the meaning of section 29(g)(1)(A).

5. The credit allowed under section 29 may be passed through to and allocated among all the members of P in accordance with the member’s interest in P under the principles of section 702(a)(7). 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 qualified fuel.

6. Because the Facility was “placed in service” before July 1, 1998 within the meaning of section 29(g)(1), the Facility will continue to be treated as placed in service before July 1, 1998, after the technical termination of P under section 708(b)(1)(B) on Date 4, upon the purchase of the Series A Interest by C from A and B.

7. A future termination of P under section 708(b)(1)(B) will not preclude the new partnership from taking the section 29 credit for the production of qualified fuel from the Facility that is sold to an unrelated person.

8. Because 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, will not result in a new placed in service date for the Facility for purposes section 29 provided the essential components are relocated, 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, and the production capacity of the relocated Facility is not significantly increased at the new location.

The changes in facts since the issuance of PLR 199904027 are the merger which left P the remaining entity, the sale of an interest to C, and the plans to use minus 3/8" feedstock in one of the production lines that will eliminate the extruder and dryer.

The above rulings are not affected by the merger nor the sale of an interest to C. You have requested rulings regarding whether a change in feedstock and the elimination of a process step for one production line would affect the above rulings.

Section 3 of Rev. Proc. 2001-34, 2001-22 I.R.B. 1293, provides that the Service will issue rulings that a solid fuel (other than coke) produced from coal is a qualified fuel under section 29(c)(1)(C) if the conditions set forth below are satisfied and evidence is presented that all, or substantially all, of the coal used as feedstock undergoes a significant chemical change. The use of coal particles the majority of which, by weight, are no larger than 3/8" are permitted. The taxpayer is also permitted to eliminate the use of the extruder provided the taxpayer represents that omission of this procedure will not significantly increase production of the facility.

Section 29(f)(1)(B) of the Internal Revenue Code provides that the credit is available with respect to solid synthetic fuel from coal that is produced in a facility placed in service after December 31, 1979 and before January 1, 1993.

Section 29(g) provides that a facility for producing solid synthetic fuel from coal is treated as being placed in service before January 1, 1993, if such facility is placed in service before July 1, 1998, pursuant to a binding written contract in effect before January 1, 1997.

Generally, the specifications of the binding written contracts required by section 29(g) provide for construction of facilities with an “expected” or “target” level of production of qualified fuel at the time the facility is placed in service. This level of production is evidenced by such factors as the size of conveyers, mixers, briquetters, heaters, and other equipment installed in the facility as well as production levels permitted by governmental entities or indicated in feedstock supply or qualified fuel sales contracts. This expected production level will depend upon which of the various available qualified fuel technologies is utilized, the type of coal feedstock, configuration of the elements of the facility, speed of operation of each piece of equipment, and the size and shape of the resultant qualified fuel.

The Service has generally issued private letter rulings regarding whether a facility produces a qualified fuel based upon taxpayers’ representations that the facility constructed under the binding contract implements a process that results in a fuel product that differs chemically from coal to a significant degree. Thus, the rulings are predicated upon the cumulative effects of a specific set of activities applied under controlled conditions for a specified period of time and at a specified rate.

In Revenue Procedure 2001-30, 2001-19 I.R.B. 1163, the Service announced that it will issue rulings that a solid fuel produced from coal is a qualified fuel under section 29(c)(1)(C) under the circumstances enumerated therein. Because of the degree to which all of the activities of the facility are impacted by changes in the speed of operation and because changes to a facility may affect the placed in service requirements, the Service appropriately indicated that rulings would not be issued where a facility was modified after July 1, 1998 in a manner that would significantly increase the capacity of the facility to produce qualified fuel beyond the expected capacity contemplated in the binding contract.

You have requested a ruling that the process implemented in the facility that you have described results in a solid synthetic fuel produced from coal that is a qualified fuel for purposes of section 29 of the Code. We have previously ruled that the unmodified production line produces a qualified fuel. Based upon the facts presented and the representations made in your request, we conclude that the modified production line using the process that you have described results in a fuel that is a qualified fuel provided that that production line is not operated at a level of production that will exceed the annualized expected production level provided in the binding contract for the construction of that production line.

With addition of the above caveat for production from the modified production line, we re-issue the rulings given in PLR 199904027 for P. Thus in summary:

1. P, with use of the process, produces a “qualified fuel” within the meaning of section 29(c)(1)(C).

2. Production of qualified fuel from the Facility is attributable to P within the meaning of section 29(a)(2)(B).

3. P is entitled to the section 29 credits for the production of the qualified fuel from the Facility that is sold to an unrelated person.

4. Each of the contracts for construction of the Facility constitutes a “binding written contract” within the meaning of section 29(g)(1)(A).

5. The credit allowed under section 29 may be passed through to and allocated among all the members of P in accordance with the member’s interests in P under the principles of section 702(a)(7). 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 qualified fuel.

6. Because the Facility was “placed in service” before July 1, 1998 within the meaning of section 29(g)(1), the Facility will continue to be treated as placed in service before July 1, 1998, after the termination of P under section 708(b)(1)(B) on Date 4, upon the purchase of the Series A Interest by C from A and B.

7. A future termination of P under section 708(b)(1)(B) will not preclude the new partnership from taking the section 29 credit for the production of qualified fuel from the Facility that is sold to an unrelated person.

8. Because 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, will not result in a new placed in service date for the Facility for purposes of section 29 provided the essential components are relocated, 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, and the production capacity of the relocated Facility is not significantly increased at the new location.

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. A copy of this ruling should be attached to your tax return filed for the year in which the transaction covered by this ruling was consummated. A copy is enclosed for this purpose.

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