Private Letter Ruling 9831006, 7/31/1998, IRC Sec(s). 29

UIL No. 0029.00-00; 0029.01-00; 0029.03-00; 0029.04-00; 0029.05-00

Date: April 23, 1998
Refer Reply To: CC:DOM:P&SI:5–PLR-122559-97

In re: Request for a Private Letter Ruling on Behalf ***
LEGEND:
Taxpayer = ***
Partnership A = ***
Partnership B = ***
Partnership C = ***
Buyer = ***
Parent = ***
Corp A = ***
Corp B = ***
Corp C = ***
Corp D = ***
Builder A = ***
Builder B = ***
Builder C = ***
Site 1 = ***
Site 2 = ***
Site 3 = ***
Site 4 = ***
Site 5 = ***
Site 5A = ***
Site 5B = ***
Site 5C = ***
Division = ***
State X = ***
State Y = ***
State Z = ***
District = ***

Dear ***

This responds to a letter dated December 12, 1997, and additional correspondence, submitted on behalf of the Taxpayer. In the letter, rulings are requested under section 29 of the Internal Revenue Code relating to landfill gas to be produced at five landfill sites. The parties involved and the represented facts are set forth below.

The Taxpayer was organized as a State X limited partnership to engage in the production and sale of landfill gas produced from landfills. The district office having examination jurisdiction over the Taxpayer's return is the District. Corp A is a State X corporation and

Corp B is a State Y corporation. Both Corp A and Corp B are operating subsidiaries of Corp C, which is a wholly- owned subsidiary of Parent. Both Corp A and Corp B are engaged in the business of owning and operating solid waste landfills. Partnership A is a State X limited partnership formed to secure capitalization for the Taxpayer and for the Buyer. The Buyer will own and operate processing plants that will purchase landfill gas from the Taxpayer for processing to pipeline quality. In addition, a third-party investor may be involved to provide investment capital to both the Taxpayer and the Buyer by acquiring substantially all of Partnership B's interest in Partnership A.

In connection with the formation of the Taxpayer and in exchange for a *** percent general partner interest in the Taxpayer, Corp A and Corp B agreed to contribute to the Taxpayer: (1) leases to all rights to landfill gas produced from five certain sites in State Y and State Z (the "Landfill Sites"), (2) all ownership rights to, or contracts for construction of, facilities for the production of landfill gas at each of the Landfill Sites, and (3) all licenses and permits necessary for production of landfill gas at the Landfill Sites.

In connection with the formation of the Taxpayer and in exchange for a *** percent limited partner interest in the Taxpayer, Partnership A agreed to contribute up to *** in cash to the Taxpayer, with the cash to be used by the Taxpayer to fund construction of landfill gas collection systems and enhancements, and installation of necessary equipment, for the production of landfill gas at the Landfill Sites. The Taxpayer represents that the section 29 credits generated by the Taxpayer's sale of landfill gas produced from the landfills will be allocated to the partners in accordance with the partners' interest in the Taxpayer.

Partnership A will be formed by Partnership B and Partnership C. Partnership C will contribute cash to Partnership A in exchange for a *** percent general partnership interest. Partnership B will contribute cash to Partnership A in exchange for a percent limited partnership interest. A portion of the cash contributed by Partnership B in an amount up to *** will, in turn, be contributed by Partnership A to the Taxpayer to fund construction and installation of landfill gas collection systems and equipment at the Landfill Sites. According to the Taxpayer, if and when involved, the third-party investor will acquire substantially all of Partnership B's interest in Partnership A for cash.

Under the Operation and Maintenance Agreement between the Taxpayer and Corp A and Corp B, an annual payment will be made to Corp A and Corp B to cover all ongoing costs of the Taxpayer's operations to be performed by them, including operation and maintenance of the facilities. The Taxpayer represents that neither Corp A nor Corp B will acquire any interest in the facilities or in the production of landfill gas from the facilities as a result of the Operation and Maintenance Agreement.

The Taxpayer represents that it anticipates selling the landfill gas it produces at the Landfill Sites to the Buyer. The Buyer will be formed by Partnership A, Partnership B, and affiliates of Corp D. The Buyer will construct a total of four processing plants at four of the Landfill Sites, with two of the landfill sites sharing one processing plant. The processing plants will use technology and know-how developed by Corp D and other

unrelated third parties to process the landfill gas purchased from the Taxpayer to pipeline quality.

