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November 12, 2002

Legend

A =

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Agreement =

Date 1 =

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Site X =

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Site Z =

Dear :

This letter responds to a letter dated July 5, 2002 submitted on behalf of A by its authorized representative, requesting rulings under Sections 29 and 702 of the Internal Revenue Code.

FACTS

The facts as represented by A and A's authorized representative are as follows.

A is a limited liability company wholly owned by B, a Delaware limited partnership. A is treated as a disregarded entity for federal income tax purposes and its activities are treated in the same manner as a branch or division of its owner, B, which has two partners. The partners of B, C and D, are members of the consolidated tax group of which E is the parent. B has made (and is expected to continue to make) periodic cash capital contributions to A to enable it to pay its operating costs and other obligations.

On Date 1, A agreed to acquire a synfuel manufacturing facility (the "Facility") from F pursuant to the terms of the Agreement. A agreed to pay a fixed amount in cash plus contingent payments over time for the Facility. The amount of the purchase price was modified by a First Amendment to the Agreement, effective as of Date 2, and a Second Amendment to the Agreement, effective as of Date 3 and a third amendment as of Date 6. Approximately $A of the fixed portion of the purchase price had been paid by Date 3. Another $B is to be paid when a favorable ruling is received from the Service. The remainder of the fixed portion will be paid over time at the rate of $C a calendar quarter until September 2007. The contingent payments are also made quarterly. They are calculated as X% of the section 29 tax credits from synfuel production, but only on the first Y tons a year of annual production. A represents that, based on the expected production level of Y tons per year, the net present value of the cash and the fixed payment obligations of A will exceed 50% of the net present value of the total consideration payable by A to F in connection with the acquisition of the Facility.

Prior to closing, F agreed to move the Facility from a storage facility in Site X to Site Y, which was leased by A from G. F also had to run tests to show that the Facility had been properly reassembled at the new site. These conditions were satisfied and A acquired ownership of the Facility on Date 2.

On Date 4, an affiliate of F received PLR 9818012, which rules on certain issues similar to this letter.

The Facility was constructed pursuant to a written contract entered into by H and J on Date 5. J assigned the contract to an affiliate of F, which then reassigned the agreement to another affiliate. Both assignments occurred in 1997. Then in 1998, the second affiliate contributed the contract to the capital of F. The contract provides for liquidated damages of at least five percent of the cost of the Facility. It also includes a description of the facility to be constructed, a completion date, and a price. The construction contract is valid under state law.

The Facility was originally constructed in Site Z in 1998 and operated at the site through September 1998. F disassembled the plant starting in   and moved it to the storage facility at Site X pending a sale and move to a new site.

The Facility consists of the equipment necessary for the production of a solid synthetic fuel from coal. The Facility can be moved from one site to another depending on the availability, price and location of coal feedstock, as well as other factors. Repairs were made and certain parts were replaced at the Facility in connection with the move. Following the relocation to Site Y, the fair market value of the original property comprising a part of the Facility was more than 20% of the Facility's total value (the cost of the new property plus the value of the original property).

A entered into a Facility Operating and Maintenance Agreement with K for the operation and maintenance of the Facility. Certain feedstock and synfuel handling services are being provided by G under the terms of the site lease. A pro forma attached to the ruling request shows that project expenses are projected to exceed revenues.

A uses its parent, B, to buy feedstock for it in the spot market. B currently has contracts to purchase feedstock from three suppliers, but it may also buy from other sources. The feedstock is coal or crushed coal comprised of particles the majority of which, by weight, are no larger than 3/8 of an inch.

Pursuant to a binder supply agreement, L is the exclusive provider of chemical reagent to A. Although L has been promised that it will be the exclusive supplier, A can go elsewhere after giving notice that its customers have complained of problems with the synfuel that are attributable to the reagent -- at least until L gives notice that it is again able to perform.

The output is sold by B or A to third parties either in the spot market or under contracts negotiated with customers. Most output sales agreements have a term of one year or less and cover increments of 10,000 to 500,000 tons of synfuel.

A has supplied a detailed description of the process employed in the Facility for the production of synthetic fuel. As described, the Facility and the process implemented in the Facility meet the requirements of Rev. Proc. 2001-34, 2001-22 I.R.B. 1293.

A submitted a study comparing the chemistry of the feedstock to actual output from the Facility at the new site. The study concludes that there are significant differences in the chemical and molecular structure of the synfuel compared to the ingredients from which it was produced.

The limited partnership agreement of B provides that tax credits, cash and taxable income and loss are to be allocated between the members in the same ratio as their percentage interests in B.

The rulings requested by A are as follows:

1. The synfuel produced at A's Facility is a "qualified fuel" within the meaning of section 29(c)(1)(C).

2. The contract for the construction of the Facility satisfies the requirement in section 29(g) for a "written binding contract" before January 1, 1997.

3. Provided the Facility was "placed in service" within the meaning of section 29(g)(1) in time to qualify for tax credits, neither the relocations of the Facility nor the replacement of parts of the Facility described in the ruling request will result in a new placed-in-service date for the Facility or otherwise prevent the Facility from continuing to be treated as placed-in-service. In addition, subsequent relocations of the Facility to different sites, or the replacement of parts of the Facility, will not result in a new placed-in-service date for the Facility or otherwise prevent the Facility from continuing to be treated as placed-in-service if the fair market value of the original property is more than 20% of the Facility's fair market value immediately following the relocation or

replacement.

4. Production of qualified fuel from the Facility will be attributable solely to B, and B is entitled to all the section 29 tax credits on fuel produced at the Facility and sold by A or B to unrelated persons.

5. If A becomes a partnership for tax purposes, the section 29 tax credits to which A is entitled will pass through and be allocated among members of A under the principles of section 702(a)(7).

6. If A becomes a partnership for tax purposes and A later terminates and is reconstituted under section 708(b)(1)(B) after a sale or exchange of membership interests in A, neither the conversion to a partnership nor the termination and reconstitution under section 708(b)(1)(B) will preclude the reconstituted partnership from continuing to claim section 29 tax credits for synthetic fuel that is produced at the Facility and sold to unrelated persons.

RULING REQUEST #1

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 is 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 alternate 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) of the Income Tax Regulations.

In Rev. Proc. 2001-30, 2001-19 I.R.B. 1163, the Service announced that it will resume issuance of rulings under section 29(c)(1)(C) for processes that do not go beyond the processes approved in the rulings issued prior to 2000. The Service also reaffirmed its view that the significant chemical change standard of Rev. Rul. 86-100 is the correct standard.

Section 3 of Rev. Proc. 2001-34, 2001-22 I.R.B. 1293, provides that the Service will issue rulings that a solid fuel (other than coke) produced from coal is a qualified fuel under section 29(c)(1)(C) if the conditions set forth below are satisfied and evidence is presented that all, or substantially all, of the coal used as feedstock undergoes a significant chemical change. The conditions are that:

1. the feedstock coal consists of coal fines or crushed coal comprised of particles the majority of which, by weight, are no larger than 3/8 inch;

2. the feedstock coal is thoroughly mixed in a mixer: (a) with styrene or other monomers, (b) with quinoline (C_9H_7N) or other organic resin and left to cure for several days, (c) with ultra heavy hydrocarbons, or (d) with an aluminum and/or magnesium silicate binder following heating to a minimum temperature of 500 degrees Fahrenheit; and

3. the treated feedstock is subjected to elevated temperature and pressure that results in briquettes, pellets, or an extruded fuel product, or the taxpayer represents that that omission of this procedure will not significantly increase the production of the facility over the remainder of the period during which the section 29 credit is allowable.

Based on the information submitted by A and A's authorized representative, including the test results submitted by A, we conclude that the conditions of Rev. Proc. 2001-34 are met and that the process and reagents used in the Facility as described in A's ruling request produce a significant chemical change to the coal, transforming the coal feedstock into a solid synthetic fuel produced from coal. Therefore, we conclude that the fuel produced at the Facility using the process is a solid synthetic fuel produced from coal that constitutes a "qualified fuel" within the meaning of section 29(c)(1)(C).

RULING REQUEST #2

Sections 29(f)(1)(B) and (f)(2) provide that section 29 applies with respect to qualified fuels that 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), which qualified fuels include solid synthetic fuels produced from coal or lignite. 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, executed prior to January 1, 1997, includes liquidated damages of at least five percent as well as such essential features as a description of the facility to be constructed, a completion date, and a price. Therefore, we conclude that the construction contract is a binding written contract in effect before January 1, 1997, within the meaning of section 29(g)(1)(A).

RULING REQUEST #3

To qualify for the section 29 credit, the 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 in which it is placed in a condition or state of readiness and availability for a specifically assigned function. Sections 1.167(a)-11(e)(1)(i) and 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. When property is placed in service is a factual determination, and we express no opinion on when the Facility was placed in service.

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 has been interpreted to mean that, for purposes of section 45, a relocated facility will not get a new in-service date, even though it contains some new property, provided the fair market value of the used property is at least 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, provided the Facility was placed in service within the meaning of section 29(g)(1) in time to qualify for tax credits, neither the relocations of the Facility or the replacement of parts of the Facility described in the ruling request will result in a new placed-in-service date for the Facility or otherwise prevent the Facility from continuing to be treated as placed in service. In addition, subsequent relocations of the facility or the replacement of parts of the Facility will not result in a new placed-in-service date for the Facility or otherwise prevent the Facility from continuing to be treated as placed in service, if the fair market value of the original property is more than 20 percent of the Facility's total fair market value immediately following the relocation or replacement.

RULING REQUEST #4

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.

Under section 7701(a)(14), "taxpayer" means any person subject to any internal revenue tax. Furthermore, section 7701(a)(1) generally provides that the term "person" includes an individual, a trust, estate, partnership, association, company, or corporation.

A owns the Facility, and through a contract operator, A operates and maintains the Facility. A or B sells the resulting qualified fuel. However, A is treated as a disregarded entity within the meaning of Regulations section 301.7701-2(a) and A's activities are treated in the same manner as a branch or division of its owner, B. Accordingly, B is the taxpayer for purposes of section 29(a)(2)(B) of the Code, because a partnership such as B is a taxpayer under section 7701(a)(14). Therefore, all production of qualified fuel from the Facility will be attributable solely to B within the meaning of section 29(a)(2)(B), and B will be entitled to all the section 29 credits for the production of qualified fuel from the Facility that is sold to unrelated persons.

RULING REQUEST #5

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 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 sections 704 and 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 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) 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' 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 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 if A becomes a partnership for tax purposes, the section 29 tax credits to which A is entitled will pass through and be allocated among the members of A under the principles of section 702(a)(7) in accordance with each partner's interest in A as of the time the credit arises.

RULING REQUEST #6

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 the 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 January1, 1990, on property that first began production after January 1, 1980.

Congress has extended the section 29 credit 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 the 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 as requiring facilities producing qualified fuels to be 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 first 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 a tax incentive for production capacity in service before 1980.

Accordingly, the determination of whether a facility has satisfied the placed-in-service deadline under either section 29(f)(1)(B) or 29(g)(1)(A) is made by reference to when the facility is first placed in service, not when the facility is transferred to a different taxpayer.

Section 708(b)(1)(B) provides that a partnership shall be considered as terminated if within a 12-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 by 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.

As discussed above, the placed-in-service deadline in section 29(f)(1)(B) and 29(g)(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 sections 29(f)(1)(B) and 29(g)(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 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 if A becomes a partnership for tax purposes and it later terminates and is reconstituted under section 708(b)(1)(B), such termination will not preclude the reconstituted partnership from claiming the section 29 credit for the production and sale of synthetic fuel from the Facility to unrelated persons.

CONCLUSIONS

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

1. The synfuel produced at the Facility using the specified reagent is a "qualified fuel" within the meaning of section 29(c)(1)(C).

2. The contract for the construction of the Facility satisfies the requirement in section 29(g) for a "written binding contract" before January 1, 1997.

3. Provided the Facility was "placed in service" within the meaning of section 29(g)(1) in time to qualify for tax credits, neither the relocations of the Facility nor the replacement of parts of the Facility described in the ruling request will result in a new placed-in-service date for the Facility or otherwise prevent the Facility from continuing to be treated as placed-in-service. In addition, subsequent relocations of the Facility to different sites, or the replacement of parts of the Facility, will not result in a new placed-in-service date for the Facility or otherwise prevent the Facility from continuing to be treated as placed-in-service if the fair market value of the original property is more than 20% of the Facility's fair market value immediately following the relocation or replacement.

4. Production of qualified fuel from the Facility will be attributable solely to B, and B is entitled to all the section 29 credits on fuel produced at the Facility and sold by A or B to unrelated persons.

5. If A becomes a partnership for tax purposes, the section 29 tax credits resulting from the production and sale of qualified fuel by A from the Facility will be attributable solely to A, and the section 29 credits will pass through and be allocated among the members of A under the principles of section 702(a)(7).

6. If A becomes a partnership for tax purposes and A later terminates and is reconstituted under section 708(b)(1)(B) after a sale or exchange of membership interests in A, neither the conversion to a partnership nor the termination and reconstitution under section 708(b)(1)(B) will preclude the reconstituted partnership from continuing to claim section 29 credits for synthetic fuel that is produced at the facility and sold to unrelated persons.

Except as specifically ruled upon above, we express no opinion concerning the federal income tax consequences of the transaction described above. Specifically, we express no opinion on when the Facility was placed in service for purposes of section 29.

This ruling is directly 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. 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.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to A's authorized representative. This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,

Joseph H. Makurath

Senior Technician Reviewer

Office of Associate Chief Counsel

(Passthroughs and Special Industries)