Internal Revenue Service

Number: **200550026**
Release Date: 12/16/2005
Index Number: 29.00-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B07
PLR-136568-05
Date: September 6, 2005

LEGEND:

Taxpayer =	--	x =	
	----------------------	y =	--
A =	--	z =	----
	----------------------	Site 1 =	-----------------------------
B =	--		
	----------------------	Site 2 =	------------------------------
C =	---	Site 3 =	--------------------------
	----------------------	Year 1 =	-------
D =	--	Date 1 =	---------------------
	---	Date 2 =	------------------------
E =	-----------------	Date 3 =	--------------------------
F =	------------------------------------.	Date 4 =	-------------------
	-----------------------	Date 5 =	-------------------------
G =	--	Date 6 =	--------------------
H =	-----------------------------------	Date 7 =	------------------
J =	--	Date 8 =	----------------
K =	------------------------------	Date 9 =	------------------
	----------------------	Date 10=	-------------
L =	--	PLR 1 =	----------------------
	----------------------	PLR 2 =	----------------------
M =	--		

Dear :

This letter is in response to your letter dated July 7, 2005, submitted on behalf of Taxpayer, requesting rulings under section 29 of the Internal Revenue Code.

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

Taxpayer is a limited liability company that is classified as a partnership for tax purposes. Taxpayer is an accrual method taxpayer with a calendar taxable year. A and B are the members of Taxpayer. A, which owns x percent of Taxpayer, is a limited liability company that, for tax purposes, is disregarded as an entity separate from its single owner C. B owns the remaining y percent of Taxpayer. The sole asset of Taxpayer is its ownership interest in D, a limited liability company which, for federal tax purposes, is disregarded as an entity separate from Taxpayer. D's sole asset is the Facility at issue in this request.

The Facility was constructed in Year 1 for E to serve as a demonstration plant. The Facility began production in Year 1 at Site 1. On Date 1, B contributed the Facility to F, which then moved the Facility to Site 2. On Date 2, B and F received PLR-1, which states:

> Accordingly, based on the representations of Taxpayer and Taxpayer's authorized representative, including the preponderance of Taxpayer's test results, we conclude as follows:
> (1) the fuel to be produced in Taxpayer's facility using the described production process will result from a significant chemical change in coal, transforming the coal fines into a solid synthetic fuel from coal, and thus will be a "qualified fuel" within the meaning of section 29(c)(1)(C); and
> (2) because Taxpayer will own, operate, and maintain the facility and the facility was placed in service after December 31, 1992, Taxpayer will be entitled to the section 29 credit for the production of the qualified fuel from the facility that is sold to an unrelated person before January 1, 2008.

On Date 3, G purchased the Facility from F and contributed it to its subsidiary H. Pursuant to the purchase and sales agreement, the Facility was moved to Site 3. After being tested to ensure that it had been properly reassembled at Site 3, the Facility began production in Date 4.

On Date 5, H received PLR-2, which ruled on the issues addressed by this letter. On Date 6, because H was unable to meet its payment obligations to F, H surrendered possession of the Facility to F. F contributed the Facility to Taxpayer, in exchange for a x percent interest in Taxpayer and the issuance of a y percent interest in Taxpayer for its general partner, B.

On Date 7, A was formed by C to acquire F's interest in Taxpayer. In anticipation of the transaction, Taxpayer contributed the Facility to D in exchange for a total equity interest in D. On Date 8, the sale of F's interest in Taxpayer to A was completed, and the Facility recommenced production on Date 9. The sale of F's interest in Taxpayer to A requires A to make certain fixed and contingent cash payments. Taxpayer represents that the net present value of the fixed payments exceed fifty percent of the total purchase price of the interest in Taxpayer.

The Facility is currently located at Site 3, pursuant to a lease agreement with J, a party unrelated to D. On Date 10, Taxpayer replaced the Facility's briquetter rolls and hydraulic motors due to the effects of normal wear and tear. The Facility continues to utilize all of its original major components. Taxpayer has represented that the fair market value of the original property comprising the Facility is more than 20 percent of the Facility 's total fair market value (the cost of the new property plus the value of the original property). The Facility is operated and maintained on D's behalf by K, pursuant to an Operating Agreement. Under a Synfuel Purchase Agreement, D sells the synthetic fuel produced by the Facility to J.

C plans to transfer a z% membership interest in Taxpayer to L. L is a member of an affiliated group of corporations that file a consolidated federal income tax return with M as its parent. After the transfer L will assume a proportionate amount of the rights and obligations of the members of Taxpayer as specified in the Amended and Restated Limited Liability Company Agreement of Taxpayer.

Taxpayer 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 chemical reagent, 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 synthetic fuel 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. Taxpayer, with use of the process, expects to maintain a level of chemical change in the production of synthetic fuel that is determined through similar analysis by experts to be a significant chemical change.

Taxpayer has requested the following rulings:

1. The replacement of the rollers at the Facility will not result in a new placed in service date for the Facility for purposes of Section 29 provided that the fair market value of the property used at the original Facility continues to be more than 20 percent of the Facility's total fair market value taking into account relocation and replacements (the cost of the new equipment included in the Facility plus the value of the property used at the original Facility).

2. The section 29 credits to which Owner LLC is entitled will pass through and be allocated among members of Owner LLC under the principles of section 702(a)(7) and in accordance with each members' interest in the profits and losses of Taxpayer as provided in the LLC Agreement.

The only factual changes that have occurred since the issuance of the Prior Rulings are the replacement of the Facility's briquetter rolls and hydraulic motors and the proposed sale of an Interest in Taxpayer to L as described in the ruling request.

The Prior Rulings are not affected by the replacement of the Facility's briquetter rolls and hydraulic motors and the proposed sale of an Interest in Taxpayer to L as described in the ruling request.

RULING REQUEST 1

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 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, Taxpayer'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.

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 <u>necessary for the production</u> 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 Taxpayer’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, or replacement of part of the Facility after June 30, 1998, 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).

RULING REQUEST 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 taxpayer.

Section 7701(a)(14) provides that "taxpayer" means any person subject to any internal revenue tax. Generally, under § 7701(a)(1), the term "person" includes an individual, a trust, estate, partnership, association, company, or corporation.

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 1.702-1(a) provides that the distributive share is determined as provided in § 704 and § 1.704-1.

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 1.704-1(b)(4)(ii) provides that allocations of tax credits and tax credit recapture (except for § 38 property) are not reflected by adjustments to the partners' capital accounts. Thus, these allocations cannot have economic effect under § 1.704- 1(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 § 1.704-1(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).

Based on the information submitted and the representations made, we conclude that the credit will be allowed to Taxpayer and the credit may be passed through to and allocated among the members of Taxpayer under the principles of § 702(a)(7) in accordance with each member’s interest in Taxpayer as of the time the credit arises. For purposes of the § 29 credit, a member's interest in Taxpayer is determined based on a valid allocation of the receipts from the sale of the § 29 qualified fuel.

CONCLUSIONS

Accordingly, we conclude as follows:

1. The replacement of the rollers at the Facility will not result in a new placed in service date for the Facility for purposes of Section 29 *provided* that the fair market value of the property used at the original Facility continues to be more than 20 percent of the Facility's total fair market value taking into account relocation and replacements (the cost of the new equipment included in the Facility plus the value of the property used at the original Facility).

2. The section 29 credits to which Owner LLC is entitled will pass through and be allocated among members of Owner LLC under the principles of section 702(a)(7) and in accordance with each members' interest in the profits and losses of Taxpayer as provided in the Taxpayer's LLC Agreement.

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, I.R.B. 2005-1. 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 representative.

Sincerely,

/s/
Joseph H. Makurath
Senior Technician Reviewer, Branch 7
(Passthroughs & Special Industries)