Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:PSI:B07 – GENIN-104282-04
Date:
March 09, 2004

Dear [redacted]:

I am responding to your letter, dated January 3, 2004, regarding Rev. Proc. 2001-34, which relates to the tax credit for solid synthetic fuels produced from coal (§ 29 of the Internal Revenue Code). In your letter, you ask that the Internal Revenue Service (Service) once again review its ruling practice regarding this subject.

Section 29 provides a tax credit for the production and sale of solid synthetic fuels produced from coal. Rev. Rul. 86-100, 1986-2 C.B. 3, adopts for purposes of § 29(c)(1)(C) the definition of synthetic fuel in § 1.48-9(c)(5) of the Income Tax Regulations. Section 1.48-9(c)(5)(ii) provides that, to be "synthetic," a fuel must differ significantly in chemical composition, as opposed to physical composition, from the substance used to produce it. Rev. Rul. 86-100 describes favorably processes such as gasification, liquefaction, and production of solvent refined coal that result in substantial chemical changes to the entire coal feedstock rather than changes that affect only the surface of the coal.

In the fall of 2000, both the Treasury Department and the Congress began to receive comments regarding the ruling position of the Service and the operational practices of some members of the “synfuel” industry. In response to these comments, Treasury and the Service published Rev. Proc. 2000-47, announcing a suspension of rulings while the Service reconsidered the ruling position. During the reconsideration, over five hundred pages of comments were received expressing a broad range of opinions, from those that alleged outright fraud to those that expressed the belief that the Service had been correctly administering a valuable national program.

In the spring of 2001, the Service announced in Rev. Proc. 2001-30, as modified by Rev. Proc. 2001-34, that the rulings would continue, but that new rulings would not go

beyond the processes approved in the rulings issued prior to the year 2000. Since then, the Service has issued numerous private letter rulings. In issuing these letters, the Service has, in every case, reviewed a report prepared by the taxpayer's experts which states that the taxpayer's process, when applied to coal feedstock, results in a fuel that differs significantly in chemical composition from the coal.

In the past year, the Service released Announcement 2003-46, stating that the Service would review the scientific validity of test procedures and results presented as evidence of significant chemical change, and that the rulings on the question of significant chemical change are suspended until the completion of the review.

During the review, the Service and the Treasury received many comments from the synfuel industry and members of Congress, stating that Announcement 2003-46 has created significant economic problems, including plant closings and employee layoffs, interference with transfers of facilities, and financial reporting complications. Many comments also stated that the suspension of rulings and the questioning of longstanding testing procedures are tantamount to a repeal of the credit and could undermine taxpayers' ability to rely on Acts of Congress and the private letter ruling process.

On October 29, 2003, the Service issued Announcement 2003-70, upon completion of the review. The Announcement states that the test procedures and results used by taxpayers are scientifically valid if the procedures are applied in a consistent and unbiased manner. The Service believes, however, that the processes approved under its long standing ruling practice and as set forth in Rev. Proc. 2001-30 do not produce the level of chemical change required by § 29(c)(1)(C) and Rev. Rul. 86-100. Nevertheless, the Service continues to recognize that many taxpayers and their investors have relied on its long standing ruling practice to make investments. Therefore, the Service will continue to issue private letter rulings on significant chemical change but will impose additional requirements regarding taxpayers' sampling and data/record retention practices. Moreover, the Service will only allow the credit where the taxpayer's facility was placed in service prior to July 1998.

I hope this letter addresses these concerns you had on the subject. Please contact me or [redacted] if you have any questions.

Sincerely,

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