

Y formed a limited liability company, P, to purchase a synthetic fuel facility (the "Facility") that produces a solid synthetic fuel from coal (the "Product") from A. P has elected to be treated as a partnership for federal income tax purposes. The partners of P are V, W, and Z. Z is a wholly owned subsidiary of W, which is a wholly owned subsidiary of Y, which in turn is a wholly owned subsidiary of U. W, Y, and Z file a consolidated federal income tax return with U, which is the parent of the affiliated group. Z has control of the day-to-day management of P. Y has extensive experience in energy, coal, and related businesses.

On Date 2, W sold a% interest in P to X. Following the closing of the sale X owned a%, W owned b%, and Z owned c% of P. In exchange for a% interest in P, X paid to W an amount of cash at closing and X is obligated to make certain fixed and variable payments to W. P provided projections based on expected operations that the net present value of the contingent payments to be made to W under the Agreement for Purchase of Membership Interest are less than fifty percent of the total payments made to W.

Certain adjustments, repairs and improvements have been made to the Facility, material preparation, handling and sampling systems, and the site. P has provided an expert report which states that many of these adjustments, repairs and improvements are not part of the Facility necessary to produce synthetic fuel. The expert report concludes that the remaining adjustments, repairs and improvements to the Facility necessary to produce synthetic fuel do not affect the production capacity of the Facility.

On Date 4, the Facility was relocated from Site 1 to Site 2. In connection with the relocation of the Facility, most major components of the Facility directly necessary to produce a qualified fuel, owned by B and C and made available to P under an Easement and Services Agreement, were relocated to Site 2. Certain equipment included in the original construction, including the drying oven and chemical reagent application system, were not relocated. A new chemical reagent application system was installed in the Facility at Site 2. In connection with the relocation, P also installed certain equipment, such as a maintenance building, a building to house the Facility, and certain coal preparation and material handling equipment, which are not directly necessary for the production of qualified fuel. Following the relocation, the fair market value of the original property included in the Facility was more than 20% of the Facility's total value (the cost of the new equipment included in the Facility plus the value of the original property).

P has entered into a Synthetic Fuel and Coal Supply Agreement with B under which B will purchase the Product from P.

On Date 5, X sold an a% membership interest in P to V pursuant to an Agreement for Purchase of Membership Interest. Following the closing of the sale, V owned a%, Z owned c%, and W owned b% of the membership interests in P. In exchange for the membership interests in P, V paid to X an amount of cash at closing

and V is obligated to make certain fixed and variable payments to X. P has provided projections based on expected operations that the net present value of the contingent payments to be made to X under the Agreement for Purchase of Membership Interest will be less than fifty percent of the total payments made to X. In connection with the sale, P entered into an Operation and Maintenance Agreement with T (a wholly-owned subsidiary of Y) for the operation and maintenance of the Facility. Z continues to control day-to-day management of P.

On Date 6, Z agreed to sell a d% membership interest in P to W. The closing of this sale is conditioned upon the receipt of this private letter ruling and the sale will result in a technical termination of P under § 708(b)(1)(B). Following the closing of the sale, W will own e%, Z will own f%, and V will own a% of the membership interests in P.

As members of P, V, W, and Z have made (and are expected to continue to make) periodic capital contributions to P to enable it to pay its operating costs and other obligations. A proforma attached to the ruling request demonstrates that project expenses are expected to exceed revenues.

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 Facility, including changes made to the Facility. P received signed Forms 870-PT from the Service which closed the audit and concluded that P's Facility was placed-in-service prior to July 1, 1998, pursuant to a binding written contract in effect before January 1, 1997.

P has supplied a detailed description of the process employed at the Facility. As described, the Facility and the process implemented in the Facility, including the alternative chemical reagents, meet the requirements of Rev. Proc. 2001-34, 2001-22 I.R.B. 1293. A recognized expert in combustion, coal, and chemical analysis has performed numerous tests on the coal used at the Facility and the Product produced at the Facility and has submitted reports in which the expert concludes that significant chemical changes take place with the application of the process to the coal, including the alternative chemical reagents. P, with use of the process, expects to maintain a level of chemical change in the production of the Product that is determined through similar analysis by experts to be a significant chemical change.

The remaining facts are the same as stated in the Prior Ruling. The Prior Rulings that you wish to be reconfirmed in this private letter ruling are as follows:

(1) P, with use of the enumerated process and the specified chemical reagents, will produce a "qualified fuel" within the meaning of § 29(c)(1)(C) of the Code.

(2) The Construction Contract constitutes a "binding written contract in effect before January 1, 1997" within the meaning of § 29(g)(1)(A) of the Code.

(3) The Facility is "placed in service" for the purposes of § 29(g)(1) on the date that the Facility was first placed in a condition or state of readiness and availability to produce qualified fuel.

(4) The production of qualified fuel from the Facility will be attributable solely to P within the meaning of § 29(a)(2)(B) of the Code, and P will be entitled to the § 29 credit for qualified fuel from the Facility that is sold to unrelated persons.

(5) The § 29 credit attributable to P may be allocated to the members of P in accordance with the members' interests in P when the credit arises. For the allocation of the § 29 credit, a member's interest in P is determined based on a valid allocation of P's income that arises from the receipts from the sale of the § 29 qualified fuel.

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

(7) Because the Service has determined (taking into account any relocation or replacement of parts prior to Date 3) that the Facility was "placed in service" prior to July 1, 1998 within the meaning of § 29(g)(1), relocation of the Facility to a different location after Date 3, 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 § 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 relocation or replacement.

The only factual changes that have occurred since the issuance of the Prior Ruling are the sale of membership interests in P to X, W and V and the relocation of the Facility as described in the ruling request.

The above rulings are not affected by the sale of membership interests in P to X, W and V or the relocation of the Facility as described in the ruling request.

RULING REQUEST 1

Consistent with its private letter ruling practice that began in the mid 1990's, 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 asserting 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 expert test results submitted by P and its Members, we conclude that the synthetic fuel produced at the Facility using the described process and specified chemical reagents is a solid synthetic fuel produced from coal constituting a "qualified fuel" within the meaning of § 29(c)(1)(C). Because P owns the Facility and operates and maintains the Facility through its agent, we conclude that P will be entitled to the § 29 credit for the production of the qualified fuel from the Facility that is sold to an unrelated person.

RULING REQUEST 3

To qualify for the § 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. Although § 29 does not define "placed-in-service," the term has been defined for the purposes of the deduction for depreciation and the investment tax credit. For these purposes, property is deemed to have been "placed-in-service" in the taxable year that 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.

Accordingly, P's Facility will be deemed to have been "placed-in-service" for purposes of § 29(g)(1) on the date that the Facility was first placed in a condition or state of readiness and availability to produce a qualified fuel. As discussed above, the issue regarding when the Facility was placed-in-service was subject to examination. The Service determined, without mutual concessions, that P's Facility was placed-in-service prior to July 1, 1998, pursuant to a binding written contract in effect before January 1, 1997. It is the policy of the Service that such determinations are not reconsidered absent extraordinary circumstances (for example fraud or misrepresentation). See IRC § 6224(c).

RULING REQUEST 6

Section 708(b)(1)(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)(4) 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)(4) applies to terminations of partnerships under § 708(b)(1)(B) occurring on or after May 9, 1997. As discussed above, the placed in service deadline in § 29(f)(1)(B) and 29(g)(1)(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 §§ 29(f)(1)(B) and 29(g)(1)(A) focus on the facility, and not the taxpayer owning the facility. Accordingly, the placed in service deadline under § 29(f)(1)(B) and 29(g)(1)(A) is determined by reference to when the facility is first placed in service. Therefore, because the Facility was “placed in service” prior to July 1, 1998 within the meaning of § 29(g)(1), the sale of the Facility after June 30, 1998 will not result in a new placed in service date for the Facility for purposes of § 29 for the new owner. Further, a termination of P under § 708(b)(1)(B) will not preclude the reconstituted partnership from claiming the § 29 credit on the production and sale of synthetic fuel to unrelated persons.

RULING REQUEST 7

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 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 § 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, because the Facility was placed in service prior to July 1, 1998, within the meaning of § 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 or otherwise prevent the Facility from continuing to be treated as originally placed in service prior to July 1, 1998, if the fair

market value of the property used at the original facility is more than 20 percent of the Facility's total market value immediately following the 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 § 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. Rul. 94-31. Thus, for purposes of determining the 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 briquetters or other forming equipment (including output hoppers, if any). Hence, the Facility's total fair market value includes the process equipment such as pugmills or mixers, the 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. The 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 the 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, paving), separate office and bathhouse trailers for facility personnel, and buildings (if a "building" for purposes of § 168 of the Code), 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.

Consistent with the holding in Rev. Rul. 94-31, because the Service has determined on examination (taking into account any relocation or replacement of parts prior to Date 3) that P's Facility was "placed in service" prior to July 1, 1998, within the

meaning of § 29(g)(1), relocation of the Facility to a different location after Date 3, or replacement of part of the Facility after that date, will not result in a new placed in service date for the Facility for purposes of § 29, provided the fair market value of the original property is more than 20% 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 used property).

CONCLUSIONS

Accordingly, based on the representations of P and P's authorized representatives, we reissue the Prior Rulings:

(1) P, with use of the enumerated process and the specified chemical reagents, will produce a "qualified fuel" within the meaning of § 29(c)(1)(C) of the Code.

(2) The Construction Contract constitutes a "binding written contract in effect before January 1, 1997" within the meaning of § 29(g)(1)(A) of the Code.

(3) The Facility is "placed in service" for the purposes of § 29(g)(1) on the date that the Facility was first placed in a condition or state of readiness and availability to produce qualified fuel.

(4) The production of qualified fuel from the Facility will be attributable solely to P within the meaning of § 29(a)(2)(B) of the Code, and P will be entitled to the § 29 credit for qualified fuel from the Facility that is sold to unrelated persons.

(5) The § 29 credit attributable to P may be allocated to the members of P in accordance with the members' interests in P when the credit arises. For the allocation of the § 29 credit, a member's interest in P is determined based on a valid allocation of P's income that arises from the receipts from the sale of the § 29 qualified fuel.

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

(7) Because the Service has determined (taking into account any relocation or replacement of parts prior to Date 3) that the Facility was "placed in service" prior to July 1, 1998 within the meaning of § 29(g)(1), relocation of the Facility to a different location after Date 3, 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 § 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 relocation or replacement.

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 the 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 § 11.04 of Rev. Proc. 2005-1, 2005-1 I.R.B. However, when the criteria in § 11.06 of Rev. Proc. 2005-1 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
(Passthroughs & Special Industries)

cc: