199939041

Internal Revenue Service

Department of the Treasury

Index Number: 29.00-00

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:DOM:P&SI:6-PLR-120615-98
Date: JUN 30 1999

X =

Y =

Z =

Company =

D1 =

D2 =

D3 =

Dear

This letter responds to a letter dated November 6, 1998, and subsequent correspondence, submitted on behalf of X by its authorized representative, requesting rulings under section 29 of the Internal Revenue Code.

FACTS

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

Company is a limited liability company with X as its sole member. Company is disregarded as an entity separate from X. Y is also a limited liability company with X as its sole member. Y is also disregarded as an entity separate from X.

Company is the assignee of a contract dated D1 for the construction of a facility that is to produce a solid synthetic fuel from coal fines using the process described below. The construction contract was assigned to Company on D2. As consideration for the assignment, Company agreed to pay the assignor a fixed dollar amount plus contingent quarterly payments equal to a fixed percentage of the section 29 credit through D3.

The construction contract is valid under state law and provides for liquidated damages of at least five percent of the cost of the facility. It also includes a description of the facility to be constructed, a completion date, and a maximum price. The facility was placed in service before July 1, 1998.

Company contracted with Y for the operation and maintenance of the facility. Y subcontracted with Z for the operation and maintenance of the facility. Z is unrelated to Company, Y, and X. Z will be paid a fixed dollar mount per month plus reimbursement of all costs. The subcontract may be terminated by Y upon 60 days prior written notice to Z. Y will acquire the coal fines for the facility on the spot market for Company. Y will also sell the fuel produced by the facility to unrelated persons on the spot market.

Because Company and Y are each disregarded as an entity separate from X, X is treated as owning, operating, and maintaining the facility.

In the first phase of the production process, fine coal screenings are crushed to a uniform size feedstock material for processing by the facility. In the next phase, crushed feedstock material is conveyed to a high speed mixer designed to homogenize the material prior to the application of the binder material. The sized homogenous feedstock material is then mixed in a high speed paddle type mixer with a customized blend of chemically reactive aromatic hydrocarbons (i.e., co-reactants). These customized co-reactants consist of high viscosity, high molecular weight, oxygen deficient, aromatic molecules. Prior to mixing, the co-reactants are heated to an appropriate reactive temperature. In the final phase of production, the mixture of feedstock material and co-reactants is subjected to pressures up to 3000 pounds per square inch by passing through a hydraulically driven roll type briquetter.

Company has had experts conduct numerous tests on fuel produced from coal fines using the process. By the preponderance of these tests' results, X and X's authorized representative represent that there is a significant chemical difference between the fuel produced by the process and the coal fines from which the fuel was made.

RULING REQUESTS #1 AND #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. The credit for the taxable year is an amount equal to $3.00 (adjusted for inflation) multiplied by the barrel-of-oil equivalent of qualified fuels sold.

Section 29(c)(1)(C) defines "qualified fuels" to include liquid, gaseous, or solid synthetic fuels produced from coal (including lignite), including such fuels when used as feedstocks.

In Rev. Rul. 86-100, 1986-2 C.B. 3, the Internal Revenue Service ruled that the definition of the term "synthetic fuel" under section 48(l) and its regulations are relevant to the interpretation of the term under section 29(c)(1)(C). Former section 48(l)(3)(A)(iii) provided a credit for the cost of equipment used for converting an alternate substance into a synthetic liquid, gaseous, or solid fuel. Rev. Rul. 86-100 notes that both section 29 and former section 48(l) contain almost identical language and have the same overall congressional intent, namely to encourage energy conservation and aid development of domestic energy production. Under section 1.48-9(c)(5)(ii) of the Income Tax Regulations, a synthetic fuel "differs significantly in chemical composition," as opposed to physical composition, from the alternate substance used to produce it. Coal is an alternate substance under section 1.48-9(c)(2)(i).

Based on the representations of X and X's authorized representative, including the preponderance of the test results, we agree that the fuel to be produced in the facility using the enumerated process on the coal fines will result from a significant chemical change in coal, transforming the coal fines into a solid synthetic fuel from coal. Because X is treated as owning, operating, and maintaining the facility, we conclude that X will be entitled to the section 29 credit for the production of the qualified fuel from the facility that is sold to unrelated persons.

RULING REQUEST #3

Section 29(d)(5) defines "barrel-of-oil equivalent" with respect to any fuel as that amount of the fuel which has a Btu content of 5.8 million; except that in the case of qualified fuels described in section 29(c)(1)(C), the Btu content shall be determined without regard to any material from a source not described in section 29(c)(1)(C). Section 29(d)(6) defines "barrel" to mean 42 United States gallons.

As required by section 29(d)(5), the Btu content of the qualified fuel produced by the facility and sold to unrelated persons must be determined without regard to any

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material other than coal. This means that the Btu content of the qualified fuel attributable to any binder material must be disregarded for purposes of calculating the section 29 credit.

RULING REQUEST #4

Sections 29(f)(1)(B) and (f)(2) provide that section 29 applies with respect to qualified fuels which are produced in a facility placed in service after December 31, 1979, and before January 1, 1993, and which are sold before January 1, 2003.

Section 29(g)(1) modifies section 29(f) in the case of a facility producing qualified fuels described in section 29(c)(1)(C). Section 29(g)(1)(A) provides that for purposes of section 29(f)(1)(B), a facility shall be treated as placed in service before January 1, 1993, if the facility is placed in service before July 1, 1998, pursuant to a binding written contract in effect before January 1, 1997. Section 29(g)(1)(B) provides that if the facility is originally placed in service after December 31, 1992, section 29(f)(2) shall be applied by substituting "January 1, 2008" for "January 1, 2003".

A contract is binding only if it is enforceable under local law against a taxpayer, and does not limit damages to a specified amount, e.g., by use of a liquidated damages provision. A contract provision limiting damages to an amount equal to at least five percent of the total contract price, for example, should be treated as not limiting damages. The construction contract, executed prior to January 1, 1997, includes such essential features as a description of the facility to be constructed, a completion date, and a maximum price. It is represented that the contract is binding under applicable law and that the contract provides for liquidated damages of at least five percent of the cost of the facility. Therefore, the contract is a binding written contract for purposes of section 29(g)(1).

RULING REQUEST #5

To qualify for the section 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. While section 29 does not define "placed in service," the term has been defined for purposes of the deduction for depreciation and the investment tax credit. Property is "placed in service" in the taxable year 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. "Placed in service" has consistently been construed as having the same meaning for purposes of the deduction for depreciation and the investment tax credit. See Rev. Rul. 76-256, 1976-2 C.B. 46.

CONCLUSIONS

Accordingly, based on the representations of X and X's authorized representative, we conclude as follows:

(1) The facility, with use of the enumerated process, will produce a "qualified fuel" within the meaning of section 29(c)(1)(C);

(2) X will be entitled to the section 29 credit for the production of qualified fuel by the facility that is sold to unrelated persons;

(3) the Btu content of the qualified fuel produced by the facility and sold to unrelated persons will be determined without regard to any material from a source not described in section 29(c)(1)(C) as required by section 29(d)(5);

(4) the contract for construction of the facility constitutes a "binding written contract" within the meaning of section 29(g)(1)(A); and

(5) The facility is "placed in service" for purposes of section 29(g)(1) on the date that the facility was first placed in a condition or state of readiness and availability to produce qualified fuel, as provided in sections 1.46-3(d)(1)(ii) and 1.167(a)-11(e)(1)(i).

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 whether the facility is placed in service for purposes of section 29.

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 section 12.04 of Rev. Proc. 99-1, 1999-1 I.R.B. 6, 47. However, when the criteria in section 12.05 of Rev. Proc. 99-1 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 X's authorized representative.

Sincerely yours,

CHARLES B. RAMSEY
Branch Chief, Branch 6
Office of Assistant Chief Counsel
(Passthroughs and Special Industries)

Enclosure:
Copy for section 6110 purposes