Collected landfill gas may be flared, used to dispose of leachate or condensate at the Landfill Sites, or used as a fuel to produce energy. The Taxpayer represents that it will not claim the section 29 credit on any landfill gas that is flared by the Taxpayer, on any landfill gas used in connection with the production of the landfill gas including, processed gas repurchased from the Buyer, and on any landfill gas that is flared before the date the proposed processing plants become operational and begin processing landfill gas. The Taxpayer also represents that it will not use any landfill gas in connection with the running of the Landfill Sites or purchase the landfill gas back from the Buyer.

Partnership A will own a *** percent limited partnership interest in the Taxpayer and a *** percent limited partnership interest in the Buyer. Article XII of the Limited Partnership Agreement of the Taxpayer provides that no partner in the Taxpayer shall take or permit any action whereby the Taxpayer and any party to whom the Taxpayer sells landfill gas could become "related persons" within the meaning of section 29(d)(7) of the Code. The Taxpayer has further represented that no individual or entity, or group of individuals or entities will own, directly or indirectly, more than 50 percent of the profit interest or capital interest in both the Taxpayer and the Buyer.

According to the Taxpayer, the Landfill Sites in State Z are referred to as Site 1, Site 2, and Site 3, and the Landfill Sites in State Y are referred to as Site 4 and Site 5. A portion of the landfill gas produced at Site 5 has been sold under an existing contract to a third party. No landfill gas produced at any of the other Landfill Sites has been previously sold.

Prior to January 1, 1997, Corp A and Corp B entered into four separate binding written contracts (the "Contracts") to construct and install landfill gas collection systems or additions to existing landfill gas collection systems at all of the Landfill Sites except Site 1. At Site 1, a pipeline will be installed to connect the existing landfill gas collection system to a processing plant but no other addition to the existing landfill gas collection system will be constructed or installed.

The Taxpayer represents that all of the Contracts are legally binding under local law and will be legally binding against the Taxpayer when contributed and assigned to the Taxpayer. The Taxpayer also represents that all of the Contracts have a liquidated damages provision that limits damages to 5 percent of the contract price.

For Site 1, a landfill gas collection system consisting of wells, drilled or dug into the landfill, a header system to collect the landfill gas, a blower that draws a vacuum on the wells, a condensate knock-out vessel, and meter was placed in service prior to *** wells were installed and operating before January 1, 1993. An additional *** wells were added between January 1, 1993, and *** . The landfill was closed for new waste in *** .

The Taxpayer will install a pipeline from the existing facility to the nearby processing plant, thus enabling the Taxpayer to transport the landfill gas produced at Site 1 for sale to the processing plant. An additional meter for measuring the landfill gas sold to the processing plant will be installed by the Taxpayer.

All ownership rights to the landfill gas collection system at Site 1 and all rights to the landfill gas produced at Site 1 will be transferred to the Taxpayer by a contribution agreement by and among Corp B, Corp A, Partnership A, and the Taxpayer (the "Contribution Agreement").

Site 2 is located approximately *** from Site 1. Because the processing plant to be constructed at Site 1 is close to Site 2, landfill gas produced at Site 2 will be sold to the processing plant located at Site 1.

The landfill at Site 2 began operations in *** Prior to January 1, 1997, Corp A entered into a binding written contract (the "Site 2 Contract") with Builder A for the installation of a landfill gas collection system at Site 2. The Site 2 Contract calls for the installation of *** wells, header, blower, meters, and condensate knock- out vessel. In addition, the Taxpayer anticipates that the Site 2 Contract will be amended for installation of additional pipe. The Site 2 Contract, all ownership rights to the landfill gas collection system constructed pursuant to the Site 2 Contract, and all rights to landfill gas produced at Site 2 will be transferred to the Taxpayer by the Contribution Agreement. The Taxpayer represents that the landfill gas collection system constructed pursuant to the Site 2 Contract will be placed in service before July 1, 1998, and production of landfill gas at Site 2 will commence before that date.

The landfill at Site 3 began operations in *** Prior to January 1, 1997, Corp A entered into a binding written contract (the "Site 3 Contract") with Builder A for the installation of a landfill gas collection system at Site 3. The Site 3 Contract calls for installation of *** wells, header, blower, meters, and condensate knock-out vessel. The Site 3 Contract will be amended for additional engineering and administrative costs. The Site 3 Contract, all ownership rights to the landfill gas collection system constructed pursuant to the Site 3 Contract, and all rights to landfill gas produced at Site 3 will be transferred to the Taxpayer by the Contribution Agreement. The Taxpayer represents that the landfill collection system constructed pursuant to the Site 3 Contract will be placed in service before July 1, 1998, and production of the landfill gas at Site 3 will commence before that date.

For Site 4, a landfill gas collection system consisting of wells, drilled or dug into the landfill, a header system to collect the landfill gas, a blower that draws a vacuum on the wells, a condensate knock-out vessel and meter (the "First Site 4 System") was placed in service at Site 4 prior to January 1, 1993, with *** wells installed and operating before that date. A second landfill gas collection system consisting of a header system to collect the landfill gas, a blower that draws a vacuum on the wells, a condensate knock-out vessel and meter (the "Second Site 4 System") and an additional *** wells were placed in service at Site 4 after December 31, 1992, and before January 1, 1997.

Prior to January 1, 1997, Division, a division of Corp B, entered into a binding written contract (the "Site 4 Contract") with Builder B for the installation of *** wells, header systems, and drip legs to be added to the Second Site 4 System. The Site 4 Contract, all ownership rights to the landfill gas collection system constructed pursuant to the Site 4 Contract, and all rights to landfill gas produced at Site 4 will be transferred to the Taxpayer by the Contribution Agreement. The Taxpayer represents that the equipment listed in the Site 4 Contract will be placed in service before July 1, 1998, and production of landfill gas by such equipment will commence before that date.

Site 5 consists of three separate landfills known as Site 5A, site 5B, and Site 5C, all of which are in close proximity to one another. The landfills at Site 5A and Site 5B are separated by a *** The landfills at Site 5B and Site 5C are separated by a *** .

For Site 5A, a landfill gas production facility consisting of wells drilled or dug into the landfill, a header system to collect the landfill gas, a blower that draws vacuum on the wells, a condensate knock-out vessel, and meter was placed in service prior to *** wells were installed and operating at Site 5A landfill before January 1, 1993. In *** a processing plant was constructed at the Site 5A landfill to compress the landfill gas for sale to local industry in a cogeneration plant. Landfill gas produced at Site 5A not processed for such sale has been flared.

From *** wells were drilled in the landfill at Site 5B and, in *** were connected to the Site 5A system, thus becoming part of an integrated landfill gas collection system. *** of these wells were installed and operating before January 1, 1993, and *** wells were added between January 1, 1993, and January 1, 1997.

A second landfill gas collection system including *** wells drilled or dug into the Site 5B landfill and *** wells drilled or dug into the Site 5C landfill, a header system to collect the landfill gas, a blower that draws a vacuum on the wells, a condensate knock-out vessel, and meter was placed in service in *** The system is known as the Site 5B collection system.

Prior to January 1, 1997, Corp B entered into a binding written contract (the "Site 5 Contract") with Builder C for the installation of eight wells and well heads at the Site 5C landfill. These *** wells and well heads will be connected to the Site 5B collection system, thus becoming part of an integrated gas collection system. The Site 5B Contract, all ownership rights to the Site 5A and Site 5B collection systems, and all rights to landfill gas produced at Site 5 will be transferred to the Taxpayer by the Contribution Agreement. The Taxpayer represents that the equipment listed in the Site 5 Contract will be placed in service before July 1, 1998, and production of landfill gas by such equipment will commence before that date.

Section 29(a) of the Code (originally designated as section 44D by the Crude Oil Windfall Profit Tax Act of 1980 ("COWPTA")) provides as a credit against tax for the taxable year an amount equal to (1) $3 (adjusted for inflation) multiplied by (2) the

barrel-of-oil equivalent of qualified fuels (A) sold by the taxpayer to an unrelated person during the taxable year, (B) the production of which is attributable to the taxpayer. Under section 29(d)(5), a barrel-of-oil equivalent is the amount of fuel that has a Btu (British thermal unit) content of 5.8 million, generally the energy equivalent of one barrel of oil.

Under section 29(b)(1) of the Code, the full amount of the credit is available when the calendar-year "reference price" is at or below $23.50 (adjusted for inflation). The amount of the credit allowable decreases as the reference price increases above $23.50, and is entirely phased out when the reference price exceeds the $23.50 amount by $6 (both adjusted for inflation). Under section 29(d)(2)(C), the reference price for a calendar year is the annual average wellhead price per barrel for all unregulated domestic crude oil.

Section 29(c)(1)(B)(ii) of the Code provides that the term "qualified fuels" includes gas produced from biomass. Under section 29(c)(3), the term "biomass" means any organic material other than (A) oil and natural gas (or any product thereof), and (B) coal (including lignite) or any product thereof.

The COWPTA Conference Report generally defines biomass as any organic substance other than oil, natural gas, or coal, or a product of oil, natural gas, or coal. Biomass includes waste, sewage, sludge, grain, wood, oceanic and terrestrial crops and crop residues, and waste products that have a market value. Also, the definition of biomass does not exclude waste materials, such as municipal and industrial waste, that include processed products of oil, natural gas or coal such as used plastic containers and asphalt shingles. H.R. Conf. Rep. No. 817, 96th Cong., 2d Sess. 132 (1980), 1980-3 C.B. 245, 292.

Sections 29(f)(1)(B) and 29(f)(2) of the Code provide that the section 29 credit applies to qualified fuels which are produced in a facility that was placed in service after December 31, 1979, and before January 1, 1993, and which are sold before January 1, 2003. Section 29(g)(1)(A), as amended by section 1207 of the Small Business Jobs Protection Act (Pub. L. No. 104-188), modifies section 29(f)(1)(B) to extend the section 29 credit for qualified fuels described in sections 29(c)(1)(B)(ii) and 29(c)(1)(C) that are produced in facilities placed in service before July 1, 1998, pursuant to a binding written contract in effect before January 1, 1997. For qualified fuels produced in these facilities, section 29(g)(1)(B) modifies section 29(f)(2) to provide that the credit is available for fuels sold before January 1, 2008.

The first requested ruling involves whether the landfill gas produced at the Landfill Sites is a "qualified fuel" under section 29(c) of the Code. The waste deposit in the Landfill Sites clearly is biomass under section 29(c)(3) and the COWPTA Conference Report. Thus, the landfill gas produced from that waste meets the definition of a qualified fuel under section 29(c)(1)(B)(ii).

The second requested ruling involves the written binding contract requirement in section 29(g)(1)(A) of the Code. Section 29(g)(1) extends the section 29 credit to certain qualified fuels if the facility producing the fuel is placed in service after 1992 and before

July 1, 1998, pursuant to a binding written contract in effect before January 1, 1997. Section 29 does not define the term "facility," however. In our view, the facility includes wells, drilled or dug into the landfill, the compressor that draws a vacuum on the producing wells, and the collection system that collects the gas. The Service does not view wells, drilled or dug into the landfill, as wells in the sense of obtaining gas from gas deposits for qualified fuels under section 29(c)(1)(B)(i). Rather, the facility required to produce, filter, compress, and measure the gas is considered to be the "facility" for purposes of section 29(g)(1). Thus, the facility is the entire gas collection system (wells, condensate knock-out vessel, blower, and meter) because it produces, filters, compresses, and measures the landfill-produced methane gas.

A written contract to acquire or construct a "facility" for producing qualified fuels will satisfy the written binding contract requirement under section 29(g)(1) of the Code. 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. Design changes to a binding contract to construct a facility that are made for reasons of technical or economic efficiencies of operation and that cause an insignificant increase in the original contract price should not constitute substantial modifications of the contract so as to affect the status of the facility under the written binding contract requirement of section 29(g)(1).

The Taxpayer represents that the Contracts are valid under state law and provide for liquidated damages of 5 percent of the cost of the production facility. Provided that each of the Contracts is not substantially modified, each one entered into with a contractor satisfies the written binding contract requirement under section 29(g)(1) of the Code.

The third requested ruling involves the definition of "facility" for purposes of section 29 of the Code. Section 29 does not define the term "facility" as that term is used in sections 29(g)(1) and 29(f)(1). In our view, the definition of facility is dependent upon the nature of the qualified fuel. For example, gas produced from geopressured brine, devonian shale, coal seams, or a tight formation is a qualified fuel under section 29(c)(1)(B)(i) that is produced by drilling through the earth to the gas deposit. The Taxpayer's landfill gas is recovered through wells drilled into the landfill and the gas is produced by using a compressor that draws a vacuum on the producing wells. As previously stated, the Service does not view the wells drilled into the landfill as wells in the sense of obtaining gas from gas deposits for qualified fuels under section 29(c)(1)(B)(i). Rather, the facility required to produce, filter, compress, and measure the gas is considered to be the "facility" for purposes of sections 29(g)(1) and 29(f)(1).

The fourth requested ruling involves the placed-in-service requirement in section 29(g)(1)(A) of the Code. In order to qualify for the section 29 credit on qualified fuels sold through the year 2007 under section 29(g)(1)(B), the facility must be placed in service before July 1, 1998. Section 29 does not describe when property is treated as placed in service. However, the term is defined for purposes of the investment tax credit

and depreciation deductions. For example, section 1.46-3(d)(1)(ii) of the Income Tax Regulations provides that property is considered placed in service in the taxable year in which the property is first placed in a condition or state of readiness and availability for a specifically assigned function. Section 1.46-3(d)(2) provides examples of when property is considered in a condition or state of readiness and availability for a specifically assigned function within the meaning of section 1.46- 3(d)(1)(ii). Such examples include where "[e]quipment is acquired for a specifically assigned function and is operational but is undergoing testing to eliminate any defects." See section 1.167(a)-11(e)(1)(i) for the meaning of "placed in service" for depreciation. The term "placed in service" has consistently been construed as having the same meaning for purposes of the investment tax credit and depreciation deductions. See, e.g., Rev. Rul. 76-256, 1976-2 C.B. 46; Wilkison v. Commissioner, 55 T.C.M. 1635 (1988).

In Rev. Rul. 76-256, the Internal Revenue Service determined whether a coal-fired electric generating unit was placed in service (i.e., in a condition or state of readiness and availability for a specifically assigned function) on a given date for depreciation and investment credit purposes. Enumerated facts in making that determination are that: (1) the necessary permits and licenses to operate the generating unit had been approved; (2) the generating unit was synchronized into the taxpayer's power grid for its function in the business of generating electric energy for the production of income; (3) the critical tests for the various components of the generating unit had been completed; (4) the generating unit was placed in the control of the taxpayer by the contractor; and (5) the daily operation of the generating unit had begun, notwithstanding the fact that the generating unit would undergo further testing to eliminate any defects.

Rev. Rul. 76-428, 1976-2 C.B. 47, concerns when a nuclear electric generating unit was first placed in service for depreciation and investment credit purposes. It describes the major components that are necessary to the operation of a nuclear generating unit as including a nuclear steam supply, a reactor auxiliary system, a control and safety instrumentation system, a radioactive waste disposal system, a fuel handling and storage system, a turbine system, and a containment system. Under the facts and circumstances described in Rev. Rul. 76-428, the unit was placed in service on the specified date in that: (1) the necessary permits and licenses had been approved; (2) the critical tests for the various components had been completed; (3) the nuclear electric generating unit had been placed in the control of the taxpayer by the contractor; and (4) the generating unit had been synchronized into the taxpayer's power grid for its function in the business of generating nuclear electrical energy for the production of income, even though the generating unit would undergo further testing to eliminate any defects.

The Taxpayer represents that each of the Contracts requires the landfill gas collection equipment to be operative before July 1, 1998. If, based on the above factors, prior to July 1, 1998, the Taxpayer obtains approval for all licenses and permits necessary to operating each landfill gas collection system, the Taxpayer completes all critical testing of such landfill gas collection system, such landfill gas collection system is under the Taxpayer's control, such landfill gas collection system is capable of producing landfill gas for sale, and operation of the landfill gas collection system has begun, even if further

testing to eliminate defects occurs after that date, then such facilities will be placed in service for purposes of section 29(g)(1)(A) of the Code, but only for wells in place by that date.

The determination of whether a landfill gas facility has satisfied the placed-in-service deadline under either section 29(f)(1)(B) or section 29(g)(1)(A) of the Code is made by reference to when the facility is first placed in service, not when the facility is transferred or sold to a different taxpayer.

The fifth requested ruling involves whether the production of the qualified fuel is attributable to the Taxpayer within the meaning of section 29(a)(2)(B) of the Code. The COWPTA Senate Report states that in the case of energy production from biomass, solid agricultural by-products, coal liquefaction and gasification, and qualifying processed wood, the credit would be based on the taxpayer's interest in the facility. S. Rep. No. 394, 96th Cong., 1st Sess. 89 (1979), 1980-3 C.B. 131, 207. In this regard, the Taxpayer has represented that, under the Contribution Agreement, all ownership rights to the landfill gas collection systems at the Landfill Sites, and all rights to landfill gas produced at the Landfill Sites, will be transferred by Corp A and Corp B to the Taxpayer. Furthermore, the Taxpayer represents that neither Corp A nor Corp B will acquire an interest in the facilities or the production from the facilities under the Operation and Maintenance Agreement. Thus, because the Taxpayer has the benefits and burdens of producing the landfill gas at the Landfill Sites, and neither Corp A nor Corp B will have an interest in such, all production of the landfill gas will be attributable to the Taxpayer for purposes of section 29(a)(2)(B).

The sixth requested ruling involves whether the Taxpayer and the Buyer are "related persons" within the meaning of section 29(d)(7) of the Code. Section 29(d)(7) provides that persons shall be treated as related to each other if such persons would be treated as a single employer under the regulations prescribed under section 52(b).

Section 52(b) of the Code provides that, under regulations prescribed by the Secretary, all employees of trades or businesses (whether or not incorporated) that are under common control are treated as employed by a single employer for purposes of sections 51, 51A, and 52.

Section 1.52-1(b) of the regulations defines the term "trades or businesses that are under common control" as any group of trades or businesses that is either a "parent-subsidiary group under common control," a "brother-sister group under common control," or a "combined group under common control."

Section 1.52-1(b) of the regulations defines the term "organization" as a sole proprietorship, a partnership, a trust, an estate, or a corporation. An organization may be a member of only one group of trades or businesses under common control.

Section 1.52-1(c)(1) of the regulations defines the term "parent-subsidiary group under common control" as one or more chains of organizations conducting trades or businesses

that are connected through ownership of a controlling interest with a common parent organization if two conditions are satisfied. First, a controlling interest in each of the organizations, except the common parent organization, must be owned (directly and with the application of section 1.414(c)-4(b)(1), relating to options) by one or more of the other organizations. Second, the common parent organization must own (directly and with the application of section 1.414(c)-4(b)(1), relating to options) a controlling interest in at least one of the other organizations, excluding, in computing the controlling interest, any direct ownership interest by other organizations.

Section 1.52-1(c)(2) of the regulations defines the term "controlling interest" in the context of parent-subsidiary group under common control to mean, in the case of a partnership, ownership of more than 50 percent of the profit interest or capital interest of the partnership.

Section 1.52-1(d) of the regulations defines the term "brother-sister group under common control" as two or more organizations conducting trades or businesses if two conditions are satisfied. First, the same five or fewer persons who are individuals, estates or trusts must own (directly and with the application of section 1.414(c)-4(b)(1)) a controlling interest in each organization. In this context, "controlling interest" has the same meaning as for a parent-subsidiary group under common control except that the percentage is increased from more than 50 percent to at least 80 percent. Second, the same five or fewer persons must be in effective control of each organization, taking into account the ownership of each person only to the extent that it is identical with respect to each organization. In this context, "effective control" has the same meaning as "controlling interest" has in the parent- subsidiary group under common control.

Section 1.52-1(e) of the regulations defines the term "combined group under common control" as a group of three or more organizations if two conditions are satisfied. First, each organization must be a member of either a parent-subsidiary group under common control or of a brother-sister group under common control. Second, at least one organization must be the common parent of a parent-subsidiary group under common control and also a member of the brother-sister group under common control.

In this case, no individual or entity, or group of individuals or entities will own, directly or indirectly, more than 50 percent of the profit interest or capital interest in both the Taxpayer and the Buyer. Accordingly, the Taxpayer and the Buyer are not treated as a single employer under the regulations prescribed under section 52(b) of the Code and therefore are not related persons within the meaning of section 29(d)(7).

The seventh and last requested ruling involves whether the owners of the partnership interests in the Taxpayer will be entitled to claim the section 29 credits from the sales of landfill gas produced at the Landfill Sites that are attributable to the Taxpayer.

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

Section 702(a)(7) of the Code 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) of the regulations provides that the distributive share is determined under section 704 and section 1.704-1.

Section 704(a) of the Code provides that a partner's distributive share of income, gain, loss, deduction, or credit is determined by the partnership agreement, except as otherwise provided in chapter 1 of subtitle A of title 26. 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 for 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) of the regulations provides that allocations of tax credits and tax credit recapture (except for section 38 property) are not reflected by adjustments to the partners, capital accounts. Thus, these allocations cannot have economic effect under section 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 taxable 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 regarding the 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 section 1.704-1(b)(5), Example (11). Identical principles apply in determining the partners' interests in the partnership regarding tax credits that arise from receipts of the partnership (whether or not taxable). Thus, generally, the allocation of section 29 credits in proportion to the allocation of the receipts from the sale of the qualified fuel will be respected if the allocation of the receipts satisfies the substantial economic effect safe harbor or the allocation is consistent with the partner's interest in the partnership.

An allocation of a partnership item that has a corresponding economic benefit or burden is a valid allocation under section 704(b) of the Code if the allocation satisfies either (1) the substantial economic effect safe harbor of section 1.704-1(b)(2) of the regulations, or (2) the partners' interest in the partnership standard of section 1.704-1(b)(3). To satisfy the substantiality component of the substantial economic effect safe harbor, the economic effect of the allocation must be substantial under section 1.704-l(b)(2)(iii).

Section 1.704-1(b)(2)(iii) of the regulations provides that an allocation is not substantial if (1) the after-tax economic consequences (including the effect of the section 29 credit) of at least one partner may, in present value terms, be enhanced compared to such consequences if the allocation (or allocations) were not contained in the partnership

agreement, and (2) there is a strong likelihood that the after-tax economic consequences of no partner will, in present value terms, be substantially diminished compared to such consequences if the allocation (or allocations) were not contained in the partnership agreement. In determining the after-tax economic benefit or detriment to a partner, tax consequences that result from the interaction of the allocation with the partner's tax attributes that are unrelated to the partnership are taken into account.

The section 29 credits attributable to the Taxpayer may be allocated to the partners of the Taxpayer in accordance with the partners' interests in the Taxpayer when the credit arises. For the section 29 credits, a partner's interest in the Taxpayer is determined based on a valid allocation of the receipts from the sale of the section 29 qualified fuel.

Accordingly, based on the Taxpayer's representations, we rule as follows:

(1) The landfill gas produced at the Landfill Sites is a "qualified fuel" under section 29(c)(1)(B)(ii) of the Code.
(2) Provided that each of the Contracts are not substantially modified, each one is a "binding written contract in effect before January 1, 1997," for purposes of section 29(g)(1)(A) of the Code.
(3) The landfill gas collection systems at the Landfill Sites are "facilities" for purposes of section 29 of the Code.
(4) With respect to each of the landfill gas collection systems, including the wells, to be constructed and the wells and piping to be installed pursuant to each of the Contracts, if, prior to July 1, 1998, (a) the Taxpayer obtains approval for all licenses and permits necessary to operating each landfill gas collection system, (b) the Taxpayer completes all critical testing of such landfill gas collection system, (c) such landfill gas collection system is under the Taxpayer's control, (d) such landfill gas collection system is capable of producing landfill gas for sale, and (e) operation of the landfill gas collection system has begun, even if further testing to eliminate defects occurs after that date, then such landfill gas collection system will be placed in service for purposes of section 29(g)(1)(A) of the Code.
(5) After the transfer of all ownership rights to the landfill gas collection systems and the lease of landfill gas produced at each of the Landfill Sites under the Contribution Agreement, production of the landfill gas at each of the Landfill Sites will be "attributable to" the Taxpayer for purposes of section 29(a)(2)(B) of the Code.
(6) The sale by the Taxpayer to the Buyer of landfill gas produced from the Landfill Sites will not be a sale by the Taxpayer to a "related person" within the meaning of section 29(d)(7) of the Code.
(7) The owners of partnership interests in the Taxpayer will be entitled to claim section 29 credits that arise from the sales of landfill gas produced from the Landfill Sites that are attributable to the Taxpayer.
No opinion is expressed concerning the consequences of the above described facts under any other provision of the Code or regulations.

This letter ruling is directed only to the taxpayer who requested it. Section 6110(j)(3) of the Code provides that this ruling 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 been adopted. Therefore, this ruling will be modified or revoked by the adoption of temporary or final regulations to the extent any such regulations are inconsistent with any conclusions in this ruling. See section 12.04 of Rev. Proc. 98-1, 1998-1 I.R.B. 7, 47. However, when the criteria of section 12.05 of Rev. Proc. 98-1 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, a copy of this letter is being sent to the Taxpayer's authorized legal representative. A copy of this letter should be attached to the Taxpayer's federal income tax return for the first taxable year in which it claims section 29 credits for landfill gas produced at one of the Landfill Sites.

Sincerely yours,

Harold E. Burghart

Assistant to the Chief,

Branch 6

Office of the Assistant

Chief Counsel

(Passthroughs and Special

Industries)

Enclosure:

6110 copy