E&MLF
CITE AS
27 *Energy & Min. L. Inst.* ch. 5 (2007)

Chapter 5

Out with Section 29 and In with Section 45: Have Synfuel Tax Credits Really Been "Refined"?

Daniel L. Kesten
Greenberg Traurig LLP
New York, New York

Synopsis

§ 5.01. Introduction 158
§ 5.02. Scope of Chapter 159
§ 5.03. "Old" Section 29: Tax Credits for Synthetic Fuel from Coal 159
[1] — Legislative History 159
[2] — Qualification and Value of Synfuel Tax Credits 160
[a] — Qualification Requirements 160
[b] — Value of the Credit 161
[3] — Understanding the History of Section 29: Sometimes a Chemical Change Is Just a Chemical Change 164
§ 5.04. "New" Section 45K and Transition Issues: The End of Credits for Synthetic Fuel from Coal? 167
[1] — A Difference Between Section 45K and Section 29. 167
[2] — Significance of the Synfuel Industry Measured in Dollars 168
[3] — Sunset Issues 169
§ 5.05. Tax Credits for Refined Coal Under Section 45(c)(7) 170
[1] — Introduction 170
[2] — Refined Coal Added to Section 45 171
[3] — Requirements for the Refined Coal Credit 171
[a] — Definitional Requirements 171
[b] — Sold to Unrelated Buyer to Produce Steam / Electricity 172
[c] — Qualified Emission Reduction 173
[d] — Increase in Market Value of Feedstock 174
[4] — Value of Credit for Refined Coal 175
[5] — Business and Tax Planning for the Credit for Refined Coal 175
§ 5.06. Conclusion 177

§ 5.01. Introduction.

The Section 29[1] tax credit, which was recently re-designated as Section 45K,[2] provides a credit against federal income tax for taxpayers who produce and then sell "synthetic fuels produced from coal."[3] Synthetic fuel from coal intended to qualify for the tax credit is commonly referred to as "synfuel," and the Section 29 tax credit gave rise to an entire industry related to the production and sale of synfuel as well as a multi-billion dollar market for the tax credits generated by the synfuel industry. Insofar as the purpose of the Section 29 tax credit was to subsidize domestic energy production, the credit program has been a notable success. Nevertheless, tax credits for synfuel have been the target of a great deal of political and journalistic derision and the proponents of synfuel may have missed an opportunity to prolong the economic benefits of Section 29 by refusing to yield to pressure to make the requirements for claiming the credit more meaningful.

The synfuel credit program is about to expire, and taxpayers in the coal industry will be left with the much less valuable (and likely more difficult to obtain) credit for "refined coal."[4] However, the fact that lawmakers are under

---

1 Except as otherwise indicated, all section references are to the Internal Revenue Code of 1986, as amended.

2 The re-designation within the Internal Revenue Code from Section 29 to Section 45K was part of the Energy Tax Incentives Act of 2005, Pub. L. No. 109-58. This chapter refers to "Section 29" as a way of making general reference to the subject tax credits, a practice which is in accordance with the vernacular of the industry. However, Section 5.04[1] of the chapter examines a technical change to the credit made when Section 29 was re-designated Section 45K, and in that part of the chapter reference is by necessity (and with more accuracy) made to Section 45K. Section 5.05 of the chapter explores an entirely separate and distinct tax credit, the credit for refined coal. This credit happens to be found in Section 45 of the Internal Revenue Code, but it is nonetheless different from the credit for synthetic fuel from coal.

3 Historically, Section 29 provided a credit for four categories of "nonconventional source fuels:" oil produced from shale and tar sands; gas produced from geopressured brine, Devonian shale, coal seams, or a tight formation; gas produced from biomass; and liquid, gaseous, or solid synthetic fuels produced from coal (including lignite). Due to various sunset provisions within the statute, however, the credits are no longer available for any qualified fuels other than gas produced from biomass and synthetic fuels produced from coal. The latter qualified fuel is the Section 29 qualified fuel covered in this chapter.

4 As noted above, this credit is found in Section 45(c)(7), not to be confused with Section 45K.

intense pressure to address national energy policy, and the current close association between energy policy and national security, means the true future of synfuel is less certain. Even if the synfuel era is over, its history provides an interesting case study of the inter-play between energy policy and tax policy.

§ 5.02. Scope of Chapter.

This chapter begins with a primer on the synfuel credit including the qualification requirements and an examination of the true value of the tax credit to the taxpayer.[5] Next the chapter surveys the 26-year history of the credit and the controversy it generated in the last five years, posing the question whether current energy issues facing the country validate the credit program. Then the chapter focuses on transitional issues facing the synfuel industry as the credit either expires by 2008 or phases out prior to that time—assuming there is no new legislation. Finally the chapter sets forth the requirements for claiming the new credit for refined coal and calculates its potential economic benefic in comparison to the benefits achieved by synfuel producers.

§ 5.03. "Old" Section 29: Tax Credits for Synthetic Fuel from Coal.

[1] — Legislative History.

The Arab oil embargo, the Iran-Iraq war and the oil crisis of the late 1970s put intense pressure on Congress not only to alleviate long lines at the gas pumps but also to address concern that the country was overly reliant on foreign oil.[6] In order to incentivize the use of domestic energy sources such as coal, Congress enacted the Energy Tax Act of 1978 which included the creation of a tax credit for investment in alternative energy property.[7] The legislative history behind the Energy Tax Act of 1978 indicates an express

5 This portion of the chapter serves as a summary and update of "Section 29 Tax Credits for Synthetic Fuel from Coal," 21 *Energy & Min. L. Inst.,* ch. 11 (2001).

6 Section 5.04[3] of the chapter considers how current political instability in the Middle East is creating the same pressure on Congress, and how that could impact synfuel tax credits.

7 *See* Section 48(l) of the Internal Revenue Code of 1954, as enacted by the Energy Tax Act of 1978, Pub. L. No. 95-618.