Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Number: **200242007**
Release Date: 10/18
Index Number: 29.00-00

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:B07-PLR-117406-02
Date:
July 3, 2002

Taxpayer =
Member A =
Member B =

A =
B =
C =
Date 1 =

Date 2 =

Dear :

This letter responds to a letter dated March 20, 2002, submitted on behalf of Taxpayer by its authorized representatives, requesting rulings under section 29 of the Internal Revenue Code.

FACTS

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

The Taxpayer is a limited liability company that is classified as a partnership for federal tax purposes, all of the interests in which presently are owned by Member A and Member B.

Taxpayer has entered into an agreement with A to purchase a synthetic fuel facility (the "Facility") that produces solid synthetic fuel from coal (the "Product").

The Facility was constructed pursuant to a construction contract between B and

C entered into on Date 1 and amended on Date 2. The construction contract did not limit the amount of damages that either party could seek against the other party in the event of the other party's default under the contract. B obtained an opinion of counsel that the construction contract constituted a binding written contract under applicable state laws prior to January 1, 1997, and at all times thereafter through completion of the contract.

The Facility 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. The Facility's equipment includes four processors in which coal is exposed to heat and pressure, two oil heaters that heat the oil that is circulated through the processors, and a screw conveyor in which a dust control agent is applied to the processed coal.

The Taxpayer intends to relocate the Facility. The Taxpayer has represented that following the relocation the fair market value of the original property will be more than 20 percent of the Facility's total value (the cost of the new property plus the value of the original property). In connection with the relocation of the Facility, the Taxpayer intends to make certain modifications to the processors in the Facility. The Taxpayer has represented that these modifications will not significantly increase the production capacity of the Facility or significantly extend the life of the Facility.

The Taxpayer will pay all costs and expenses associated with the operation and maintenance of the Facility, including any applicable property taxes and the cost of hazard insurance.

The Taxpayer has supplied a detailed description of the patented process employed at the Facility. The Taxpayer will obtain a license from the holder of the patent permitting the Taxpayer to use this process in the Facility. In the Facility the oil used in the processors will be heated to approximately degrees Fahrenheit and the will be admitted at approximately p.s.i.

A recognized expert in combustion, coal, and chemical analysis has performed numerous tests on the coal to be used at the Facility 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 and that the material is reduced by 6 to 7% by weight.

You have requested the following rulings:

(1) The contract for construction of the Facility constitutes a "binding written contract in effect before January 1, 1997," within the meaning of section 29(g)(1)(A).

(2) Taxpayer, with the use of the enumerated process, will produce a "qualified

fuel" within the meaning of section 29(c)(1)(C).

(3) The production of the qualified fuel from the Facility will be attributable solely to Taxpayer, entitling Taxpayer to the section 29 credit for the production of the qualified fuel from the Facility that is sold to an unrelated person.

(4) If 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 parts 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 the relocation or replacement.

(5) If the Facility was "placed in service" prior to July 1, 1998, within the meaning of section 29(g)(1), the proposed modifications to the processors will not result in a new placed in service date for the Facility for purposes of section 29 provided such changes do not significantly increase the production capacity of the Facility or significantly extend the life of the Facility.

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

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

RULING REQUEST #1

Sections 29(f)(1)(B) and (f)(2) provide that section 29 applies with respect to qualified fuels which are produced in a facility placed in service after December 31, 1979, and before January 1, 1993, and which are sold before January 1, 2003.

Section 29(g)(1) modifies section 29(f) in the case of a facility producing qualified fuels described in section 29(c)(1)(C). Section 29(g)(1)(A) provides that for purposes of section 29(f)(1)(B), a facility shall be treated as placed in service before January 1, 1993, if the facility is placed in service before July 1, 1998, pursuant to a binding written contract in effect before January 1, 1997. Section 29(g)(1)(B) provides that if the facility is originally placed in service after December 31, 1992, section 29(f)(2) shall be applied by substituting "January 1, 2008" for January 1, 2003".

A contract is binding only if it is enforceable under local law against a taxpayer, and does not limit damages to a specified amount, e.g., by use of a liquidated damages

provision. A contract provision limiting damages to an amount equal to at least five percent of the total contract price, for example, should be treated as not limiting damages. The construction contract for the Facility, executed prior to January 1, 1997, did not limit the amount of damages that either party could seek against the other party in the event of breach. B obtained an opinion of counsel that the contract is binding under applicable law. Therefore, the contract is a binding written contract for purposes of section 29(g)(1).

