

**Office of Chief Counsel
Internal Revenue Service
Memorandum**

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date: May 11, 2009

to: Associate Area Counsel (Detroit)
(Large & Mid-Size Business)
Attn: Katy Lin

from: Branch Chief, Branch 7
(Passthroughs & Special Industries)

subject: Application of I.R.C. § 40(g)(1)

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

LEGEND

Taxpayer =

Taxable Year =

Month A =

Month B =

Month C =

Month D =

Month E =

A Gallons =

B Gallons =

C Gallons =

D Gallons =

E Gallons =

F Gallons =

G Gallons =

Gallons per Month =

\$ =

ISSUE

Whether Taxpayer's Facility had a productive capacity for alcohol in excess of 60,000,000 gallons during Taxable Year for purposes of the small ethanol producer credit under § 40(b)(4) of the Internal Revenue Code (the Code).

CONCLUSIONS

Taxpayer's Facility did not have a productive capacity for alcohol in excess of 60,000,000 gallons during Taxable Year for purposes of the small ethanol producer credit under § 40(b)(4) of the Code.

FACTS

Based on the facts provided, Taxpayer is a calendar year filer that owned one ethanol production facility (Facility) in Taxable Year. The engineered boilerplate capacity of the Facility was A Gallons, which is less than 60,000,000 gallons. In Month A of Taxable Year, Taxpayer received from the Environmental Protection Agency (EPA), through the relevant State agency responsible for regulating environmental quality, a "Permit Limit Production Capacity Rating" limiting Taxpayer's ethanol production at the Facility to B Gallons, which is less than 60,000,000 gallons. Taxpayer began production of ethanol in Month B of Taxable Year. During Taxable Year, Taxpayer produced a total of C Gallons of ethanol. (Its monthly production was Gallons per Month.)

During the second quarter of the year after Taxable Year, Taxpayer determined that its actual capacity at the Facility could exceed both the A Gallons engineered boilerplate capacity and the B Gallons EPA ethanol production capacity rating. Taxpayer applied for and received in Month C of the year after Taxable Year a revised EPA "Permit Limit

Production Capacity Rating" limiting Taxpayer's ethanol production to D Gallons, a number of gallons in excess of 60,000,000 gallons. Other than routine repairs and maintenance, there were no upgrades at the Facility during Taxable Year or the year after Taxable Year that would result in the increased capacity.

In Month D of the year after Taxable Year, Taxpayer filed its Taxable Year tax return and claimed a small ethanol producer credit of \$ for E Gallons of ethanol. Thus, at the time Taxpayer claimed the credit on its Taxable Year return, Taxpayer had actual knowledge that its Facility had a production capacity in excess of 60,000,000 gallons. Taxpayer did not claim a small ethanol producer credit for the year after Taxable Year. Taxpayer chose not to provide any additional facts or arguments for Counsel review.

LAW AND ANALYSIS

Section 40(a)(3) of the Code allows, in the case of an eligible small ethanol producer, the small ethanol producer credit.

Section 40(b)(4)(A) provides that the small ethanol producer credit of any eligible small ethanol producer for any taxable year is 10 cents for each gallon of qualified ethanol fuel production of such producer. Section 40(b)(4)(B) provides that "qualified ethanol fuel production" means any alcohol that is ethanol that is produced by an eligible small ethanol producer, and which during the taxable year is sold for use or used by the producer in certain specified uses. Section 40(b)(4)(C) limits the small ethanol producer credit to 15,000,000 gallons for any taxable year.

Section 40(g)(1) provides that "eligible small ethanol producer" means a person who, at all times during the taxable year, has a productive capacity for alcohol not in excess of 60,000,000 gallons. Section 40(g)(2) provides that for purposes of the 15,000,000 gallon limitation of section 40(b)(4)(C) and the 60,000,000 gallon limitation of section 40(g)(1), all facilities under common control or ownership should be treated as one person. Section 40(g)(3) provides that the rules of §§ 40(b)(4)(C) and 40(b)(1) are applied at the entity level and at the partner level.

Taxable Year was Taxpayer's first year of operation at the Facility. During Taxable Year, Taxpayer actually produced less than 60,000,000 gallons of ethanol. During Taxable Year, Taxpayer was limited by the EPA "Permit Limit Production Capacity Rating" to less than 60,000,000 gallons. During Taxable Year, Taxpayer was limited by the engineered boilerplate capacity to less than 60,000,000 gallons. Taxpayer realized during the second quarter of the year after Taxable Year that its actual capacity could exceed the EPA capacity, the engineered boilerplate capacity, and the statutory 60,000,000 gallon capacity limitation. Taxpayer knew this before it filed its Taxable Year return and claimed the small ethanol producer credit of \$. However, there is no evidence that Taxpayer had actual knowledge at any point during Taxable Year that its actual capacity could exceed the statutory 60,000,000 gallon capacity limitation. For

example, during Taxable Year, Taxpayer produced the most ethanol in Month E, with F Gallons. If Taxpayer had produced F Gallons each month during Taxable Year (F Gallons x 12), it would have produced G Gallons, which is less than the statutory limit. Thus, during Taxable Year, despite its subsequent knowledge, Taxpayer did not have a productive capacity for alcohol in excess of 60,000,000 gallons if the conditions of § 40(g)(3) have also been met.

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Please call (202) 622-3130 if you have any further questions.