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Department of the Treasury
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Person To Contact:
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Date:
August 14, 2007

LEGEND:

Taxpayer =
State =
State 2 =
Parent =
Company A =
Company B =
Seller =
Date 1 =
Date 2 =
Date 3 =
Date 4 =
A =
B =

Dear :

This letter responds to a letter dated June 15, 2007, submitted on behalf of Taxpayer, requesting rulings under § 45K, formerly § 29, of the Internal Revenue Code.

The facts as represented are as follows:

Taxpayer is a State corporation and an indirect wholly owned subsidiary of Parent, a publicly traded corporation. Taxpayer owns all of the membership interests of Company A and Company B, State limited liability companies. Taxpayer has

represented that Company A and Company B are disregarded as entities separate from Taxpayer for federal income tax purposes.

Pursuant to an agreement with Seller dated as of Date 1, Company A acquired a synthetic fuel facility and related assets (Facility 1). Pursuant to an agreement with Seller dated as of Date 2, Company B acquired a synthetic fuel facility and related assets (Facility 2).

In consideration for its purchase of Facility 1 and Facility 2 (Facilities), Company A and Company B each made upfront cash payments to Seller and Company A and Company B will also make fixed payments and variable payments based on production in the Facilities to Seller, subject to certain adjustment set forth in the agreements. Taxpayer represents that, based on the estimated annual production of qualified fuel each year, the net present value of the variable payments to be made to Seller is expected to be less than fifty percent of the total payments to be made to Seller under the purchase agreement.

The Facilities were constructed pursuant to identical construction contracts between A and B entered into on Date 3. The construction contracts were assigned to Seller on Date 4. The Facilities were designed to produce synthetic fuel from coal. The construction contracts were governed by the law of State 2 in which the Facilities were located and were binding and enforceable under the law of State 2. The construction contracts 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 and provided that A could be required to pay liquidated damages of at least five percent of the total contract price. The Facilities were constructed and completed in accordance with the terms and conditions of the construction contracts. The Facilities were constructed with equipment that can be disassembled and moved to another site to take advantage of other supplies of coal, potential customers or other business reasons.

The Facilities produce synthetic fuel from coal using a process involving the combination of feedstock coal with a chemical reagent (Process). Each Facility consists primarily of a mixer and a briquetter. The coal feedstock is conveyed to the mixer by a belt conveyor. A proprietary chemical reagent, which is designed to produce a chemical reaction as part of the synthetic fuel production process is then applied to the feed stock coal and thoroughly combined in the mixer. The product then passes through a chute into the briquetter, and is then conveyed to a stockpile.

A recognized expert in coal combustion chemistry and analysis performed tests on the coal used at both of the Facilities and has submitted reports concluding that significant chemical changes take place to the coal with the application of Process to the coal.

The Facilities have each been relocated at least once after the date that they were placed in service, and Taxpayer may relocate one or both of the Facilities again. In connection with any relocation, Taxpayer may repair or replace worn or broken parts. Taxpayer has represented that the fair market value of the original property of each Facility immediately prior to the relocation of that Facility or the replacement of parts of each Facility was, and in the case of a relocation to any other site will be, more than twenty percent (20%) of that Facility's total fair market value (the cost of the new property plus the value of the property that was originally placed in service) at the time of the relocation or replacement.

Taxpayer has entered into a number of agreements with parties unrelated to Taxpayer with respect to the operation of synthetic fuel production at the Facilities. These agreements have been provided and described in detail in the ruling request.

The rulings requested by Taxpayer are:

(1) The construction contracts constitute "binding written contracts in effect before January 1, 1997," within the meaning of § 45K(f)(1)(A);

(2) Taxpayer, with the use of Process, will produce a "qualified fuel" within the meaning of § 45K(c)(1)(C);

(3) Production from the Facilities will be attributable solely to Taxpayer within the meaning of § 45K(a)(2)(B), entitling Taxpayer to a credit under § 45K for the production of the qualified fuel from the Facilities that is sold to an unrelated person; and

(4) Provided the Facilities were "placed in service" prior to July 1, 1998, within the meaning of § 45K(f)(1), the relocation of either of the Facilities after June 30, 1998, or the replacement of parts of that Facility after that date, will not result in a new placed in service date for that Facility for purposes of § 45K provided that the fair market value of the original property is more than twenty percent of that Facility's total fair market value at the time of the relocation or replacement.

RULING REQUEST 1

Section 45K(f)(1)(A) modifies § 45K(e) in the case of a facility producing qualified fuels described in § 45K(c)(1)(C), which qualified fuels include solid synthetic fuels produced from coal or lignite. Section 45K(f)(1)(A) provides that for purposes of § 45K(e), 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 45K(f)(1)(B) provides that if the facility is originally placed in service after December 31, 1992, § 45K(e)(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 contracts were entered into before January 1, 1997, and include the essential features necessary for a binding written contract. Taxpayer has represented that each construction contract is binding under applicable state law and that each contract provides for liquidated damages of at least five percent. Therefore, we conclude that the construction contracts are binding written contracts in effect before January 1, 1997, within the meaning of § 45K(f)(1)(A).

RULING REQUESTS 2 & 3

Section 45K(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 45K(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 § 48(l) and its regulations are relevant to the interpretation of the term under § 45K(c)(1)(C), formerly § 29(c)(1)(C). Former § 48(l)(3)(A)(iii) provided a credit for the cost of equipment used for converting an alternate substance into a synthetic liquid, gaseous, or solid fuel. Rev. Rul. 86-100 notes that both § 29 and former § 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 § 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 § 1.48-9(c)(2)(i).

Consistent with its private letter ruling practice that began in the mid 1990s, the Service, in Rev. Proc. 2001-30, provided that taxpayers must satisfy certain conditions in order to obtain a letter ruling that a solid fuel (other than coke) produced from coal is a qualified fuel under § 29(c)(1)(C). Rev. Proc. 2001-30, as modified by Rev. Proc. 2001-34, 2001-1 C.B. 1293. The revenue procedure requires taxpayers to present evidence that all, or substantially all, of the coal used as feedstock undergoes a significant chemical change. To meet this requirement and obtain favorable private letter rulings, taxpayers provided expert reports confirming that their processes resulted in a significant chemical change.

In Announcement 2003-46, 2003-1 C.B. 222, the Service announced that it was reviewing the scientific validity of test procedures and results presented as evidence of significant chemical change in expert reports. In Announcement 2003-70, 2003-2 C.B. 1090, the Service announced that it had determined that the test procedures and results used by taxpayers were scientifically valid if the procedures were applied in a consistent and unbiased manner. However, the Service concluded that the processes approved under its long standing ruling practice and as set forth in Rev. Proc. 2001-30 did not produce the level of chemical change required by § 29(c)(1)(C). Nevertheless, the Service announced that it recognized that many taxpayers and their investors have relied on its long standing ruling practice to make investments. Therefore, the Service announced that it would continue to issue rulings on significant chemical change, but only under the guidelines set forth in Rev. Proc. 2001-30, as modified by Rev. Proc. 2001-34.

This ruling is provided to Taxpayer consistent with Announcement 2003-70 and the Service's long standing ruling practice. Accordingly, based on the information supplied by Taxpayer and Taxpayer's authorized representative, including the test results submitted by Taxpayer, we agree that the fuel produced in the Facilities using the Process described in Taxpayer's ruling request will result in a significant chemical change to the coal, transforming the coal into a solid synthetic fuel from coal. Because Taxpayer owns the Facilities and operates and maintains the Facilities, we conclude Taxpayer will be entitled to the § 45K credit for the production of the qualified fuel from the Facilities that is sold to an unrelated person.

RULING REQUEST 4

Rev. Rul. 94-31, 1994-1 C.B. 16, concerns § 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 a 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 § 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 the Facilities were "placed in service" prior to July 1, 1998, within the meaning of § 45K(f)(1), the relocation of either Facility 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 § 45K, 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 the Facilities were placed in service.

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

(1) The construction contracts constitute "binding written contracts in effect before January 1, 1997," within the meaning of § 45K(f)(1)(A);

(2) Taxpayer, with the use of Process, will produce a "qualified fuel" within the meaning of § 45K(c)(1)(C);

(3) Production from the Facilities will be attributable solely to Taxpayer within the meaning of § 45K(a)(2)(B), entitling Taxpayer to a credit under § 45K for the production of the qualified fuel from the Facilities that is sold to an unrelated person; and

(4) Provided the Facilities were "placed in service" prior to July 1, 1998, within the meaning of § 45K(f)(1), the relocation of either of the Facilities after June 30, 1998, or the replacement of parts of that Facility after that date, will not result in a new placed in service date for that Facility for purposes of § 45K, provided that the fair market value of the original property is more than twenty percent of that Facility's total fair market value at the time of the relocation or replacement.

The conclusions drawn and rulings given in this letter are subject to the requirements that taxpayer (i) maintain sampling and quality control procedures that conform to ASTM or other appropriate industry guidelines at the facilities that are the subject of this letter, (ii) obtain regular reports from independent laboratories that have analyzed the fuel produced in such facilities to verify that the coal used to produce the fuel undergoes a significant chemical change, and (iii) maintain records and data underlying the reports that taxpayer obtains from independent laboratories, including raw FTIR data and processed FTIR data sufficient to document the selection of absorption peaks and integration points.

Except as specifically ruled upon above, we express no opinion concerning the federal income tax consequences of the transaction described above. In particular, we express no opinion as to (1) whether, in fact, the Facilities were placed-in-service prior to July 1, 1998; or (2) whether any particular sale of qualified fuel is a sale to an unrelated person.

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 § 11.04 of Rev. Proc. 2007-1, 2007-1 I.R.B. 1. However, when the criteria in § 11.06 of Rev. Proc. 2007-1 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 your authorized representative.

Sincerely,

Peter C. Friedman
Senior Technician Reviewer, Branch 6
Office of Associate Chief Counsel
(Passthroughs and Special Industries)