Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:7 PLR-109701-00
Date:
October 24, 2001

X =

Company1 =

Company2 =

Dear

This letter responds to a letter dated May 3, 2000, and subsequent correspondence, submitted on behalf of X by its authorized representative, requesting rulings under section 29 of the Internal Revenue Code.

FACTS

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

Company 1 is a limited liability company with X as its sole member. Company 1 is disregarded as an entity separate from X. Company 2 is a limited partnership predominately owned, for federal income tax purposes, by X. Company 1 and Company 2 each have an identical facility designed to produce synthetic fuel from coal.

Initially, each facility produced a solid synthetic fuel from coal using the following process: Coal was crushed to a uniform size feedstock and conveyed to a high speed mixer designed to homogenize the material prior to the application of the binder material. The sized homogenized feedstock material was then mixed in a high speed paddle type blender with water and the binder material to produce a rather gummy mixture. The gummy mixture was subjected to pressures up to 2000 pounds per square inch by passing through a hydraulically driven, roll type briquetter.

The initial binder used was a "straight run asphalt" material that was purchased and trucked to the facilities where it was stored in heated tanks.

The original production process independently added water and binder to the coal before the mixture of fines, water, and binder entered the briquetter. You now mix the water and binder together with a small amount of soap to form an emulsion which is then mixed with the coal. You further propose that, from time to time, one of two alternative substances will be used in place of the emulsion.

The feedstock coal, the modified binder, and the two alternative substances meet the requirements of Rev. Proc. 2001-30, 2001-19 I.R.B. 1163 and Rev. Proc. 2001-34, 2001-22 I.R.B. 1293.

You have represented that the modification of the binder, or the use of the alternative substances does not increase the "production output" of either facility. 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.

X has had an expert conduct numerous tests and has submitted expert reports on fuel produced from coal using the process as modified and the alternative substances. By the preponderance of these tests' results, X and X's authorized representative represent that there is a significant chemical difference between the fuel produced in each case and the coal from which the fuel was made.

The original site of the facilities is not large enough to accommodate the storage of the coal input. The facilities were designed to be relocated. Although relocation of the facilities will involve the replacement of concrete pads and certain items of equipment that could not physically or economically be relocated to a new site, the other equipment (including major components such as the pan feeder, crusher, mixer, blender, emulsifier, briquetter, hydraulic power units, and binder pumps) will be incorporated into the relocated facilities. Following relocation of the facilities, the fair market value of the equipment from each original facility that is included in a relocated facility will exceed 20 percent of the fair market value of the total equipment in the relocated facility.

RULING REQUESTS #1, #2 AND #3

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 are 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).

The feedstock coal, the modified binder and the two alternative substances meet the requirements of Rev. Proc. 2001-30,2001-19 I.R.B. 1163 and 2001-34,2001-22 I.R.B. 1293.

Based on the representations of X and X's authorized representative, including the preponderance of the test results, we agree that the fuel to be produced in the facilities using the modified process on the coal will result in a significant chemical change in coal, transforming the coal into a solid synthetic fuel from coal. Because X (Company 1 is disregarded as an entity separate from X) and Company 2 will each own and operate a Facility, we conclude that X and Company 2 will each be entitled to the section 29 credit for their production of the qualified fuel from their own Facility provided the fuel is sold to an unrelated person.

RULING REQUEST #4

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 section 704 and section 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 partners 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 the section 29 credit attributable to Company 2 may be allocated to the partners of Company 2 in accordance with the partners' interests in Company 2 when the credit arises. For the section 29 credit, a partner's interest in Company 2 is determined based on a valid allocation of the receipts from the sale of the section 29 qualified fuel.

RULING REQUEST #5

To qualify for the section 29 credit, the facility must have been 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 the property 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 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 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 facility after June 30, 1998, will not prevent the relocated facility from continuing to be treated as originally placed in service prior to July 1, 1998, for purposes of section 29 provided the fair market value of the used property is more than 20 percent of the relocated facility's total

fair market value at the time of the relocation.

CONCLUSIONS

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

(1) each facility, with use of the modified process (including the two alternative substances), will produce a "qualified fuel" within the meaning of section 29(c)(1)(C);

(2) the production of the qualified fuel from Company 1's Facility will be attributable solely to X entitling X to the section 29 credit for the production of the qualified fuel from the Facility that is sold to an unrelated person;

(3) the production of the qualified fuel from Company 2's Facility will be attributable solely to Company 2, entitling Company 2 to the section 29 credit for the production of the qualified fuel from the Facility that is sold to an unrelated person;

(4) the section 29 credit that is attributable to Company 2 may be allocated to the partners of Company 2 according to their ownership interest in Company 2 at the time that the credit arises. For purposes of this allocation a partner's interest in Company 2 is determined by reference to a valid allocation of that partner's share in the gross receipts from sale of the qualified fuel.

(5) if a facility was "placed in service" prior to July 1, 1998, within the meaning of section 29(g)(1), relocation of the facility after June 30, 1998, will not result in a new placed in service date for the facility for purposes of section 29 provided the fair market value of the used property (that is, the property originally placed in service prior to July 1, 1998) is more than 20 percent of the relocated facility's total fair market value at the time of the relocation.

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 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. 2000-1, 2000-1 I.R.B. 4, 46. However, when the criteria in section 12.05 of Rev. Proc. 2000-1 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 X's authorized representative.

Sincerely yours,
Joseph H. Makurath
Senior Technician, Branch 7
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure:
Copy for section 6110 purposes