Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Person To Contact:
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Refer Reply To:
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Date:
November 7, 2003

LEGEND:

Taxpayer	=
Parent	=
Subsidiary A	=
Subsidiary B	=
Company	=
A	=
B	=
C	=
D	=
Date 1	=
Date 2	=

Dear :

This letter responds to a letter dated April 24, 2003, submitted on behalf of Taxpayer by its authorized representative, requesting rulings under section 29 of the Internal Revenue Code.

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

On Date 1, Taxpayer received PLR 102756-02 (the Prior Letter Ruling), which ruled on issues similar to those addressed by this letter. Taxpayer seeks a confirmation of the rulings in the Prior Letter Ruling in light of the completion of the relocation of a synthetic fuel facility (Facility) that produces solid synthetic fuel from coal (Product), the use of an alternative chemical change agent, and certain changes to the production process in the Facility, all as described in the ruling request.

Taxpayer is a limited liability company that is classified as a partnership for federal tax purposes, all of the interests in which presently are owned by Subsidiary A and Subsidiary B. Parent is a publicly traded corporation and the parent of an affiliated group of corporations that includes Subsidiary A and Subsidiary B.

The Prior Ruling stated that Taxpayer has entered into an agreement to purchase all of the interests in the Company, a limited liability company whose sole asset is the Facility. It was represented that the Company is disregarded as a separate entity from Taxpayer for federal tax purposes.

The Facility was constructed pursuant to a construction contract between B and C entered into on Date 2. The construction contract did not limit the amount of damages that either party could seek against the other party in the event of the other party's default under the contract. B obtained 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 Prior Letter Ruling also stated that the Facility was designed and built with equipment that can be readily disassembled and moved to another site to take advantage of a supply of coal or for other business reasons. Pursuant to the purchase agreement, the Facility was relocated to a site described in the ruling request. In connection with the relocation, the Facility was refurbished, and certain parts were replaced. At the site, certain site work and preparation was undertaken to accommodate the relocation of the Facility. A new binder system complete with associated storage, delivery, electrical and instrumentation components was integrated in order to accommodate the use of new chemical change agents. In addition, certain coal and material handling equipment was installed to facilitate the delivery of fuel produced in the Facility to the electric power generating station located at the site.

The Prior Letter Ruling further stated that it is anticipated that certain parts will be replaced on a periodic basis as part of the regular maintenance and upkeep of the Facility. The frequency of this maintenance depends on the coal feedstock used, the

total hours of operation and the volume of production. However, all essential components will be retained and no new essential components will be incorporated into the Facility.

Since the Prior Ruling was issued, Taxpayer has used other chemical change agents in the production of synthetic fuel at the Facility. As described in Taxpayer's letter ruling request, the Facility and the process implemented in the Facility, including the alternative chemical reagent used to produce the synthetic fuel, meet the requirements of Rev. Proc. 2001-34, 2001-22 I.R.B. 1293.

A recognized expert in coal combustion chemistry performed tests on the coal used at the Facility and the product produced at the Facility, including the changed reagents, and has submitted a report in which the expert concludes that significant chemical changes take place with the application of the process to the coal.

The rulings issued in the Prior Letter Ruling, which you wish to be reconfirmed in this letter ruling, are as follows:

1. The contract for construction of the Facility constitutes a "binding written contract in effect before January 1, 1997," within the meaning of section 29(g)(1)(A);

2. Taxpayer, with the use of the enumerated process, will produce a "qualified fuel" within the meaning of section 29(c)(1)(C);

3. The production of the qualified fuel from the Facility will be attributable solely to Taxpayer, entitling Taxpayer to the section 29 credit for the production of the qualified fuel from the Facility that is sold to an unrelated person;

4. If the 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, 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 section 29 provided the fair market value of the original property is more than 20 percent of the Facility's total fair market value at the time of the relocation or replacement;

5. The section 29 credit attributable to Taxpayer may be allocated to the members of Taxpayer in accordance with the members' interest in Taxpayer when the credit arises. For the section 29 credit, a member's

interest in Taxpayer is determined based on a valid allocation of the receipts from the sale of the section 29 qualified fuel; and

6. A termination of Taxpayer under section 708(b)(1)(B) will not preclude the reconstituted partnership from claiming the section 29 credit on the production and sale of synthetic fuel to unrelated persons.

The changes in facts since the issuance of the Prior Letter Ruling are the completion of the relocation of the Facility, the use of an alternative chemical change agent, and certain changes to the production process in the Facility, all as described in the ruling request. The above rulings are not affected by these changed facts.

