Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:B07-PLR-128550-02
Date:
June 27, 2002

Legend

P =

P1 =
A =

B =

C =

V =
W =
Facility =

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

Dear :

In a letter dated May 21, 2002 your representative requested rulings regarding your sale of an additional interest in a facility designed to produce solid synthetic fuel from coal.

You have represented the facts to be as follows:

On Date 1, P received PLR-119828-01, which rules on the issues addressed by this letter. You seek a confirmation of the prior ruling in light of the sale by A and B to C of additional 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 production lines located within . The was constructed pursuant to 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 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 and as a part of its coal preparation plant to recover coal. The coal previously could not be recovered and was part of the from the coal preparation plant. One production line uses the coal or a blend of the coal and other coal. The production line uses coal feedstock that is at least 50 percent by weight than inch. The product produced by the production line is not processed through the or the at the Facility. The process flow for the first line continues to be processed through an and was modified to allow the product to be processed through either .

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 on Date 4 pursuant to a Purchase and Sale Agreement ("Original 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 1 of annual production ("Phase I") and 1% of the production in excess of Amount 1 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.

Pursuant to the Original 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. C has recently exercised its option to purchase the Series B Interest. In exchange for the Series B Interest, A and B will receive an amount of cash at closing and the fixed recourse promissory note and contingent promissory note A and B received at the closing of the sale of the Series A Interest will be amended and restated to reflect the remaining price to be paid for the combined Series A Interest and Series B Interest. The Amended and Restated Limited Liability Agreement of P executed on Date 4 will be amended and restated (the "New LLC Agreement") to reflect the new ownership of the Series B Interest which will be combined with the Series A Interest into a Series A/B Interest. The Series A/B Interest will be generally allocated ninety-nine percent of all income, gains, losses, deductions and section 29 credits and the Series C Interest will be generally allocated the remaining one percent.

The remaining facts are the same as stated in PLR-119828-01. The rulings issued in PLR-119828-01, which you wish to be reconfirmed in this private letter ruling, are as follows:

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 and, in the event it is determined that the sale of the Series B Interest results in a termination of P, after the closing of the purchase of the Series B 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, 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 of section 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 changes in facts since the issuance of PLR-119833-01 are the sale of an additional interest to C and the amendment and restatements of the Amended and Restated Limited Liability Company Agreement of P and the initial fixed recourse promissory note and contingent promissory note.

The above rulings are not affected by the sale of the additional interest to C nor the amendment and restatements of the Amended and Restated Limited Liability Company Agreement of P and the initial fixed recourse promissory note and contingent promissory note. You have requested rulings regarding whether the elimination of a process step for one production line would affect the above rulings.

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 modified and 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 the modification does not increase the "production output" of the Facility. The "production output" is the amount of qualified fuel (including the production of a briquetted fuel product) that can reasonably be expected to be actually produced by the Facility using the prevailing practices in the industry regarding the performance of maintenance with regard to the various pieces of equipment in the Facility, reasonable allowances for shutdowns for repairs and/or replacement of parts,

etc.

With addition of the above caveat for production from the modified production line, we re-issue the rulings given in PLR-119833-01 for C. 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 and, in the event it is determined that the sale of the Series B Interest results in a termination of the P, after the closing of the purchase of the Series B 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, 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 of section 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.

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)