Internal Revenue Service

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Department of the Treasury
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October 29, 2007

LEGEND:

Taxpayer:
P:
Prior Ruling:
A:
B:
C:
D:
E:
F:
G:
Q:
W:
X:
Y:
Z:
TAM:

Date 1:
Date 2:
Date 3:
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Date 5:
Date 6:
a%:
b%:

Dear :

This letter responds to a letter dated April 20, 2007, and subsequent correspondence, submitted on behalf of Taxpayer by its authorized representatives,

requesting rulings under §§ 45K, 702 and 708 of the Internal Revenue Code.

FACTS

The facts as represented by Taxpayer and Taxpayer's authorized representatives, and the representations of P and P's authorized representatives in obtaining Prior Ruling, are as follows:

P received Prior Ruling on Date 1, which ruled on the issues addressed by this letter. Taxpayer seeks confirmation of the Prior Ruling in light of certain changes in the facts, including the sale of membership interests in P to A and B and amendments to certain agreements relating to the operation of the Facilities.

P was a limited liability company, taxable as a partnership that was formed to purchase a synthetic fuel facility. X and Y were the members in P. W is the sole member of X. Because X is disregarded as an entity for federal income tax purposes, W was treated as owning X's member interest in P. Y is a wholly-owned subsidiary of W. Z is the indirect parent corporation of W.

P acquired the Facility from Q pursuant to an Asset Purchase Agreement dated as of Date 2. Q was the original owner of the Facility, which was constructed pursuant to a construction contract dated Date 3 that was assigned to Q. The construction contract does not provide for liquidated damages or any other limitation on the maximum amount of damages available should either party fail to perform. The construction contract includes a description of the facility to be constructed, a completion date and a price. 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 Facility is a movable facility that can be moved from one site to another depending on the availability, price and location of coal feedstock. Subsequent to the purchase, P relocated the Facility to a leased site owned by an indirect subsidiary of W. Following the relocation, the fair market value of the original property was more than 20 percent of the Facility's total value (the cost of the new property plus the value of the original property).

On Date 4, X sold a% membership interest in P to A pursuant to an Agreement for Purchase of Membership Interest. Also on Date 4, Y sold b% interest in P to B pursuant to an Agreement for Purchase of Membership Interest. The sales may be rescinded if a favorable private letter ruling is not issued on the transaction. The sales resulted in a technical termination of P under § 708(b)(1)(B) and the formation of Taxpayer. Following the sales, A owns a% and B owns b% of the membership interests in Taxpayer.

In exchange for the membership interests in P, A and B paid to X and Y an amount of cash at closing and A and B are obligated to make certain fixed and variable payments to X and Y. Taxpayer has provided projections based on expected operations that the net present value of the contingent payments to be made to X and Y under the Agreement for Purchase of Membership Interest will be less than fifty percent of the total payments made to X and Y.

On Date 4, A and B executed the Second Amended and Restated Limited Liability Company Agreement as the new members of Taxpayer. The Agreement allocates receipts from the sale of synthetic fuel among its members in accordance with their membership interests.

On Date 4, in connection with the sale, Taxpayer entered into a number of related agreements. Taxpayer entered into a Lease Agreement with C (an affiliate of X and Y) for the site on which the Facility is located. Taxpayer entered into an Operating and Maintenance Agreement with C under which C will operate and maintain the Facility. Taxpayer entered into a Supply and Marketing Agreement with D (an affiliate of X and Y) under which D will procure the coal feedstock from unrelated parties necessary to manufacture qualified fuel and market, as agent for Taxpayer, the qualified fuel for sale to unrelated parties. Taxpayer entered into a Chemical Supply Agreement with E (an affiliate of X and Y) under which E will supply to Taxpayer the chemical reagent used in the production of qualified fuel. Taxpayer entered into a Sublicense Agreement with F under which F granted a sublicense of its right to use a patented process for production of qualified fuel which was licensed to F by G. In all events Taxpayer will retain control over the Facility.

The Facility was designed and constructed to produce qualified fuel from coal using a process (the “Process”) involving the combination of feedstock coal with a chemical reagent. In the first phase of the Process, feedstock coal is thoroughly mixed with a heated chemical reagent in a pugmill. After leaving the pugmill, the mixture is carried by conveyor belt to a conveyor from which it is distributed to one of three briquetters by an arrangement of diverters and chutes. Each briquetter is equipped with a short conveyor belt running under it that receives the resulting solid synthetic fuel product and carries it to a common collection belt and then out of the Facility to a storage area. In Taxpayer's production process, the combination of the chemically reactive agent, the mixing process, the retention time, and the compression pressure used in the roll briquetter process results in the formation of a solid synthetic fuel product. The Facility utilizes coal feedstock and chemical reagents that meet the requirements of Rev. Proc. 2001-34, 2001-22 I.R.B. 1293.

The Service recently completed an audit of P. In connection with the audit, the Service requested and reviewed information and various documents regarding the placed in service facts of the Facility, including changes made to the Facility. On , the Service issued to P TAM that concluded that P’s Facility was

placed in service prior to July 1, 1998, pursuant to a binding written contract in effect before January 1, 1997. In addition, P received a letter executed on from the Service that closed the audit with no adjustment to the amount of the § 45K credits claimed.

Taxpayer has supplied a detailed description of the process employed at the Facility. As described, the Facility and the process implemented in the Facility, including the alternative chemical reagents, meet the requirements of Rev. Proc. 2001-34. A recognized expert in combustion, coal, and chemical analysis has performed numerous tests on the coal used at the Facility and the Product produced at the Facility 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. Taxpayer, with use of the process, will maintain a level of chemical change in the production of the Product that is determined through similar analysis by experts to be a significant chemical change.

The remaining facts are the same as stated in the Prior Ruling. The Prior Rulings that Taxpayer wishes to be reconfirmed in this private letter ruling are as follows:

(1) Taxpayer, with use of the Process (as herein defined) and chemical reagents described in Taxpayer's ruling request, including the Primary Chemical Reagent and the Alternative Chemical Reagents (as herein defined), will produce a "qualified fuel" within the meaning of § 45K(c)(1)(C).

(2) The contract for construction of the Facility constitutes a "binding written contract" in effect before January 1, 1997, within the meaning of § 45K.

(3) Production of qualified fuel from the Facility will be attributable solely to Taxpayer within the meaning of § 45K(a)(2)(B), entitling Taxpayer to the § 45K tax credits for all qualified fuel from the Facility that is sold to an unrelated person.

(4) The § 45K tax credits attributable to Taxpayer may be allocated to all the members of Taxpayer, to consist of A and B (as herein defined), under the principles of § 702(a)(7) in accordance with each member's interest in Taxpayer as of the time the credit arises. For purposes of the § 45K tax credits, a member's interest in Taxpayer is determined based on a valid allocation of the receipts from the sale of the § 45K qualified fuel.

(5) Because the Facility was placed in service prior to July 1, 1998, within the meaning of § 45K, relocation of the Facility to a different location 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 § 45K, provided that the fair market value of the original property incorporated into the Facility is more than 20 percent of the

Facility's total fair market value immediately following the relocation or replacement.

(6) A termination of P or Taxpayer under § 708(b)(1)(B) will not preclude the reconstituted partnership from claiming the § 45K tax credits on the production and sale of qualified fuel to unrelated persons.

RULING REQUESTS 1 & 3

Consistent with its private letter ruling practice that began in the mid 1990's, 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 produced from coal is a qualified fuel under § 45K(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 asserting that their processes resulted in a significant chemical change.

In Announcement 2003-46, 2003-30 I.R.B. 222, the Service announced that it was reviewing the scientific validity of test procedures and results presented of significant chemical change in expert reports. In Announcement 2003-70, 2003-46 I.R.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 § 45K(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 expert test results submitted by Taxpayer, we conclude that the synthetic fuel produced at the Facility using the described process and specified chemical reagents is a solid synthetic fuel produced from coal constituting a "qualified fuel" within the meaning of § 45K(c)(1)(C). Because Taxpayer owns the Facility and operates and maintains the Facility through its agent, we conclude that Taxpayer will be entitled to the § 45K credit for the production of the qualified fuel from the Facility that is sold to an unrelated person.

RULING REQUEST 2

Sections 45K(e)(1)(B) and (e)(2) provides that § 45K 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 45K(f)(1) 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)(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 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. The construction contract, executed prior to January 1, 1997, does not provide for liquidated damages or any other limitation on the maximum amount of damages available should either party fail to perform and includes such essential features as a description of the facility to be constructed, a completion date, and a price. 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. Therefore, we conclude that the construction contract is a binding written contract in effect before January 1, 1997, within the meaning of § 45K(f)(1)(A).

RULING REQUEST 4

Section 45K(a) allows a credit for qualified fuels solid by the taxpayer to an unrelated person during the taxable year, the production of which is attributable to the taxpayer.

Under § 7701(a)(14), “taxpayer" means any person subject to any internal revenue tax. Furthermore, § 7701(a)(1) provides that when used in Title 26, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof, "person" will be construed to mean and include an individual, trust, estate, partnership, association, company, or corporation.

Section 702(a)(7) provides that each partner 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) of the Income Tax Regulations provides that the distributive share is determined as provided in § 704 and § 1.704-1 of the Income Tax Regulations.

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 partner's 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) of the Income Tax Regulations provides that allocations of tax credits and tax credit recapture (except for § 38 property) are not reflected by adjustments to the partners' capital accounts. Thus, these allocations cannot have economic effect under § 1.704-1(b)(2)(ii)(b)(1) of the Income Tax Regulations, and the tax credits and tax credit recapture must be allocated in accordance with the partners' interests in the partnership as of the time the tax credit or 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 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 § 1.704-1(b)(5) of the Income Tax Regulations, 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, assuming the solid synthetic fuel produced and sold qualifies for the § 45K credit, the credit will be allowed to Taxpayer and the credit may be passed through to and allocated among the members of Taxpayer, consisting of A and B, under the principles of § 702(a)(7) in accordance with each member's interest in Taxpayer as of the time the credit arises. For purposes of the § 45K credit, a member's interest in Taxpayer is determined under § 1.704-1(b)(4)(ii) of the Income Tax Regulations and is proportionate to valid allocations of the receipts from the sale of the § 45K credit qualified fuel.

RULING REQUEST 5

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 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 § 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, relocation of the Facility to a different location after the Facility's placed in service date, 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 § 45K, provided the fair market value of the original property is more than 20% of the 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 used property).

RULING REQUEST 6

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 interests in partnership capital and profits.

Section 1.708-1(b)(4) of the Income Tax Regulations 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)(4) of the Income Tax Regulations applies to terminations of partnerships under § 708(b)(1)(B) occurring on or after May 9, 1997.

The placed in service deadline in § 45K(e)(1)(B) and § 45K(f)(1)(A) must be read as applying to when the facility is first placed in service within the applicable dates. The placed in service deadlines contained in § 45K(e)(1)(B) and § 45K(f)(1)(A) focus on the facility, and not the taxpayer owning the facility.

Accordingly, the determination of whether a facility has satisfied the placed in service deadline under § 45K(e)(1)(B) and § 45K(f)(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 P under § 708(b)(1)(B) will not preclude the reconstituted partnership from claiming the § 45K credit for the production and sale of synthetic fuel to unrelated persons.

CONCLUSIONS

Accordingly, based on the representations of Taxpayer and Taxpayer's

authorized representatives, and on the representations of P and P's authorized representatives in obtaining Prior Ruling, we issue the following Rulings:

(1) Taxpayer, with use of the Process (as herein defined) and chemical reagents described in Taxpayer's ruling request, including the Primary Chemical Reagent and the Alternative Chemical Reagents (as herein defined), will produce a "qualified fuel" within the meaning of § 45K(c)(1)(C).

(2) The contract for construction of the Facility constitutes a "binding written contract" in effect before January 1, 1997, within the meaning of § 45K.

(3) Production of qualified fuel from the Facility will be attributable solely to Taxpayer within the meaning of § 45K(a)(2)(B), entitling Taxpayer to the § 45K tax credits for all qualified fuel from the Facility that is sold to an unrelated person.

(4) The § 45K tax credits attributable to Taxpayer may be allocated to all the members of Taxpayer, to consist of A and B (as herein defined), under the principles of § 702(a)(7) in accordance with each member's interest in Taxpayer as of the time the credit arises. For purposes of the § 45K tax credits, a member's interest in Taxpayer is determined based on a valid allocation of the receipts from the sale of the § 45K qualified fuel.

(5) If the Facility was placed in service prior to July 1, 1998, within the meaning of § 45K, as was determined in TAM, relocation of the Facility to a different location 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 § 45K, provided that the fair market value of the original property incorporated into the Facility is more than 20 percent of the Facility's total fair market value immediately following the relocation or replacement.

(6) A termination of P or Taxpayer under § 708(b)(1)(B) will not preclude the reconstituted partnership from claiming the § 45K tax credits on the production and sale of qualified fuel to unrelated persons.

The conclusions drawn and rulings given in this letter are subject to the requirements that the taxpayer (i) maintain sampling and quality control procedures that conform to ASTM or other appropriate industry guidelines at the facility that is the subject of this letter, (ii) obtain regular reports from independent laboratories that have analyzed the fuel produced in such facility 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 the 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.

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 representatives.

Sincerely,

Charles B. Ramsey
Branch Chief, Branch 6
(Passthroughs & Special Industries)