To qualify for the section 29 credit, a 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. Treasury Regulation §§ 1.167(a)-11(e)(1)(i) and 1.46-3(d)(1)(ii). "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.

Revenue Procedure 2001-30, 2001-19 I.R.B. 1163, provides that "a facility (including one of multiple facilities located at the same site) may be relocated without affecting the availability of the credit if all essential components of the facility are retained and the production capacity of the relocated facility is not significantly increased at the new location."

Revenue Ruling 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 twenty percent of the facility's total value (the cost of the new property included in the facility 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 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 section 29

provided the fair market value of the property used at the original facility is more than twenty percent 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 property used at the original facility).

Rev. Rul. 94-31 describes a windfarm that consists of an "array of wind turbines, towers, pads, transformers, roadways, fencing, on-site power collection systems, and monitoring and meteorological equipment." Notwithstanding that the windfarm consisted of all of these items, the ruling concludes that the "facility" for purposes of section 45 is confined to "the property on the windfarm *necessary for the production* of electricity from wind energy" (emphasis added). The present situation is similar to Rev. Proc. 94-31. Thus, for purposes of determining a Facility's total fair market value at the time of relocation or replacement, a Facility consists of the process equipment directly necessary for the production of the qualified fuel, starting at the immediate input of the coal and chemical reagents to the pug mills or mixers (including any coal hoppers and reagent tanks directly feeding the pug mills or mixers) through the output from the roll briquetters or other forming equipment (including output hoppers, if any). Hence, each Facility's total fair market value includes the process equipment such as pugmills or mixers, the roll briquetters or other forming equipment, the equipment necessary to interconnect such equipment, the electrical, instrumentation, control systems and auxiliaries related to such equipment (including the structures that house such electrical, instrumentation and control systems), the foundation platform(s) for the above-referenced equipment, and an appropriate allocation of the engineering, project management, overhead, and other costs assignable to the relocation of such equipment and construction. A Facility's total fair market value does not include costs associated with the purchase and installation of equipment that supports the operation of the Facility but is not directly necessary for the production of qualified fuel, such as coal beneficiation or preparation equipment (e.g., crushers, screens, dryers or scales), other material handling or conveying equipment (e.g., stacking tubes, transfer towers, storage bunkers, mobile equipment or conveyors), certain site improvements (e.g., fencing, lighting, earthwork or paving), separate office and bathhouse trailers for facility personnel, and buildings (if a "building" for purposes of section 168), and other administrative assets. Sampling and quality control are necessary for operational control of a production facility. However, a particular type of sampling equipment generally is not necessary for the production of qualified fuel. Thus, the costs of sampling equipment are excluded from the Facility's total fair market value unless the particular sampling equipment is necessary for operational control of the facility.

Based on the information submitted and representations made, including the preponderance of the test results, we agree that the fuel to be produced in the Facility using the described process on the coal will result in a significant chemical change in coal, transforming the coal feedstock into a solid synthetic fuel.

Accordingly, based on the information submitted and the representations made, we conclude as follows:

1. The contract for construction of the Facility constitutes a "binding written contract in effect before January 1, 1997," within the meaning of section 29(g)(1)(A);
2. Taxpayer, with the use of the enumerated process, will produce a "qualified fuel" within the meaning of section 29(c)(1)(C);

3. The production of the qualified fuel from the Facility will be attributable solely to Taxpayer, entitling Taxpayer to the section 29 credit for the production of the qualified fuel from the Facility that is sold to an unrelated person;

4. If the 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, 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 section 29 provided the fair market value of the original property is more than 20 percent of the Facility's total fair market value at the time of the relocation or replacement;

5. The section 29 credit attributable to Taxpayer may be allocated to the members of Taxpayer in accordance with the members' interests in Taxpayer when the credit arises. For the section 29 credit, a member's interest in Taxpayer is determined based on a valid allocation of the receipts from the sale of the section 29 qualified fuel; and

6. A termination of Taxpayer under section 708(b)(1)(B) will not preclude the reconstituted partnership from claiming the section 29 credit on the production and sale of synthetic fuel to unrelated persons.

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 facility or facilities that are the subject of this letter, (ii) obtain regular reports from independent laboratories that have analyzed the fuel produced in such facility or 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 Taxpayers obtain 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 section 12.04 of Rev. Proc. 2003-1, 2003-1 I.R.B. 1, 50. However, when the criteria of section 12.05 of Rev. Proc. 2003-1 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 Taxpayer and to a second authorized representative.

Sincerely,

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

Enclosure:
Copy for § 6110 purposes

cc: