Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:B07-PLR-138078-02
Date:
January 27, 2003

LEGEND:
P =
P1 =
X =
Y =
A =
B =
C =
D =
E =
F =
Location 1 =
Date 1 =
Date 2 =
Date 3 =
Date 4 =
Date 6 =
Date 7 =
Amount 1 =
Amount 2 =

Dear :

This letter responds to a letter dated July 11, 2002, submitted on behalf of P by its authorized representative, requesting rulings under section 29 of the Internal Revenue Code.

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

On Date 1, P received PLR 9832011 and P1 received PLR 9832017, which ruled on similar issues addressed by this letter. P seeks a confirmation of the rulings in light of the purchase of the interests in P and P1 by X and Y, the merger of P and P1, a change in the chemical reagents used to produce synthetic fuel, and the relocation of P's two synthetic fuel facilities (the Facilities) to E's, an affiliate of F, site in Location 1 (the Site) as described in the ruling request.

P is a Delaware limited liability company, taxable as a partnership. On Date 2, P merged with P1. P became the resulting partnership for federal income tax purposes. P owns and operates the Facilities for producing a solid synthetic fuel from coal (the Product) using the process described below. The Facilities were constructed by P and P1. The Facilities are Secondary Coal Recovery System #2000 facilities designed by A. Each Facility consists of three production lines each of which consists of a briquetter which is fed by its associated mixer and each of which is capable of being operated independently. Because each production line is capable of being operated independently and can independently produce synthetic fuel, each independent production line may be treated as a separate facility.

Each Facility was constructed pursuant to a written contract entered into by A and B on Date 3. A assigned to each of P and P1 all of its rights and obligations under the construction contract with respect to one facility. On Date 4, B subcontracted with C to perform the procurement, assembly and installation services under the construction contract. P provided 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 issue regarding when the facilities were placed in service was subject to examination and the issue was reviewed by Appeals. Following such examination and review, the Service determined, without mutual concessions, that the facilities were placed in service prior to July 1, 1998. It is the policy of the Internal Revenue Service that such determinations are not reconsidered absent extraordinary circumstances (for example fraud or misrepresentation) and then only with the consent of the Regional Director of Appeals.

On Date 6, X purchased an interest in P and P1 from A pursuant to a Purchase Agreement. Y purchased the remaining interest in P and P1 from D on Date 7 pursuant to a Purchase Agreement. X and Y have made (and are expected to continue to make) periodic capital contributions to P to enable it to pay its operating costs and other obligations. A proforma attached to the ruling request demonstrates that project expenses are projected to exceed revenues.

P has relocated the Facilities to the Site. In connection with the relocation of the Facilities, most major components of each Facility directly necessary to produce a qualified fuel were relocated to the Site. Certain equipment included in the original construction was scrapped or sold and not relocated. In connection with the relocation,

P also installed certain equipment that is not directly necessary for the production of qualified fuel such as coal and material handling equipment, a building, and an office/maintenance building at the Site. Following the relocation, the fair market value of the original property included in each Facility is more than 20 percent of each Facility's total value (the cost of the new equipment included in the Facility plus the value of the original property).

P has entered into a Synthetic Fuel and Coal Supply Agreement with E under which E agreed to purchase a minimum of Amount 1 of synthetic fuel a year and to use commercially reasonable efforts to purchase up to Amount 2 tons of synthetic fuel a year. If E does not satisfy its purchase obligation or the production of synthetic fuel exceeds E's requirements, P can sell synthetic fuel to third parties. P has represented that all sales of synthetic fuel will be to unrelated persons.

P has supplied a detailed description of the process employed at the Facilities. P also has proposed that, from time to time, one of four alternative chemical reagents may be used in the process for the production of Product. As described, the Facilities and the process implemented in the Facilities, including the chemical reagents, 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 the Facilities and the Product produced at the Facilities and has submitted reports in which the expert concludes that significant chemical changes take place with the application of the process to the coal, including the alternative chemical reagents. P, with use of the process, expects to maintain a level of chemical change in the production of synthetic fuel that is determined through similar analysis by experts to be a significant chemical change.

The rulings issued in PLR 9832011 and PLR 9832017, which you wish to be reconfirmed in this private letter ruling, are as follows:

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

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

3. Production from the Facilities will be attributable solely to P within the meaning of section 29(a)(2)(B), entitling P to the section 29 credit for qualified fuel from the Facilities that is sold to an unrelated person.

4. The section 29 credit attributable to P may be allocated to the members of P in accordance with the members' interests in P when the credit arises. 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 the section 29 qualified fuel.

5. A termination of P 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.

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

The changes in facts since the issuance of PLR 9832011 and PLR 9832017 are the purchase of interests in P and P1 by X and Y, the merger of P and P1, the change in chemical reagents used to produce the synthetic fuel and the relocation of the Facilities as described in the ruling request.

The above rulings are not affected by the purchase of interests in P and P1 by X and Y, the merger of P and P1, the change in chemical reagents used to produce the synthetic fuel or the relocation of the Facilities as described in the ruling request.

In addition, P has indicated that it may relocate one or two of the independent production lines to another location. Accordingly, P has also requested the following ruling:

7. Because each Facility was "placed in service" prior to July 1, 1998 within the meaning of section 29(g)(1), relocation of one or more of the independent production lines of a Facility to a new location after June 30, 1998, will not result in a new placed in service date for that Facility or an independent production line for purposes of section 29 provided all essential components of the independent production line are retained and the production output of the independent production line is not significantly increased at the new location.

RULING REQUEST #6

To qualify for the section 29 credit, P's Facilities must have been placed in service before July 1, 1998, pursuant to a binding written contract in effect before January 1, 1997. As discussed above, the Service made a determination that the Facilities were placed in service prior to July 1, 1998.

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 included in the facility 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 the Facilities to a different location after June 30, 1998, or replacement of part of the Facilities after that date, will not result in a new placed in service date for each Facility for purposes section 29 provided the fair market value of the property used at the original facility is more than 20 percent of each Facility's total fair market value at the time of relocation or replacement (the cost of the new equipment included in the Facility plus the value of the property used at the original facility).

Rev. Rul. 94-31 describes a windfarm that consists of an "array of wind turbines, towers, pads, transformers, roadways, fencing, on-site power collection systems, and monitoring and meteorological equipment." Notwithstanding that the windfarm consisted of all of these items, the ruling concludes that the "facility" for purposes of section 45 is confined to "the property on the windfarm *necessary for the production* of electricity from wind energy." (emphasis added.) The present situation is similar to Rev. Rul. 94-31. Thus, for purposes of determining a Facility's total fair market value at the time of relocation or replacement, a Facility consists of the process equipment directly necessary for the production of the qualified fuel, starting at the immediate input of the coal and chemical reagents to the pug mills or mixers (including any coal hoppers and reagent tanks directly feeding the pug mills or mixers) through the output from the briquetters or other forming equipment (including output hoppers, if any). Hence, each Facility's total fair market value includes the process equipment such as pugmills or mixers, the briquetters or other forming equipment, the equipment necessary to interconnect such equipment, the electrical, instrumentation, control systems and auxiliaries related to such equipment (including the structures that house such electrical, instrumentation and control systems), the foundation platform(s) for the above-referenced equipment, and an appropriate allocation of the engineering, project management, overhead, and other costs assignable to the relocation of such equipment and construction. A Facility's total fair market value does not include costs associated with the purchase and installation of equipment that supports the operation of the Facility but is not directly necessary for the production of the qualified fuel, such as coal beneficiation or preparation equipment (e.g., crushers, screens, dryers, or scales), other material handling or conveying equipment (e.g., stacking tubes, transfer towers, storage bunkers, mobile equipment, or conveyors), certain site improvements (e.g., fencing, lighting, earthwork, paving), separate office and bathhouse trailers for facility personnel, and buildings (if a "building" for purposes of section 168 of the Code), and other administrative assets.

Sampling and quality control are necessary for operational control of a production facility. However, a particular type of sampling equipment generally is not necessary for the production of qualified fuel. Thus, the costs of sampling equipment are excluded from the Facility's total fair market value unless the particular sampling equipment is necessary for operational control of the facility.

RULING REQUEST #7

Revenue Procedure 2001-30, 2001-19 I.R.B. 1163, provides that "a facility (including

one of multiple facilities located at the same site) may be relocated without affecting the availability of the credit if all essential components of the facility are retained and the production capacity of the relocated facility is not significantly increased at the new location."

P has represented that each of the Facilities are designed with three separate and independent production lines so that each line can be operated as a separate unit to produce synthetic fuel. P has represented that all of the major components of the production line would be relocated if the production line is relocated to a new site. P has also represented that relocation of one or more production lines to another site would require the duplication of relatively minor components, and site specific items involved in the relocation of any facility, such as site preparation, paving, foundations, area lighting, and utilities.

Based on the information submitted and the representations made, we conclude that P may relocate one or more of the independent production lines provided the major or essential components of the independent production line are retained and the "production output" of the relocated production line is not significantly increased at the new location. 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 each 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.

CONCLUSIONS

Accordingly, based on the representations of P and P's authorized representative, we conclude as follows:

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

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

3. Production from the Facilities will be attributable solely to P within the meaning of section 29(a)(2)(B), and P will be entitled to the section 29 credit for qualified fuel from the Facilities that is sold to an unrelated person.

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

5. A termination of P 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.

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

7. Because each Facility was "placed in service" prior to July 1, 1998 within the meaning of section 29(g)(1), relocation of one or more of the independent production lines of a Facility to a new location after June 30, 1998, will not result in a new placed in service date for that Facility or an independent production line for purposes of section 29 provided all essential components of the independent production line are retained and the production output of the independent production line is not significantly increased at the new location.

Except as specifically ruled upon above, we express no opinion concerning the federal income tax consequences of the transaction described above. We also express no opinion on the determination of fair market value of either the property constituting the Facility or the used property transferred from the original facility.

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 in section 12.05 of Rev. Proc. 2002-1 are satisfied, a ruling is not revoked or modified retroactively, except in rare or unusual circumstances.

Sincerely,

/s/

Joseph H. Makurath

Senior Technician Reviewer

Office of Associate Chief Counsel

(Passthroughs and Special Industries)

cc: