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Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Index Number: 29.00-00; 702.01-09

Person to contact:

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CC:DOM:P&SI:6-PLR-107568-99
Date: JAN 12 2000

P =

X =

Y =

Z =

Date 1 =

Dear

This letter responds to a letter dated April 9, 1999, and subsequent correspondence, submitted on behalf of P by its authorized representative, requesting rulings under sections 29 and 702 of the Internal Revenue Code.

FACTS

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

P is a limited liability limited partnership. X is the sole general partner of P. X and Y are the limited partners in P. Z is the indirect parent corporation of X. X owns a general partnership interest and a limited partnership interest. Y owns a limited partnership interest.

P is the assignee of three contracts dated Date 1 for the construction of three facilities that produce a fuel from coal fines using the process described below. The construction contracts are valid under state law. Each of the construction contracts

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provides for liquidated damages of at least five percent of the cost of the facility. Each of the construction contracts includes a description of the facility to be constructed, a completion date, and a maximum price. P represents that the facilities were placed in service before July 1, 1998.

X operates and maintains the facility. P will pay X a fixed dollar amount per ton of raw coal fines fed into the facilities adjusted annually for inflation. P will also reimburse X for certain costs.

X will supply the coal fines for the facilities from X's own sources or from a source other than X. P will pay X the cost of the coal fines, the cost of transporting the coal fines, and a fixed dollar amount per ton. The cost of the coal fines supplied from X's own sources will be a market price mutually agreed upon by P and X.

The fuel is being sold to unrelated utilities, power generators, and other third party coal users.

The facilities consist of three production lines. P purchases various qualities and types of coal fines. These fines are blended as necessary and loaded into coal hoppers. The hoppers dump the feedstock onto conveyor belts where it is transported to a pulverizer. The pulverized coal is then transported to a mixer/blender where it is mixed with a hot asphaltic, hydrocarbon binder. After leaving the mixer/blender, the mixture is gravity fed into a briquetter where it is subjected to high pressure. The resulting product is then transported by conveyor to a storage area and is ready for marketing.

P has had experts conduct numerous tests on fuel produced from coal fines using the process. By the preponderance of these tests' results, P and P's authorized representative represent that there is a significant chemical difference between the fuel produced by the process and the coal fines from which the fuel was made.

The Amended and Restated Agreement of Limited Partnership of P provides that the credits against federal income tax with respect to P's operations or property shall be allocated among the partners in accordance with their partners' percentages for the period during which the event giving rise to the credit occurred. In particular, section 29 credits shall be allocated among the partners in accordance with their partners' percentages at the time of the sale of the solid synthetic fuel giving rise to the credits.

RULING REQUESTS #1 AND #2

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

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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)(l)(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)(l)(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-l 00 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).

Based on the representations of P and P's authorized representative, including the preponderance of P's test results, we agree that the fuel to be produced in P's facilities using the process on the coal fines will result from a significant chemical change in coal, transforming the coal fines into a solid synthetic fuel from coal. Because P will own the facilities and because X on behalf of P will operate and maintain the facilities, we conclude that P will be entitled to the section 29 credit for the production of the qualified fuel from the facilities that is sold to an unrelated person.

RULING REQUEST #3

Section 29(d)(5) defines "barrel-of-oil equivalent" with respect to any fuel as that amount of the fuel which has a Btu content of 5.8 million; except that in the case of qualified fuels described in section 29(c)(l)(C), the Btu content shall be determined without regard to any material from a source not described in section 29(c)(l)(C). Section 29(d)(6) defines "barrel" to mean 42 United States gallons.

As required by section 29(d)(5), the Btu content of the qualified fuel produced and sold by P must be determined without regard to any material other than coal. This means that the Btu content of the qualified fuel attributable to any binder material must be disregarded for purposes of calculating the section 29 credit.

RULING REQUEST #4

Sections 29(f)(l)(B) and (f)(2) provide that section 29 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 29(g)(l) modifies section 29(f) in the case of a facility producing qualified fuels described in section 29(c)(l)(C), Section 29(g)(l)(A) provides that for purposes of section 29(f)(l)(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)(l)(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 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. It is represented that the contracts are binding under applicable law and that the contracts provide for liquidated damages of at least five percent of the cost of the facility. Therefore, the contracts are binding written contracts for purposes of section 29(g)(l).

RULING REQUEST #5

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 the property is placed in a condition or state of readiness and availability for a specifically assigned function. Sections 1.167(a)-1 l(e)(l)(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 P's facilities were placed in service.

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RULING REQUEST #6

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, orcorporation.

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-I (a) provides that the distributive share is determined as provided in section 704 and section 1.704-I.

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-I (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-I (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-I (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).

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Based on the information submitted and the representations made, we conclude that, assuming the solid synthetic fuel produced qualifies for the section 29 credit, the credit will be allowed to P and the credit may be passed through to and allocated to the partners of P under the principles of section 702(a)(7) in accordance with each partner's interest in P as of the time the tax credit arises, We express no opinion, however, regarding how the partners' interests in P are determined.

RULING REQUEST #7

Section 708(b)(l)(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 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 for 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)(l)(B) occurring on or after May 9, 1997.

The placed-in-service deadline in sections 29(f)(l)(B) and 29(g)(l)(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)(l)(B) and 29(g)(l)(A) focus on the facility, and not the taxpayer owning the facility.

Section 29(g)(2) demonstrates that Congress knows how to preclude transferees of facilities from claiming the section 29 credit. That provision provides that extension of the period for placing facilities in service after 1992 does not apply to any facility that produces coke or coke gas unless the original use of the facility commences with the taxpayer.

Accordingly, the determination of whether a facility has satisfied the placed-in-service deadline under sections 29(f)(l)(B) and 29(g)(l)(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.

CONCLUSIONS

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

(1) P, with use of the process, will produce a "qualified fuel" within the meaning of section 29(c)(l)(C);

(2) P will be entitled to the section 29 credit for the production of the qualified fuel from the facilities that is sold to an unrelated person;

(3) the Btu content of the qualified fuel produced and sold by P will be determined without regard to any material from a source not described in section 29(c)(l)(C) as required by section 29(d)(5);

(4) each of the contracts for construction of the facilities constitutes a "binding written contract" within the meaning of section 29(g)(l)(A);

(5) each of P's facilities is "placed in service" for purposes of section 29(g)(l) on the date that the facility was first placed in a condition or state of readiness and availability to produce qualified fuel, as provided in sections 1.46-3(d)(1)(ii) and 1.167(a)-11(e)(1)(i) (we express no opinion on when the facilities were placed in service);

(6) the credit allowed under section 29 may be passed through to and allocated among all the partners in P in accordance with the principles of section 702(a)(7); and

(7) any termination of P under section 708(b)(l)(B) arising from prior sales or exchanges of interests in P will not preclude P from taking the section 29 credit for the production of the qualified fuel from the facilities that is sold to an unrelated person.

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 P's facilities were placed in service for purposes of section 29 or how the partners' interests in P are determined.

This ruling is directed only to the taxpayer who requested it. Section 611 O(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. 99-1, 1999-1 I.R.B. 6, 47.

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However, when the criteria in section 12.05 of Rev. Proc. 99-1 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 P's authorized representative.

Sincerely yours,

Charles B Ramsey

CHARLES B. RAMSEY
Branch Chief, Branch 6
Office of Assistant Chief Counsel
(Passthroughs and Special Industries)

Enclosure:
Copy for section 61 10 purposes