

Internal Revenue Service

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Washington, DC 20224

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Person To Contact:

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CC:PSI:B07 – PLR-132596-03

Date:

November 13, 2003

LEGEND:

A =

B =

C =

D =

E =

Date 1 =

Date 2 =

Reagent X =

Reagent Y =

Reagent Z =

Dear :

This letter responds to a letter, dated May 8, 2003, submitted on behalf of A by its authorized representative, requesting a ruling under § 29 of the Internal Revenue Code.

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

A is a Delaware limited liability company that is classified as a disregarded entity for federal tax purposes. A owns a facility that processes coal feedstock into solid synthetic fuel (Facility). B is a Delaware limited liability company and owns all of the membership interest in A. B is classified as a disregarded entity for federal income tax purposes. C is a Delaware limited partnership and owns all of the membership interest in B. Because B is treated as a disregarded entity for federal tax purposes, C is treated

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as owning B's membership interest in A. Because A is treated as a disregarded entity for federal tax purposes, C is treated as owning all of the assets of A.

D, a Delaware limited liability company, owns a 99.9% limited partnership interest in C. E, a Massachusetts corporation, owns a 0.1% general partnership interest in C.

On Date 1, A received PLR-147521-02 (Initial Ruling) stating, among other things, that the "synthetic fuel produced by the Facility is a solid synthetic fuel produced from coal feedstock that differs significantly in chemical composition from the coal from which it is produced and thus constitutes a 'qualified fuel' within the meaning of § 29(c)(1)(C)." The Initial Ruling was issued in response to a private letter ruling request submitted on Date 2 (Prior Request).

A seeks confirmation of the Initial Ruling in light of A's potential use of alternative chemical reagents. In both the Prior Request and the current request for rulings, A described the process which occurs in the Facility to consist of the following steps: (i) thoroughly mixing coal feedstocks with a chemical reagent in a mixer/blender auger, (ii) feeding metered amounts of the coal feedstock and chemical reagent mixture into a roll briquetter, and (iii) compressing the mixture into synthetic fuel.

As stated in the Prior Request and approved in the Initial Ruling, A produces synthetic fuel using a chemical reagent known as Reagent X. Recently, A became aware that the U.S. Patent Office is expected to issue a patent to certain third parties for the process of producing synthetic fuel using a chemical reagent that includes one of the ingredients that has been included in Reagent X. A's continued use of Reagent X might infringe the third parties' patent, if valid. Accordingly, it may be necessary for A to use an alternative chemical reagent. Therefore, A has tested Reagent Y and Reagent Z.

In connection with this proposed change in chemical reagent, A has represented that the use of a new chemical reagent will not increase the production output of the Facility.

A has engaged recognized experts in coal combustion chemistry to conduct tests on synthetic fuel samples produced by the Facility using each reagent described in the request for rulings. These tests are described in A's letter ruling request. Based on this testing of the reagents, the experts have concluded that there was a measurable, significant change in the chemical composition of the resulting synthetic fuel compared to the unreacted coal feedstocks and chemical reagent.

Other than the potential use of alternative chemical reagents, A has not made and does not contemplate making any material changes to the facts, representations, or

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documents as represented in the Prior Request. As described, the Facility and the process implemented in the Facility satisfy the requirements of Rev. Proc. 2001-34, 2001-22 I.R.B. 1293.

ANALYSIS

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 Service ruled that the definition of the term “synthetic fuel” under § 48(l) and its regulations is relevant to the interpretation of the term under § 29(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 must “differ 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) of the Income Tax Regulations.

In Rev. Proc. 2001-30, 2001-1 C.B. 1163, the Service announced that it will resume issuance of rulings under § 29(c)(1)(C) for processes that do not go beyond the processes approved in the rulings issued prior to 2000.

Section 3 of Rev. Proc. 2001-34 provides that the Service will issue rulings that a solid fuel (other than coke) produced from coal is a qualified fuel under § 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 (C₉H₇N) or other organic resin and left to cure for several days, (c) with ultra heavy hydrocarbons, or (d) with an aluminum and/or magnesium

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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 the omission of this procedure will not significantly increase the production of the facility over the remainder of the period during which the § 29 credit is allowable.

Based on the representations of 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 from coal. Therefore, we further conclude that A, by using the process and reagents described in the request for rulings and the Facility, produces a solid synthetic fuel from coal that constitutes a "qualified fuel" within the meaning of § 29(c)(1)(C).

CONCLUSION

Based solely on the information and representations submitted with the supplemental ruling request, we conclude as follows:

The use of alternative chemical reagents, Reagent Y or Reagent Z, in the production of synthetic fuel by the Facility will have no adverse effect on the rulings contained in the Initial Ruling and the synthetic fuel produced by the Facility using either of these reagents is a solid synthetic fuel produced from coal feedstock that differs significantly in chemical composition from the coal from which it is produced and thus constitutes a "qualified fuel" within the meaning of § 29(c)(1)(C).

The conclusions drawn and rulings given in this letter are subject to the requirements that the taxpayer (i) maintain sampling and quality control procedures that conform to ASTM or other appropriate industry guidelines at the facility that is the subject of this letter, (ii) obtain regular reports from independent laboratories that have analyzed the fuel produced in such facility 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.

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

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conclusion in this ruling. See § 12.04 of Rev. Proc. 2003-1, I.R.B. 2003-1. However, when the criteria in § 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 A's authorized representative.

Sincerely yours,

/s/

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

Enclosure:

Copy for § 6110 purposes