Internal Revenue Service

Number: **200726007**
Release Date: 6/29/2007
Index Number: 45K.00-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

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Refer Reply To:
CC:PSI:B07
PLR-154760-06
Date: March 29, 2007

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Dear:

This letter is in response to your letter of Date 1, submitted on behalf of P, requesting rulings under section 29 (redesignated as section 45K) of the Internal Revenue Code.

FACTS:

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

Company is a limited liability company classified disregarded as an entity separate from P for federal income tax purposes. Company is the current owner of a synthetic fuel production facility (Facility).

P is a State limited liability company classified as a partnership for federal income tax purposes. P is owned entirely by A and B, which are indirect wholly owned subsidiaries of the Parent of an affiliated group of corporations.

On Date 2, P acquired all of the membership interests in Company from X and Y pursuant to a Purchase Agreement. Upon acquisition of all of the membership interests in the Company by Taxpayer, Company became a disregarded entity for federal income tax purposes. As a result, while Company owns the Facility, Taxpayer is treated as the owner of the Facility for federal income tax purposes. The Facility was previously owned by Z, and was transferred to Company prior to Taxpayer acquiring all of the membership interests in Company.

Under the Purchase Agreement, P agreed to make certain fixed and variable payments to X and Y. P has provided projections based on expected operations that the net present value of the contingent payments to be made to X and Y under the Agreement are less than fifty percent (50%) of the total payments made to X and Y.

The Facility was constructed pursuant to a Construction Contract between C and D entered into on Date 3. C constructed and completed the Facility in Date 4 at Site 1. The Facility was designed to produce synthetic fuel from coal. The Construction Contract was governed by State 2 law and was binding and enforceable under State 2 law. 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. C constructed and completed the Facility in accordance with the terms and conditions of the Construction Contract.

The Facility was also constructed with equipment that can be disassembled and moved to another site to take advantage of other supplies of coal, potential customers or other business reasons. The Facility's equipment consists primarily of a mixer and a briquetter. In the Process, coal feedstock is conveyed to the mixer by a belt conveyor. A proprietary chemical reagent, which is designed to produce a chemical reaction as

part of the synthetic fuel production process, is then applied to the feedstock coal and thoroughly combined in the mixer. The product then passes through a chute into the briquetter, and is then conveyed to a stockpile.

A recognized expert in coal combustion chemistry and analysis performed numerous tests on the coal used at the Facility and has submitted a report concluding that significant chemical changes take place to the coal with the application of the process to the coal.

The Facility has been relocated a number of times between the date that it was placed in service (Date 4) and the date that it was acquired by P (Date 2). Immediately prior to P's acquisition of the Facility from X and Y, the Facility was located at Site 2. In Date 5, the Facility was relocated to Site 3. P anticipates relocating the Facility again in early 2007. In connection with any relocation, P may repair or replace worn or broken parts. P has represented that these modifications will not significantly increase the production capacity of the Facility or significantly extend the life of the Facility.

P has represented that the fair market value of the original property immediately prior to the relocation to the Current Site or the replacement of parts of the Facility was, and in the case of a relocation to any other site will be, more than twenty percent (20%) of the Facility's total fair market value (the cost of the new property plus the value of the property that was originally placed in service) at the time of the relocation or replacement.

The Service recently completed an audit of the Z's taxable years ending Date 6 and Date 7. In connection with the examination, the Service requested and reviewed information and various documents regarding the placed in service facts of the Facility and the Facility's eligibility for tax credits. Z received a letter executed on Date 8 from the Service that closed the audit with no adjustment to the amount of the § 29 credits claimed (redesignated as section 45K).

P requests the following rulings:

(1) P, with the use of the Process, will produce a "qualified fuel" within the meaning of § 45K(c)(1)(C).

(2) Production from the Facility will be attributable solely to P within the meaning of § 45K(a)(2)(B), entitling P to a credit under § 45K for the production of the qualified fuel from the Facility that is sold to an unrelated person.

(3) Because the Facility was "placed in service" prior to July 1, 1998, within the meaning of § 45K(f)(1), the relocation of the Facility after June 30, 1998, or the 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 § 45K provided that the fair market value of

the original property is more than 20% of the Facility's total fair market value at the time of the relocation or replacement.

RULING REQUESTS 1 & 2

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 produced from coal is a qualified fuel under § 29(c)(1)(C) (redesignated as § 45K(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) (redesignated as § 45K(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, 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) (redesignated as § 45K(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 § 45K credit for the production of the qualified fuel from the Facility that is sold to an unrelated person.

RULING REQUEST 3

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 audited and allowed Z to claim credits under § 29 (redesignated as § 45K) for the production of qualified fuel from the Facility by reaching the conclusion that the Facility was placed in service prior to July 1, 1998 (taking into account any relocation or replacement of parts prior to Date 4) within the meaning of §29(g)(1) (redesignated as § 45K(f)), relocation of the Facility to a different location after Date 4, 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 § 45K, 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 issue the following rulings:

(1) P, with the use of the Process, will produce a “qualified fuel” within the meaning of § 45K(c)(1)(C).

(2) Production from the Facility will be attributable solely to P within the meaning of § 45K(a)(2)(B), entitling P to a credit under § 45K for the production of the qualified fuel from the Facility that is sold to an unrelated person.

(3) Because the Facility was “placed in service” prior to July 1, 1998, within the meaning of § 45K(f)(1), the relocation of the Facility after June 30, 1998, or the 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 § 45K provided that the fair market value of the original property is more than 20% of the Facility’s total fair market value at the time of the 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. 2007-1, 2007-1 I.R.B. 1. However, when the criteria in § 11.06 of Rev. Proc. 2007-1 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
Branch Chief, Branch 7
(Passthroughs & Special Industries)