Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

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Person To Contact:
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Refer Reply To:
CC:PSI:B07
PLR-110119-06
Date:
August 04, 2006

LEGEND

P =

T =
U =
V =
Facility 1 =
Facility 2 =
Facility 3 =
Facility 4 =
Site 1 =
Site 2 =
Reagent 1 =
Location 1 =
Location 2 =
Location 3 =
Location 4 =
Location 5 =
Location 6 =
Date 1 =
Date 2 =

Dear :

This letter is in response to your letter dated January 31, 2006, submitted on behalf of P by its authorized representative, requesting rulings under §§ 45K (formerly § 29) and 702 of the Internal Revenue Code.

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

P received PLR-130091-02 on Date 1 and PLR-110057-97 on Date 2, which rule on issues addressed by this letter. P seeks a confirmation of the rulings in light of the relocation of Facility 1 and Facility 2.

P is a Delaware limited partnership classified as a partnership for federal income tax purposes. The members of P are U and V (Partners). V is responsible for the day-to-day management of P. P owns Facility 1, Facility 2, Facility 3, and Facility 4 (the Facility or Facilities). Facility 1 was originally located in Location 3. Facility 2 was originally located in Location 4. Facility 3 was originally located in Location 5. Facility 4 was originally located in Location 6.

Each Facility consists of two production lines, each of which consists of a briquetter that is fed by its associated mixer. P has supplied a detailed description of the process employed at the Facilities. P is now using Reagent 1 in the process for the production of synthetic fuel at the Facilities.

P relocated and reassembled Facility 1 and began operating at Site 1 in Location 1. Site 1 is on land owned by T. P relocated and reassembled Facility 2 and is in the final stages of relocating to Location 2. Site 2 is on land owned by T.

P has entered into a number of agreements with parties unrelated to P and its Partners with respect to the operation of synthetic fuel production at Facility 1 and Facility 2. These agreements have been provided and described in detail in the ruling request.

P has provided a detailed list of costs from the relocations of Facility 1 and Facility 2 and has represented that following the relocations, the fair market value of the used property will be more than 20 percent of each Facility's total fair market value (the cost of the new property plus the value of the used property).

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 Facilities. Thereafter, P received signed Forms 870-PT from the Service which closed the audit without any adjustment relating to whether P's Facilities were placed-in-service prior to July 1, 1998, pursuant to a binding written contract in effect before January 1, 1997.

A recognized expert in coal combustion chemistry has performed tests on the coal used at the Facilities and the synthetic fuel produced at the Facilities, and has submitted reports on fuel produced from coal using the process described in the ruling request with the use of the reformulated chemical reagent. The expert has concluded in each case that a significant chemical change takes place with the application of the process using Reagent 1.

The rulings requested by P, in light of the proposed transactions described above, are:

1. Each Facility of P, with use of the process described and the Reagent 1, will produce a "qualified fuel" within the meaning of § 45K(c)(1)(C);

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

3. The production of qualified fuel from the Facilities will be attributable solely to P within the meaning of § 45K(a)(2)(B), and thus P will be entitled to the credit under § 45K(a) on the qualified fuel sold to unrelated persons, provided the Facilities were placed in service by the deadline in § 45K(g) (June 30, 1998);

4. The § 45K credit attributable to P will be allocated among its Partners (U and V) under the principles of § 702(a)(7) in accordance with their interests in P when the credit arises, which interest is determined based on a valid allocation of the P's gross income that arises from the receipts from the sale of the qualified fuel; and

5. Provided a Facility was "placed in service" prior to July 1, 1998 within the meaning of § 45K(g)(1), relocation of such Facility to a different location after June 30, 1998, will not result in a new placed in service date for such Facility for purposes of § 45K provided the fair market value of the used property of such Facility is more than 20 percent of such Facility's total fair market value (the cost of the new property plus the value of the used property).

The changes since the issuance of the rulings are the relocation of Facility 1 and Facility 2 and the use of Reagent 1. The rulings issued in the previous rulings are not affected by the changed facts, as described in the ruling request.

RULING REQUESTS 1 & 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). 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, 2003-30 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 § 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 P consistent with Announcement 2003-70 and the Service's long standing ruling practice. Accordingly, based on the information supplied

by P and P's authorized representative, including the test results submitted by P, we agree that the fuel produced in the Facilities using the process and Reagent 1 described in P's ruling request and in the previous rulings will result in a significant chemical change to the coal, transforming the coal into a solid synthetic fuel from coal. Because P owns the Facilities and operates and maintains the Facilities, we conclude P 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 2

Sections 45K(f)(1)(B) and (f)(2) provide that § 45K 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 that are sold before January 1, 2003.

Section 45K(g)(1) modifies § 45K(f) 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(g)(1)(A) provides that for purposes of § 45K(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 45K(g)(1)(B) provides that if the facility is originally placed in service after December 31, 1992, § 45K(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 contracts, executed prior to January 1, 1997, include such essential features as a description of the facility to be constructed, a completion date, and a maximum price. P 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 reaffirm our conclusion in the previous ruling that the construction contracts are "binding written contract" in effect before January 1, 1997, within the meaning of § 45K(g)(1)(A).

RULING REQUEST 3 & 4

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.

Under § 7701(a)(14), the term "taxpayer" means any person subject to any internal revenue tax. Section 7701(a)(1) provides that the term "person" includes an individual, trust, estate, partnership, association, company, or corporation. Accordingly, P should be treated as the "taxpayer" for purposes of the § 45K credit.

Section 702(a)(7) and the regulations thereunder require each partner to take into account separately the partner's distributive share of each class or item of the partnership's income, gain, loss, deduction, or credit. See Treas. Reg. § 1.702-1(a). Section 1.702-1(a)(8)(ii) of Income Tax Regulation requires each partner to take into account separately the partner's distributive share of any partnership item which if separately taken into account by any partner would result in an income tax liability different from that which would otherwise result. Under Treas. Reg. § 1.702-1(a), a partner's distributive share is determined as provided in § 704 and Treas. Reg. § 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 (i) the partnership agreement does not provide for the partner's distributive share of income, gain, loss, deduction, or credit (or item thereof) or (ii) the allocation to a partner under the agreement of income, gain, loss, deduction, or credit (or item thereof) lacks substantial economic effect.

Under Treas. Reg. § 1.704-1(b)(4)(ii), allocations of tax credits and tax credit recapture (except for § 38 property) do not result in any adjustments to the partners' capital accounts. Thus, these allocations cannot have economic effect under Treas. Reg. § 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 tax credit recapture arises. The regulations provide, however, that in determining the partners' interests in the partnership regarding tax credits that arise from receipts of the partnership (whether or not taxable), such as the § 45K credit, if that receipt also gives rise to a valid allocation of partnership income, the partners' interests in the partnership with respect to such item of credit will be in the same proportion as such partners' respective distributive shares of such income. Treas. Reg. § 1.704-1(b)(4)(ii).

Based on the information submitted, we conclude that the § 45K credit attributable to P may be passed through to, and allocated to, U and V in accordance with each partner's interest in P when the credit arises. For the § 45K credit, a partner's interest in P is determined based on a valid allocation of the receipts from the sale of the § 45K 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 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 Facility 1 or Facility 2 were "placed in service" prior to July 1, 1998, within the meaning of § 45K(g)(1), the relocation of either facility after June 30, 1998, or replacement of parts of Facility 1 or Facility 2 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. Each Facility of P, with use of the process described and the Reagent 1, will produce a "qualified fuel" within the meaning of § 45K(c)(1)(C);

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

3. The production of qualified fuel from the Facilities will be attributable solely to P within the meaning of § 45K(a)(2)(B), and thus P will be entitled to the credit under § 45K(a) of the Code on the qualified fuel sold to unrelated persons, provided the Facilities were placed in service by the deadline in § 45K(g) (June 30, 1998);

4. The § 45K credit attributable to P will be allocated among its Partners (U and V) under the principles of § 702(a)(7) in accordance with their interests in P when the credit arises, which interest is determined based on a valid allocation of the P’s gross income that arises from the receipts from the sale of the qualified fuel; and

5. Provided a Facility was "placed in service" prior to July 1, 1998 within the meaning of § 45K(g)(1), relocation of such Facility to a different location after June 30, 1998, will not result in a new placed in service date for such Facility for purposes of § 45K provided the fair market value of the used property of such Facility is more than 20 percent of such Facility's total fair market value (the cost of the new property plus the value of the used property).

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.

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 § 12.04 of Rev. Proc. 2006-1, 2006-1 I.R.B. 1. However, when the criteria in § 12.05 of Rev. Proc. 2006-1 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,

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

cc: