Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Number: **200309024**
Release Date: 2/28/2003
Index Number: 29.00-00

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:B07-PLR-139669-02
Date:
November 22, 2002

Legend:

P =
A =
B =
C =
D =
E =
F =
F1=
G =
H =
I =
J =
K =
L =
v =
x =
y% =
z % =
aa% =
bb% =
cc% =
State Y =
$A =
$B =
Date 1 =
Date 2 =
Date 3 =
Date 4 =
Date 5 =

Dear :

This letter responds to a letter dated July 19, 2002 and subsequent correspondence submitted on behalf of P by its authorized representative, requesting rulings under sections 29 and 702 of the Internal Revenue Code.

FACTS

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

P is a limited liability company formed for the purpose of acquiring, relocating and operating three separate facilities ("Facility" or "Facilities") for the production of synthetic fuel from coal. On Date 1, P received PLR 2002-09-044, which rules on issues similar to those addressed by this letter. P seeks a confirmation of the rulings in light of the relocation of one of the three Facilities from the x site to the v site and the constructive termination of P caused by the transfer of B's entire Class A interest in P to an affiliate, as described in the ruling request and subsequent correspondence by P's authorized representative.

P is classified as a partnership for federal income tax purposes. The initial members of P were A and B. A is a limited liability company that has elected to be classified as an association taxable as a corporation for federal income tax purposes. A and B are wholly-owned (directly or indirectly) subsidiaries of C, which is engaged in a number of businesses, directly and through affiliates, including strategic investments in the energy sector.

On Date 2, D sold the Facilities to P for a fixed dollar amount, paid in full in cash at closing. A and B, the members of P at that time, made capital contributions in cash to P in accordance with their ownership interests in an amount required to acquire and relocate the Facilities.

Prior to Date 3, A held a bb% interest in P and B held a cc% interest in P. On Date 3, the limited liability company agreement of P was amended and restated in its entirety, creating two classes of membership interests, a Class A interest and a Class B interest. A's interest was reclassified as a Class A interest, and B's interest was reclassified and divided into a Class A and Class B interest.

In two related transactions occurring on Date 3 and Date 4, J, a corporation unrelated to A or B, agreed to purchase the entire Class B interest owned by B for a fixed amount in cash plus contingent payments over time. The fixed portion, which has already been paid by J, is $A. The contingent payments, subject to a limitation, will equal $B for each dollar of section 29 tax credits allocated to a holder of the Class B interest. P represents that the fixed payment made by J exceeds 50 percent of the net present value of the total consideration payable by J to B in connection with the acquisition of the Class B interest.

After the transactions occurring on Date 3 and Date 4, the sharing ratio for the Class A interest equaled y% and the sharing ratio for the Class B interest equaled z%. After the relocation of the Facility to the v site, the sharing ratio for the Class A interest will equal y% + aa% and the sharing ratio of the Class B interest will equal z% - aa%. Each member of P has made (and will continue to make) periodic cash capital contributions to P to pay such member's share of the operating losses of P. In general, items of income, gain, loss deduction and credit are allocated to the members of P in accordance with their applicable sharing ratios.

The acquisition by J of its interest in P did not result in a termination of P pursuant to section 708(b)(1)(B). However, after receiving this private letter ruling, B intends to transfer all of its Class A interest to an affiliate, which will cause a termination of P pursuant to section 708(b)(1)(B).

D entered into separate construction contracts on Date 5 with general contracting firms to build the Facilities. The construction contracts were for synthetic fuel production facilities for producing solid synthetic fuel that was a "qualified fuel" within the meaning of section 29(c)(1)(C). P has provided an opinion of counsel that each of the construction contracts was a legal, valid and binding obligation of D under applicable state law as of Date 5. In addition, each of the construction contracts (i) provided for liquidated damages of at least five percent of the contract price, (ii) included a description of the Facility to be constructed, (iii) provided for a completion date, and (iv) provided for a maximum price. P has represented that each of the Facilities was placed in service within the meaning of section 29(g)(1)(A) before July 1, 1998.

As described in the ruling request and subsequent correspondence from P's authorized representative, each of the Facilities consists of a high-speed mixer, a ribbon blender and two pellet mills. In the process by which synthetic fuel is produced in the Facilities, coal feedstock and a chemical reagent are mixed in the high-speed mixer and transported by gravity feed to the ribbon blender. The ribbon blender provides additional blending and then distributes the mixture to the two pellet mills for final processing and delivery to the finished product conveyor belt.

The coal-based synthetic fuel originally produced in the Facilities by D was not commercially viable. As a result, D began using different chemical reagents to produce marketable synthetic fuels.

With respect to the installation and operation of the Facilities at the x site, P has entered into a number of auxiliary agreements with F, G, and H, which are unrelated to P.

P contracted with F, an affiliate of D, to reassemble and install the Facilities at the x site located in State Y. P has represented that, following the relocation at the x site, the fair market value of the original property of each Facility is more than 20% of the Facility's total fair market value (the cost of the new property plus the value of the original property).

G owns x and has granted to P a lease at the x site to enable P to reassemble and operate the Facilities. Under the surface lease agreement, P agreed to pay G a fixed monthly rent and an additional rental amount based on the amount of synfuel sold to third parties.

Pursuant to a feedstock supply agreement, H has agreed to sell coal feedstock to P. If H fails to deliver the coal feedstock it is required to deliver, P can purchase its feedstock from other suppliers. P also entered into a synthetic fuel sales agreement with G where G agreed to purchase a minimum amount of synthetic fuel produced at the Facilities each year. If G does not purchase the synthetic fuel it is obligated to purchase, P can sell the synthetic fuel to third parties. Under certain circumstances, G is required to pay liquidated damages for failing to meet its Synfuel purchase obligations. P has represented that all sales of synthetic fuel from the Facilities will be to unrelated persons.

P entered into an agreement with F for the operation and maintenance of the Facilities. F is subject to the direction and control of P, which has the sole authority to set production levels and make other strategic decisions. F is paid a graduated fixed fee (without adjustment for inflation) per ton of synthetic fuel produced in the Facilities. Any capital costs associated with the Facilities will be paid by P and must be authorized by P. F subsequently assigned its right, title and interest in the operation and maintenance agreement to F1, which is also an affiliate of D.

P will relocate one of the Facilities from the x site to the v site, which is also located in State Y. With respect to the installation and operation of the Facility at the v site, P has entered into a number of auxiliary agreements with F1, K, and L, which are unrelated to P.

P contracted with F1 to reassemble and install the Facility at the v site located in State Y. P has represented that, following the relocation at the v site, the fair market value of the original property of the Facility will be more than 20% of the Facility's total fair market value (the cost of the new property plus the value of the original property). K owns v and has granted to P a lease at the site of v to enable P to reassemble and operate the Facility. Under the surface lease agreement, P agreed to pay K a fixed monthly rent and an additional rental amount based on the amount of synfuel sold to third parties.

Pursuant to a feedstock supply agreement, L has agreed to sell coal feedstock to P. If L fails to deliver the coal feedstock it is required to deliver, P can purchase its feedstock from other suppliers. P also entered into a synthetic fuel sales agreement with K where K agreed to purchase a minimum amount of synthetic fuel produced at the Facility each year. If K does not purchase the synthetic fuel it is obligated to purchase, P can sell the synthetic fuel to third parties. Under certain circumstances, K is required to pay liquidated damages for failing to meet its Synfuel purchase obligations. P has represented that all sales of synthetic fuel from the Facilities will be to unrelated persons.

P entered into an agreement with F1 for the operation and maintenance of the Facility. F1 is subject to the direction and control of P, which has the sole authority to set

production levels and make other strategic decisions. F1 is paid a graduated fixed fee (without adjustment for inflation) per ton of synthetic fuel produced in the Facilities. Any capital costs associated with the Facilities will be paid by P and must be authorized by P.

For both the x and v sites, P has directly entered into arrangements with suppliers of chemical reagents.

P has supplied a detailed description of the process employed at each Facility. From time to time various alternative chemical reagents may be used in the process. As described, the Facilities and the process implemented in the Facilities and the alternative chemical reagents meet the requirements of Rev. Proc. 2001-34, 2001-22, I.R.B. 1293.

P had E and I, recognized experts in coal combustion chemistry, conduct numerous tests on the synthetic fuels produced using coal feedstock utilized in the Facilities at the x site and the types of coal feedstock expected to be utilized in the Facility at the v site and each of the alternative chemical reagents. These tests are described in detail in P's ruling request and subsequent correspondence by P's authorized representative. The experts have produced reports that have been submitted with the ruling request and the subsequent correspondence by P's authorized representative. The reports conclude that, with respect to each of the various alternative chemical reagents, significant chemical changes take place with the application of the process to the coal feedstock.

The rulings issued in 2002-09-044 which you wish to be reconfirmed in this private letter ruling, are as follows:

(1) P, with the use of the process and the chemical reagents, will produce a "qualified fuel" within the meaning of section 29(c)(1)(C);

(2) The production of the qualified fuel from each of the Facilities will be attributable solely to P, entitling P to the section 29 credit for the production of qualified fuel from each Facility that is sold to an unrelated person;

(3) Each of the contracts for the construction of the Facilities constitutes a "binding written contract" within the meaning of section 29(g)(1)(A);

(4) The section 29 credit attributable to P may be passed through to and allocated among the members of P in accordance with the principles of section 702(a)(7), in accordance with each member's interest in P at the time the section 29 credit arises. For the section 29 credit, a member's interest in P is determined based on a valid allocation of the receipts from the sale of the section 29 qualified fuel;

(5) The acquisition of the Facilities by P will not affect the placed in service date of any of the Facilities for purposes of section 29;

(6) Any termination of P under section 708(b)(1)(B) arising from sales or exchanges of interests in P will not preclude P as reconstituted from taking the section 29 credit for the production and sale of qualified fuel to unrelated persons; and

(7) For each of the Facilities, if the Facility was "placed in service" prior to July 1, 1998, within the meaning of section 29(g)(1), the relocation of the Facility to the x site or other location 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 for purposes of section 29 provided the fair market value of the original property of the Facility is more than 20% of the Facility's total fair market value at the time of the relocation or replacement. We express no opinion on when the Facilities were placed in service.

The changes in facts since the issuance of PLR 2002-09-044 are the relocation of one Facility from the x site to the v site and the constructive termination caused by the transfer of B's entire Class A interest in P to an affiliate, as described in the ruling request and subsequent correspondence by P's authorized representative.

The rulings set forth in PLR 2002-09-044 are not affected by these changed facts.

Accordingly, based on the representations of P and P's authorized representative, we re-issue the rulings given in PLR 2002-09-044 as follows:

(1) P, both before and after its constructive termination and reconstitution, with the use of the process and the chemical reagents, produces a "qualified fuel" within the meaning of section 29(c)(1)(C) in each of the Facilities;

(2) Both before and after its constructive termination and reconstitution, the production of the qualified fuel from each of the Facilities is attributable solely to P within the meaning of Section 29(a)(2)(B), entitling P to the section 29 credits for the production from each Facility of qualified fuel that is sold to an unrelated person;

(3) Each of the contracts for the construction of the Facilities constitutes a "binding written contract" within the meaning of section 29(g)(1)(A);

(4) The section 29 credit attributable to P may be passed through to and allocated among the members of P, both before and after its constructive termination and reconstitution, in accordance with the principles of section 702(a)(7), in accordance with each member's interest in P at the time the section 29 credit arises. For the section 29 credit, a member's interest in P is determined based on a valid allocation of the receipts from the sale of the section 29 qualified fuel;

(5) The acquisition of the Facilities by P did not affect the placed in service date of any of the Facilities for purposes of section 29;

(6) Any termination of P under section 708(b)(1)(B) arising from sales or exchanges of interests in P (including any termination arising from B's transfer of its Class A interest to an affiliate) will not preclude P as reconstituted from taking the section 29 credit for the production and sale of qualified fuel to unrelated persons; and

(7) For each of the Facilities, if the Facility was "placed in service" prior to July 1, 1998, within the meaning of section 29(g)(1), the relocation of the Facility to the x site or other location, including the relocation of one Facility to the v site, after June 30, 1998, or replacement of parts of the Facility after that date, does not result in a new placed in service date for the Facility for purposes of section 29 provided the fair market value of the original property of the Facility is more than 20% of the Facility's total fair market value at the time of the relocation or replacement. We express no opinion on when the Facilities were placed in service.

Except as specifically ruled upon above, we express no opinion concerning the federal income tax consequences of the transaction described above. Specifically, we express no opinion on when P's Facilities were placed in service or how the partners' interests in P are determined.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,

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