RULING REQUESTS #2 and #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. 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 the Facility 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 the Taxpayer will own the Facility and operate and maintain the Facility through its agent, we conclude that the Taxpayer will be entitled to the section 29 credit for the production of the qualified fuel from the Facility that is sold to an unrelated person.

RULING REQUESTS #4 and #5

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 situation. Consistent with the holding in Rev. Rul. 94-31, if the Facility was "placed in service" prior to July 1, 1998, within the meaning of section 29(g)(1), the relocation of the Facility after June 30, 1998, or replacement of parts 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 the relocation or replacement. When property is placed in service is a factual determination, and we express no opinion on when the Facility was placed in service.

Revenue Procedure 2001-30 provides that modifications of a facility after July 1, 1998 are permitted under Section 29(f) and (g) if such modifications do not significantly increase the production capacity of the facility or significantly extend the life of the facility. Accordingly, if the Facility was placed in service prior to July 1, 1998, the proposed modifications to the processors in the Facility will not result in a new placed in service date for the Facility for purposes of section 29 provided such modifications do not significantly increase the production capacity of the Facility or significantly extend the life of the Facility.

RULING REQUEST #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 the Taxpayer may be allocated to the members of Taxpayer in accordance with the members' interests in Taxpayer when the credit arises. For the section 29 credit, a member's interest in Taxpayer is determined based on a valid allocation of the receipts from the sale of the section 29 qualified fuel.

RULING REQUEST #7

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. Section 1.708-1(b)(1)(iv) applies to terminations of partnerships under section 708(b)(1)(B) occurring on or after May 9, 1997.

The section 29 credit has always been a time sensitive credit in that eligibility for the credit is determined when facilities or wells producing qualified fuels are placed in service and when such qualifying fuels are produced and sold to unrelated persons. For example, the section 44D credit, as originally enacted in the Crude Oil Windfall Profit Tax Act of 1980, was generally available for the production and sale of alternative fuels after December 31, 1979, and before January 1, 2001, from facilities placed in service after December 31, 1979, and before January 1, 1990.

The section 29 credit has been extended by Congress four times. The placed-in-service deadline and the period for claiming the section 29 credit were extended in the Technical and Miscellaneous Revenue Act of 1988 (1991 for placed in service), Omnibus Budget Reconciliation Act of 1990 (1993 for placed in service and 2003 for the end of the credit period), Energy Policy Act of 1992 (1997 for placed in service and 2007 for end of the credit period), and Small Business Job Protection Act of 1996 (June 30, 1998, for placed in service).

If Section 29(f)(1)(B) were read to require a facility to have been placed in service by the taxpayer, facilities placed in service before 1980 that are sold or transferred to a new taxpayer after 1979 would entitle the purchaser/transferee to claim the section 29 credit. It is clear from the legislative history of section 44D that Congress intended the credit to apply to facilities placed in service after 1979, and that the placed-in-service deadline in section 29(f)(1)(B) must be read as applying to when the facility is <u>first</u> placed in service within the applicable dates. The placed-in-service deadlines contained in sections 29(f) and 29(g) focus on the facility, and not the owner of the facility. The legislative history of section 44D clearly shows that Congress wanted to encourage the production of new alternative fuels from facilities first placed in service after 1979, and not provide tax incentive for production capacity in service before 1980.

Section 29(g)(2) demonstrates that Congress knows how to preclude transferees of facilities from claiming the section 29 credit. That provision provides that an 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. Therefore, we conclude that a termination of Taxpayer under section 708(b)(1)(B) will not preclude the reconstituted partnership from claiming the section 29 credit on the production and sale of synthetic fuel to unrelated persons.

CONCLUSIONS

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

(1) The contract for construction of the Facility constitutes a "binding written contract in effect before January 1, 1997," within the meaning of section 29(g)(1)(A).

(2) Taxpayer, with the use of the enumerated process, will produce a "qualified fuel" within the meaning of section 29(c)(1)(C).

(3) The production of the qualified fuel from the Facility will be attributable solely to Taxpayer, entitling Taxpayer to the section 29 credit for the production of the qualified fuel from the Facility that is sold to an unrelated person.

(4) If 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 parts 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 the relocation or replacement.

(5) If the Facility was "placed in service" prior to July 1, 1998, within the meaning of section 29(g)(1), the proposed modifications to the processors will not result in a new placed in service date for the Facility for purposes of section 29 provided such changes do not significantly increase the production capacity of the Facility or significantly extend the life of the Facility.

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

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

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. 2002-1, 2002-1 I.R.B. 1, 50. However, when the criteria of section 12.05 of Rev. Proc. 2002-1 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.

Sincerely,

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