Internal Revenue Service

Department of the Treasury

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Person to Contact:

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Taxpayer =
Subsidiary A =
Subsidiary B =
A =
B =
C =
D =
Date 1 =
Date 2 =
Date 3 =
Date 4 =
State =
$x =
$y =

Dear

This letter responds to a letter dated August 29, 2000, and subsequent correspondence, submitted on behalf of Taxpayer by its authorized representative, requesting rulings under section 29 of the Internal Revenue Code.

FACTS

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

The Taxpayer is the parent corporation of an affiliated group of corporations, including Subsidiary A and Subsidiary B, that files a consolidated federal income tax return.

On Date 1, Subsidiary A purchased a synthetic fuel facility ("Facility A") that produces solid synthetic fuel from coal (the "Product"). Facility A was constructed pursuant to a construction contract between A and B entered into on Date 2. Facility A was designed and built with equipment that can be readily disassembled and moved to another site to take advantage of a supply of coal or for other business reasons.

Facility A's equipment includes (i) raw feed hoppers that move coal onto belt conveyors which feed the coal to the machinery for processing, (ii) a fluid binder storage tank, (iii) binder pug mills that mix coal with binder and water and (iv) pellet mills that compact and extrude the combined material. Facility A will produce the Product using a process licensed to Subsidiary A from A.

Subsidiary A relocated Facility A to its existing coal operations in State. The Taxpayer has represented that following the relocation the cost of any new property incorporated into Facility A when it was reassembled is less than 20 percent of the total cost of Facility A (that is, purchase price plus cost of additions, changes, and repairs).

The dies used in the pellet mills of Facility A are made of tempered steel and must be replaced periodically. The replacement cost for the dies typically ranges from $x to $y.

The Taxpayer has supplied a detailed description of the process employed at Facility A. As described, Facility A and the process implemented in Facility A, including the chemical reagent used to produce the synthetic fuel, meet the requirements of Rev. Proc. 2001-34, 2001-22 I.R.B. 1293.

A recognized expert in combustion, coal, and chemical analysis has performed numerous tests on the coal used at Facility A and has submitted a report in which the expert concludes that significant chemical changes take place with the application of the process to the coal.

Subsidiary A intends to contribute Facility A to a Delaware limited liability company ("LLC A") that will be owned by Subsidiary A and one or more unrelated investors. LLC A will be treated as a partnership for federal income tax purposes. The operating agreement for LLC A will provide that any credits allowed under section 29(a) will be allocated among the members in accordance with their respective percentage interests at the time of the sale of the solid synthetic fuel giving rise to the credits.

On Date 3, Subsidiary B purchased a synthetic fuel facility ("Facility B") that produces the Product. Facility B was constructed pursuant to a construction contract between C and D entered into on Date 4. Facility B was designed and built with equipment that can be readily disassembled and moved to another site to take advantage of a supply of coal or for other business reasons. Facility B's equipment includes (i) raw feed hoppers that move coal onto belt conveyors which feed the coal to the machinery for processing, (ii) a fluid binder storage tank, (iii) binder pug mills that mix coal with binder and water and (iv) pellet mills that compact and extrude the combined material. Facility B will produce the Product using a process licensed to Subsidiary B from A.

Subsidiary B relocated Facility B to its existing coal operations in State. The Taxpayer has represented that following the relocation the cost of any new property incorporated into Facility B when it was reassembled is less than 20 percent of the total cost of Facility B (that is, purchase price plus cost of additions, changes, and repairs).

The dies used in the pellet mills of Facility B are made of tempered steel and must be replaced periodically. The replacement cost for the dies typically ranges from $x to $y.

The Taxpayer has supplied a detailed description of the process employed at Facility B. As described, Facility B and the process implemented in Facility B, including the chemical reagent used to produce the synthetic fuel, meet the requirements of Rev. Proc. 2001-34, 2001-22 I.R.B. 1293.

A recognized expert in combustion, coal, and chemical analysis has performed numerous tests on the coal used at Facility B and has submitted a report in which the expert concludes that significant chemical changes take place with the application of the process to the coal.

Subsidiary B intends to contribute Facility B to a Delaware limited liability company ("LLC B") that will be owned by Subsidiary B and one or more unrelated investors. LLC B will be treated as a partnership for federal income tax purposes. The operating agreement for LLC B will provide that any credits allowed under section 29(a) will be allocated among the members in accordance with their respective percentage interests at the time of the sale of the solid synthetic fuel giving rise to the credits.

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 alternative 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 information submitted and representations made, including the preponderance of the test results, we agree that the fuel to be produced in each of Facility A and Facility B using the described process on the coal will result in a significant chemical change in coal, transforming the coal feedstock into a solid synthetic fuel. Because LLC A will own Facility A, we conclude that LLC A will be entitled to the section 29 credit for the production of the qualified fuel from Facility A that is sold to an unrelated person. Because LLC B will own Facility B, we conclude that LLC B will be entitled to the section 29 credit for the production of the qualified fuel from Facility B that is sold to an unrelated person.

RULING REQUESTS #3 and #4

To qualify for the section 29 credit, a facility 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. Section 1.167(a)-11(e)(1)(i) and section 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 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 situations. Consistent with the holding in Rev. Rul. 94-31, if Facility A and Facility B were "placed in service" prior to July 1, 1998, within the meaning of section 29(g)(1), the relocations of Facility A and Facility B after June 30, 1998, or replacement of parts of either facility after that date, will not result in a new placed in service date for either facility for

purposes of section 29 provided the fair market value of the original property is more than 20 percent of each respective facility's total fair market value at the time of the relocation or replacement. When property is placed in service is a factual determination, and we express no opinion on when Facility A or Facility B was placed in service.

RULING REQUESTS #5 and #6

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 in a partnership 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 partners 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 section 38 property) are not reflected by 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' interest in the partnership as of the time the tax credit or tax 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 tax 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 the section 29 credit attributable to each of LLC A and LLC B may be allocated to the respective members of LLC A and LLC B in accordance with the members' interests in LLC A or LLC B when the credit arises. For the section 29 credit, a member's interest in LLC A or LLC B is determined based on a valid allocation of the receipts from the sale of the section 29 qualified fuel.

CONCLUSIONS

Accordingly, based on the information submitted and the representations made, we conclude as follows:

(1) LLC A, with the use of the enumerated process, will produce a "qualified fuel" within the meaning of section 29(c)(1)(C), and the production of the qualified fuel from Facility A will be attributable solely to LLC A, entitling LLC A to the section 29 credit for the production of the qualified fuel from Facility A that is sold to an unrelated person.

(2) LLC B, with the use of the enumerated process, will produce a "qualified fuel" within the meaning of section 29(c)(1)(C), and the production of the qualified fuel from Facility B will be attributable solely to LLC B, entitling LLC B to the section 29 credit for the production of the qualified fuel from Facility B that is sold to an unrelated person.

(3) If Facility A was "placed in service" prior to July 1, 1998, within the meaning of section 29(g)(1), relocation of Facility A after June 30, 1998, or replacement of parts of Facility A after that date, will not result in a new placed in service date for Facility A for purposes of section 29 provided the fair market value of the original property is more than 20 percent of Facility A's total fair market value at the time of the relocation or replacement.

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

(5) The section 29 credit attributable to LLC A may be allocated to the members of LLC A in accordance with the members' interest in LLC A when the credit arises. For

the section 29 credit, a member's interest in LLC A is determined based on a valid allocation of the receipts from the sale of the section 29 qualified fuel.

(6) The section 29 credit attributable to LLC B may be allocated to the members of LLC B in accordance with the members' interest in LLC B when the credit arises. For the section 29 credit, a member's interest in LLC B is determined based on a valid allocation of the receipts from the sale of the section 29 qualified fuel.

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. 2001-1, 2001-1 I.R.B. 4, 46. However, when the criteria of section 12.05 of Rev. Proc. 2001-1 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 and to a second authorized representative.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

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