Internal Revenue Service

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Department of the Treasury Washington, DC 20224

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Date: December 29, 2005

LEGEND:

Taxpayer = Date 1 =

Date 2 =

P =Date 3 =

Date 4 =

X = Date 5 =

Ruling 1 = Y =

Ruling 2 =

A = Ruling 3 =

B = State =

a% = Parent = b% =

C =c% =

Facility 1 = Facility 2 =

Dear

This letter is in response to your letter on behalf of Taxpayer, dated October 14, 2005, requesting rulings under section 29 of the Internal Revenue Code.

FACTS

The facts as represented are as follows:

X received Ruling 1 on Date 1, Ruling 2 on Date 2, and Ruling 3 on Date 3 (Prior Rulings), which ruled on the issues addressed by this letter. Taxpayer seeks a confirmation of those rulings in light of its purchase of a limited partnership interest in P from Y.

Taxpayer is a State limited liability company classified as a partnership for federal income tax purposes all of the interests of which are owned by A and B. A and B are wholly owned subsidiaries of, and included in the consolidated federal income tax return of Parent, which is a publicly traded corporation.

Facility 1 was owned by C, which in turn was wholly owned by X until Date 4, when X contributed its entire interest in C to P. Because C is an entity disregarded for federal income tax purposes, P is treated as the owner of Facility 1 for federal income tax purposes. Facility 2 is owned by P. P is a State limited partnership. X, indirectly through entities wholly owned by X, owns a% general partner interest and b% limited partner interest in P. Y owned the remaining c% limited partnership interest in P.

On Date 5, Y sold c% interest in P to Taxpayer. Following the closing of the sale, X owned a% general partner interest and b% limited partner interest and Taxpayer owned c% limited partnership interest in P. In exchange for the membership interest in P, Taxpayer paid to Y an amount of cash at closing and Taxpayer is obligated to make certain fixed and variable payments to Y. Taxpayer provided projections based on expected operations that the net present value of the upfront and fixed payments is expected to be greater than the net present value of the estimated variable payments made to Y.

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. P, 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.

The remaining facts are the same as stated in the Prior Rulings issued to X. The Prior Rulings that you wish to be reconfirmed in this private letter ruling are as follows (with P being substituted for Y):

- (1) The synthetic fuel produced at the Facilities using the described process and the specified reagents is a solid synthetic fuel produced from coal constituting a "qualified fuel" within the meaning of § 29(c)(1)(C).
- (2) Production from the Facilities will be attributable solely to P within the meaning of § 29(a)(2)(B), and P shall be entitled to the § 29 credit for qualified fuel from the Facilities that is sold to an unrelated person.
- (3) The § 29 credit attributable to P may be allocated to Taxpayer in accordance with the Taxpayer's interest in P when the credit arises. For the § 29 credit, the Taxpayer's interest in P is determined based on a valid allocation of the receipts from

the sale of the § 29 qualified fuel.

(4) If the Facilities were "placed in service" within the meaning of § 29(g)(1) prior to July 1, 1998, relocation of one or both of the Facilities after June 30, 1998, or replacement of a part of a Facility after that date will not result in a new placed in service date for that Facility for purposes of § 29, provided that the fair market value of the original property is more than 20 percent of that Facility's total fair market value at the time of the relocation or replacement.

The only factual change that has occurred since the issuance of the Prior Rulings is the sale of a membership interest in P to Taxpayer as described in the ruling request.

The above rulings are not affected by the sale of a membership interest in P to Taxpayer as described in the ruling request.

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.

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 P and the credit may be passed through to and allocated to Taxpayer under the principles of § 702(a)(7) in accordance with the

Taxpayer's interest in P as of the time the credit arises. For purposes of the § 29 credit, the Taxpayer's interest in P is determined based on a valid allocation of the receipts from the sale of the § 29 qualified fuel.

CONCLUSIONS

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

- (1) The synthetic fuel produced at the Facilities using the described process and the specified reagents is a solid synthetic fuel produced from coal constituting a "qualified fuel" within the meaning of § 29(c)(1)(C).
- (2) Production from the Facilities will be attributable solely to P within the meaning of § 29(a)(2)(B), and P shall be entitled to the § 29 credit for qualified fuel from the Facilities that is sold to an unrelated person.
- (3) The § 29 credit attributable to P may be allocated to Taxpayer in accordance with the Taxpayer's interest in P when the credit arises. For the § 29 credit, the Taxpayer's interest in P is determined based on a valid allocation of the receipts from the sale of the § 29 qualified fuel.
- (4) If the Facilities were "placed in service" within the meaning of § 29(g)(1) prior to July 1, 1998, relocation of one or both of the Facilities after June 30, 1998, or replacement of a part of a Facility after that date will not result in a new placed in service date for that Facility for purposes of § 29, provided that the fair market value of the original property is more than 20 percent of that 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. 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 representatives.

Sincerely,

/s/

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

CC: