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1 IN THE UNITED STATES TAX COURT

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In the Matter of:)
3)
CROSS REFINED COAL, LLC,) Docket No. 19502-17
4 USA, REFINED COAL, LLC,)
TAX MATTERS PARTNER,)
5)
Petitioner,)
6)
vs.)
7)
COMMISSIONER OF INTERNAL)
8 REVENUE,)
)
9 Respondent.)

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20 Volume: 10

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22 Place: Boston, MA

23 Date: August 14, 2019

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13 John W. McCormack Post
Office & Courthouse
14 5 Post Office Square
Boston, Massachusetts 02109
15 Room 5, 12th Floor

16 August 14, 2019

17 The above-entitled matter came on for trial
at 2:30 p.m.

18

19 BEFORE: HONORABLE DAVID GUSTAFSON
Judge

20

21 APPEARANCES:

22 For the Petitioner:
BRIAN W. KITTLE, Esq.
23 Mayer Brown LLP
1221 Avenue of the Americas
24 New York, NY 10020
Telephone: (212) 506-2187
25 Bkittle@mayerbrown.com

1 MARIA C. CRITELLI, Esq.
Mayer Brown LLP
2 71 South Wacker Drive
Chicago, IL 60606
3 Telephone: (312) 701-7229
Mcritelli@mayerbrown.com
4
JOEL V. WILLIAMSON, Esq.
5 Mayer Brown LLP
71 South Wacker Drive
6 Chicago, IL 60606
Telephone: (312) 701-7229
7 Jwilliamson@mayerbrown.com

8 JOHN W. HORNE, Esq.
Mayer Brown LLP
9 1999 K Street, N.W.
Washington, DC 20006
10 Telephone: (202) 263-3372
JWHorne@mayerbrown.com
11
GEOFFREY M. COLLINS, Esq.
12 Mayer Brown LLP
1221 Avenue of the Americas
13 New York, NY 10020
Telephone: (212) 506-2633
14 Gcollins@mayerbrown.com

15 JAMES R. CARROLL, Esq.
Skadden, Arps, Slate, Meagher & Flom LLP
16 500 Boylston Street
Boston, MA 02116
17 Telephone: (617) 573-4801
James.carroll@skadden.com
18
DAVID W. FOSTER, Esq.
19 Skadden, Arps, Slate, Meagher & Flom LLP
1440 New York Avenue N.W.
20 Washington, DC 20005
Telephone: (202) 371-7626
21 David.foster@skadden.com

22 YAW A. ANIM, Esq.
Skadden, Arps, Slate, Meagher & Flom LLP
23 500 Boylston Street
Boston, MA 02116
24 Telephone: (617) 573-4801
Yaw.anim@skadden.com
25

1 ARMANDO GOMEZ, Esq.
Skadden, Arps, Slate, Meagher & Flom LLP
2 1440 New York Avenue N.W.
Washington, DC 20005
3 Telephone: (202) 371-7626
Armando.gomez@skadden.com
4
For the Respondent Commissioner of Internal
5 Revenue:
CATHERINE T. GUGAR, Esq.
6 200 West Adams Street
Suite 2400
7 Chicago, IL 60606
Telephone: (312) 368-8768
8 Catherine.t.gugar@irscounsel.treas.gov

9 JUSTIN D. SCHEID, Esq.
2001 Butterfield Road
10 Suite 502
Downers Grove, IL 60515
11 Telephone: (630) 493-5372
Justin.d.scheid@irscounsel.treas.gov
12
JOHN P. HEALY, Esq.
13 Suite 1130
30 East 7th Street, MS2000 STP
14 St. Paul, MN 55101
John.p.healy@irscounsel.treas.gov
15
CHARLES V. DUMAS, III, Esq.
16 500 Woodward Avenue
Suite 1300
17 Ally Detroit Center
Detroit, MI 48226
18 Charles.v.dumas@irscounsel.treas.gov

19 ROGELIO A. VILLAGELIU, Esq.
Bank of America Bldg
20 Ste. 2300
200 West Adams Street
21 Chicago, IL 60606
Rogelio.a.villageliu@irscounsel.treas.gov
22
JAMES RIDER, Esq.
23 Bank of America Bldg
Ste. 2300
24 200 West Adams Street
Chicago, IL 60606
25 James.w.rider@irscounsel.treas.gov

1 For the Participating Partner Schneider Electric USA, Inc.:

2 DANIEL A. ROSEN, Esq.
Baker & McKenzie LLP
3 452 Fifth Avenue
New York, NY 10018
4 Telephone: (312) 861-6645
Daniel.rosen@bakermckenzie.com

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7
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21
22
23
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25

1 For the Participating Partner AJG Coal, Inc.:
LAWRENCE M. HILL, Esq.
2 Winston & Strawn LLP
200 Park Avenue
3 New York, NY 10166
Telephone: (212) 294-4766
4 Lhill@winston.com

5 STEPHEN V. D'AMORE, Esq.
Winston & Strawn LLP
6 35 w. Wacker Drive
Chicago, IL 60601
7 Telephone: (212) 294-4766
Sdamore@winston.com
8
9
10
11
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1 C O N T E N T S

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1 P R O C E E D I N G S
2 (2:30 p.m.)
3
4 THE CLERK: All rise.
5 THE COURT: Please be seated. Please
6 call the case.
7 THE CLERK: Calling docket 19502-17,
8 Cross Refined Coal, LLC, USA Refined Coal, LLC, Tax
9 Matters Partner.
10 THE COURT: The Court has decided to
11 render the following as its oral Findings of Fact and
12 Opinion in this case. This Bench Opinion is made
13 pursuant to the authority granted by section 7459(b)
14 of the Internal Revenue Code (26 U.S.C.), and Tax
15 Court Rule 152; and it shall not be relied on as
16 precedent in any other case.
17 By notice of final partnership administrative
18 adjustment dated June 20, 2017 (the "FPAA" (Stip 7;
19 Ex. 9-J)), the Commissioner made adjustments to
20 partnership items of Cross Refined Coal, LLC
21 ("Cross"), for the years 2011 and 2012. The
22 Commissioner made the adjustments after determining
23 that the formation of Cross among (1) AJG Coal, Inc.
24 ("AJGC", a subsidiary of Arthur J. Gallagher & Co.
25 ("Gallagher")), USA Refined Coal LLC ("USARC", a

1 subsidiary of FMR LLC ("Fidelity")), and Schneider
2 Electric Investments 2, Inc. ("Schneider") a
3 subsidiary of Schneider Electric S.E. ("Schneider
4 Electric")) was not in substance a partnership
5 for Federal tax purposes because it was not formed to
6 carry on a business or for the sharing of profits and
7 losses from the production or sale of refined coal by
8 its partners, but rather (the Commissioner determined)
9 was created to facilitate the monetizing of refined
10 coal tax credits provided under section 45(e)(8). The
11 issues for the Court to decide for the relevant years
12 are: (1) whether Cross was a bona fide partnership for
13 federal tax purposes, and (2) whether USARC and
14 Schneider were bona fide partners of Cross for federal
15 tax purposes.
16 Trial of this case was conducted on August 5
17 through 14, 2019, in Boston, Massachusetts. At trial,
18 petitioner (USARC, tax matters partner of Cross) was
19 represented by Brian W. Kittle, Geoffrey M. Collins,
20 James R. Carroll, and David W. Foster. The
21 Commissioner was represented by Catherine T. Gugar,
22 Justin Scheid, John Healy, James Rider, Charles Dumas,
23 and Rogelio Villageliu. Cross partner Schneider was
24 represented by Daniel A. Rosen, and Cross partner AJGC
25 was represented by Lawrence M. Hill.

1 **FINDINGS OF FACT**

2 **AJGC's investment in the Technology**

3 In 2004 AJGC began investing in chemical
4 technology used to produce refined coal (the
5 "Technology"). (Stip. 94.) AJGC made its investment by
6 funding tests for the Technology and purchasing
7 interests in a company called Chem-Mod that developed
8 and held the Technology. AJGC acquired 42% of Chem-Mod
9 through direct and indirect investments. (Stip. 94.)
10 In 2008 AJGC entered into an agreement to license the
11 Technology from Chem-Mod. (Stip. 22.)
12 In 2009 AJGC began to sub-license the Technology
13 to producers in the refined coal industry in exchange
14 for royalties. As sub-licensor of the technology,
15 AJGC directly received royalties that the producer
16 paid to AJGC; and as part owner of Chem-Mod, AJGC
17 indirectly received a portion of the royalties that
18 AJGC paid as licensee to Chem-Mod as owner of the
19 Technology. (See Stip. 24.) AJGC also participated
20 directly as a producer of refined coal and thus
21 obtained not only the royalties but also--important to
22 this case--the tax credits of section 45, discussed
23 below. (See Stips. 34, 47, 53, 83.) AJGC's employee
24 most involved in and responsible for the refined coal
25 projects was Sally Batanian, who was president of

1 Gallagher's Clean Energy Division and president of
2 Chem-Mod LLC.
3 Refined coal production
4 AJGC's refined-coal production model generally
5 involved (1) locating an interested utility company
6 that generated electric power by burning coal,
7 (2) entering into a contract with that utility to (a)
8 purchase "raw", "feedstock" coal from that utility and
9 then (b) sell back "refined" coal to that same
10 utility; (3) building a coal-refining facility where
11 chemical technology is used to produce refined coal;
12 and (4) procuring investors to provide capital to aid
13 in the construction of the facilities and fund the
14 ongoing operations. (See Stips. 24-27, 47, 53.)
15 At facilities like the one at Cross, the refining
16 operation was constructed between the coal yard and
17 the boilers, so that it interposed itself in the
18 existing operation of the power plant. The refining
19 process began with moving the coal by conveyor belts
20 to the refining equipment. That equipment treated the
21 coal with chemicals that would reduce the emission of
22 nitrogen oxide and mercury. The coal thus treated was
23 then taken by conveyor belt back to the plant's
24 equipment that then crushed the coal to be burned in
25 the boilers. The entire refining process-from the

1 raw coal being put on the conveyor belts into the
2 refining facility to the refined coal being conveyed
3 back to the power plant–took only 3 to 5 minutes.
4 The utility’s risks and incentives
5 For the utility participating in AJGC’s
6 arrangement, the purchase of the refined coal involved
7 significant risks. Burning coal to produce electricity
8 is a complex and costly process, which employs
9 complicated chemistry and engineering. Altering the
10 character of the coal may affect the process at many
11 stages and in many ways. It can alter the temperature
12 of the burn, change the chemical composition and
13 properties of the gas and liquid generated by the
14 process, affect the boilers and other equipment, and
15 alter the processes already in place by which the
16 plant reduces its harmful emissions. If the refined
17 coal were to create an urgent problem, it might
18 prompt the necessity of shutting down a boiler and
19 requiring the immediate release of the enormous
20 quantity of superheated steam that the process
21 generates--an event that can be heard a mile away. The
22 utility’s risks in using refined coal include
23 potential damage to equipment, uncertainty as to the
24 efficacy of the product, and interference with the

1 utility's compliance with environmental regulations.
2 The utility's principal incentive for entering
3 into the arrangement was the discounted rate at which
4 the utility would purchase back the refined coal. That
5 is, the utility would sell its raw coal to the refiner
6 at the price the utility had previously paid for the
7 coal and then, after the refining took place, would
8 purchase back the refined coal for a price discounted
9 by 75 cents per ton; the utility thus made a profit
10 (of 75 cents per ton) on selling the raw coal to the
11 refiner and buying it back refined.
12 In addition to that principal incentive of the
13 discount and the resulting savings, the utility also
14 hoped for secondary benefits, such as reducing
15 expenditures for ammonia (which was used to reduce
16 Nitrogen Oxide), or increasing calcium
17 (with a beneficial effect on the plant's catalyst).
18 (Ex. 1510-P.) But these possible secondary benefits
19 were insufficient, without the discount, to induce the
20 utility to agree to purchase refined coal.
21 <u>The producer's risks and incentives</u>
22 For the producer, the economics began with a
23 multi-million-dollar investment and an inevitable
24 before-tax loss every year of the operation. The coal
25 must ultimately be sold at a discount in order to

1 induce the utility to assume the risk of buying and
2 using the refined coal. Thus, the producer's best-case
3 scenario would involve a before-tax loss for each ton
4 of refined coal sold, and the more successful the
5 producer was in producing and selling refined coal to
6 the utility, the greater that before-tax loss would
7 be.
8 Moreover, the producer faced a real risk of the
9 non-sale (or the diminished sale) of refined coal. The
10 power plant was able to by-pass the refining facility
11 and use its unrefined raw coal when that utility
12 judged that it was not expedient to use the
13 refined coal. At the Cross facility itself, production
14 of refined coal was suspended multiple times.
15 Production might be suspended because required
16 construction or operating permits could not be
17 obtained and maintained, or because the refined coal
18 was failing to achieve the intended emissions
19 reductions, or because the refined coal
20 was causing other environmental problems (whether in
21 the gases emitted from the smokestack, or in the ash
22 or liquid that the process produced). Or the utility
23 might suspend its operations for reasons entirely
24 unrelated to the refined coal if the power generating
25 plant itself had to cease operating for other

1 reasons--mechanical, environmental, or economic. And
2 when the utility stopped using refined coal and
3 used raw coal instead, then of course the refining
4 operation stood idle, making no sale of refined coal
5 and generating no section 45 credits.
6 The producer also faced additional risks: If an
7 environmental problem arose in connection with the
8 coal-fired electrical plant using the producer's
9 refined coal and became publicized, the producer faced
10 "reputational risk". Whether fairly or unfairly, its
11 name could become associated with the problem. And if
12 the problem were severe enough, the producer faced the
13 risk that aggrieved persons might sue for
14 environmental damage under the likes of the federal
15 "Superfund" statute (the Comprehensive Environmental
16 Response, Compensation, and Liability Act
17 ("CERCLA")), 42 U.S.C. sec. 9601 et seq.; or the
18 Resource Conservation and Recovery Act ("RCRA"), 42
19 U.S.C. sec. 6791 et seq.; or equivalent provisions of
20 State law. Sufficiently motivated victims of
21 environmental harm might even attempt to go after the
22 producer's parent company by "piercing the corporate
23 veil" or pursuing statutory remedies against de facto
24 owners. These risks are impossible to quantify on the
25 evidence before us, but it suffices to say that the

1 risks are not trivial and that a reasonably prudent
2 investor would have to take them into account in
3 making its investment decision and, if it made the
4 investment, would bear some measure of risk.
5 The producer's incentive to undertake these risks
6 and to incur an inevitable before-tax loss was the tax
7 credits (discussed below) that section 45 awarded for
8 the production and sale of the refined coal. Without
9 those tax credits there was no economic reason for the
10 producer to buy high and sell low—i.e., to purchase
11 coal, incur additional cost to refine it, and then
12 sell it not at a profit but at a discount. Without the
13 tax credits as an incentive to the producer, the
14 utility would not have an occasion to use refined coal
15 and thereby reduce its harmful emissions.
16 Finding investors
17 It was in AJGC's interest to have the
18 royalty-generating Chem-Mod process being used in more
19 coal-refining operations than AJG itself could wholly
20 own. Its parent company had a limited appetite for
21 investment in coal operations. In addition, AJGC had a
22 limited ability to use credits currently, and at some
23 level of investment would have been carrying credits
24 forward (and suffering a relative loss of the time
25 value of money). Bringing in other investors would

1 enable it to spread its own investment risk over a
2 larger number of projects, to benefit from lessons
3 being learned at a greater number of facilities, to
4 earn royalties on all those projects, and to accrue
5 section 45 credits in an amount it could optimally
6 use. Sally Batanian recruited investors, including
7 Fidelity and Schneider Electric.
8 AJGC described to potential investors the high
9 returns that might be generated by the refined coal
10 operations, and in so doing AJGC emphasized the
11 section 45 credits that were critical to those
12 projected returns. One best-case-scenario that AJGC
13 provided to Schneider in July 2009, which assumed
14 uninterrupted high volume sales of refined coal over
15 the entire 10-year period during which the tax credits
16 would be available, projected an investment of $7
17 million being paid off before the end of the first
18 year, an internal rate of return ("IRR") of
19 197%, and total 10-year benefits of almost $140
20 million. (Ex. 909-J.)
21 The Santee Cooper projects
22 In 2009 AJGC began to secure contracts and
23 potential investors to produce refined coal for Santee
24 Cooper, the South Carolina Public Service Authority.
25 (Stip. 26, 27.) Santee Cooper had three generating

1 stations in South Carolina for which AJGC undertook to
2 produce refined coal: the Cross Generating Station in
3 Pineville; the Jefferies Generating Station in
4 Georgetown; and the Winyah Generating Station
5 in Moncks Corner. On August 31, 2009, AJGC entered
6 into design and construction agreements with Taggart
7 Global, LLC ("Taggart"), to build a refining
8 facility for each Santee Cooper station. (Stip. 8.)
9 AJGC contacted Fidelity and Schneider Electric to
10 propose that they invest in the projects.
11 Due diligence
12 Both Fidelity and Schneider Electric engaged in
13 substantial "due diligence" to assure the
14 appropriateness of the investment in the three Santee
15 Cooper facilities, including Cross. Personnel of both
16 Fidelity and Schneider Electric met multiple
17 times with Sally Batanian to learn about the refined
18 coal process. Both entities brought in professionals
19 from the relevant departments in their affiliated
20 companies to help assess and address risks of all
21 assess and address risks of all sorts--environmental,
22 financial, and market. Fidelity used a detailed "due
23 diligence checklist" (Ex. 951-J) of the sort that it
24 regularly used when deciding whether to make an
25 investment; and Schneider Electric used a similar list

1 recommended by their accountants (Ex. 1269-P). Both
2 entities conducted site visits at the Santee Cooper
3 power plants (see Stip. 117), during which they had
4 AJGC's Manager of Operations take them to places in
5 the facilities that, he said, he had never seen
6 before. Fidelity and Schneider Electric shared the
7 expense (Stip. 124-125) to hire two firms to assist
8 them--Southern Research Institute ("SRI") to assess
9 the Chem-Mod technology and John T. Boyd Company
10 ("Boyd") to review the three Santee Cooper power
11 stations. (Stip. 118-123.) They performed due
12 diligence on Santee Cooper (and inquired into a
13 consent decree under which it operated), on AJGC, and
14 on each other.
15 And, of course, Fidelity and Schneider Electric
16 both tried to determine whether the investments were
17 likely to make satisfactory returns. They had seen
18 AJGC's projection showing an IRR of 197%. In addition,
19 Fidelity prepared two projections of returns, one at a
20 maximum level of production (with an IRR of 249%)
21 and the other at a minimum level of production (with
22 an IRR of 144%). (Ex. 697-J at 12-13.) Clearly they
23 all expected very high returns–depending on the
24 section 45 credits.
25 Gary Greenstein was a Senior Vice President at

1 Fidelity, experienced in investments in the energy
2 field, and he led Fidelity's consideration of the
3 refined coal investment. Foreshadowing an issue that
4 later became a large problem, he learned enough about
5 the refined coal process and Santee Cooper's operation
6 that he raised questions about bromide levels in the
7 water run-off from the operation and about a possible
8 need to monitor them. (Exs. 920-J, 1294-P.)
9 Having conducted their due diligence, Fidelity
10 formally agreed to invest in all three projects
11 beginning in January 2010 (Stip. 36), and Schneider
12 Electric formally agreed to invest in all three
13 projects beginning in March of 2010 (Stip. 48).
14 Schneider Electric also invested in a fourth project
15 called "Canadys"; but losses and credits from the
16 Jefferies, Winyah, and Canadys projects are not at
17 issue here. We include facts about them only as they
18 bear on the Cross facts. By the transactions that we
19 now describe, subsidiaries of Gallagher (i.e., AJGC),
20 of Fidelity (i.e., USARC), and of Schneider Electric
21 (i.e., Schneider) became the three members of
22 Cross.
23 Forming the entities and investment structure
24 On December 9, 2009, AJGC formed USARC, Cross,
25 Jefferies Refined Coal ("Jefferies"), and Winyah

1 Refined Coal ("Winyah"), to serve as vehicles for the
2 operation. (Stip. 12.)
3 On December 19, 2009, the Cross refined coal
4 facility was deemed operational (Stip. 16) and
5 "placed in service". On December 21, 2009, AJGC and
6 USARC executed various agreements and transfers so
7 that: (1) AJGC owned 100% of USARC; (2) AJGC and USARC
8 owned 49% and 51%, respectively, of the Cross,
9 Jefferies, and Winyah LLCs; (3) Cross, Jefferies, and
10 Winyah owned 100% of the facilities for each station;
11 and (4) LandGas Coal Management, LLC ("LandGas")
12 served as the manager for the Cross, Jefferies, and
13 Winyah LLCs. (Stips. 19, 25, 31, 32, 34.)
14 Additionally, on December 21, 2009, Cross,
15 Jefferies, and Winyah entered into leases with Santee
16 Cooper to locate and operate their coal-refining
17 facilities onsite at each location (Stip. 21), and
18 each LLC also entered into agreements to purchase
19 raw coal from Santee Cooper at the respective
20 stations, refine the coal, and then sell
21 the coal back to the stations at a discounted rate
22 (Stips. 26-27). The agreements between Santee Cooper
23 and the three LLCs had terms of 10 years
24 (corresponding to the 10-year period of tax credit
25 availability provided in section 45(e)(8)(A),

1 discussed below).
2 On January 1, 2010, Fidelity, through a
3 subsidiary, Feedstock Investments V, LLC ("Feedstock
4 Investments"), purchased from AJGC 99% of USARC (Stip.
5 36)-- thereby acquiring 51% indirect ownership of
6 Cross, Jefferies, and Winyah--for a total of $9.5
7 million, $4 million of which was attributable to
8 Cross. On March 1, 2010, Schneider Electric's
9 subsidiary Schneider purchased from AJGC a 25% direct
10 interest in each of Cross, Jefferies, and Winyah for a
11 total of $4.25 million (Stip. 48), $1.8 million of
12 which was attributable to Cross.
13 After these purchases: (1) Fidelity's Feedstock
14 Investments owned 99% of USARC, which owned 51% of
15 Cross, Jefferies, and Winyah; (2) Gallagher's AJGC
16 owned 1% of USARC and 24% of each of Cross, Jefferies,
17 and Winyah; and (3) Schneider owned 25% of each of
18 Cross, Jefferies, and Winyah. (Stip. 53.) Particular
19 terms
20 Several terms of the Cross agreements are
21 especially pertinent to the issues in
22 this case:
23 First, each of the members was required to pay its
24 share of the ongoing operating costs of the three
25 refined coal operations, including Cross. At the

1 commencement of their arrangement, each had to pay an
2 amount that would be put in escrow, from which
3 operations expenditures would be made. The escrow
4 would then be replenished by the further payments that
5 the members made from month to month as those
6 expenditures were incurred. In January 2010 Fidelity
7 (the 51% owner) paid $2.2 million for this escrow of
8 which $929,000 was for Cross; and in
9 March 2010 Schneider (the 25% owner) paid $1.18
10 million, of which $496,000 was for Cross. Over the
11 course of the next few years before they exited from
12 Cross, Fidelity paid a total of almost $22 million in
13 additional capital contributions, and Schneider paid a
14 total of more than $10.5 million in additional capital
15 contributions. (Ex. 3881-R.)
16 Second, Schneider owed to AJC [sic] an additional
17 fee under their agreement (Ex. 79-J). Schneider was
18 required by section 4.2 ("Finder's Fee") to pay to
19 AJGC "an amount which is equal to $0.05 per $1.00 of
20 tax credit allocated to" Schneider. Over the course of
21 Schneider's membership in Cross, it paid under this
22 provision a total of $561,354 (i.e., $11,227,080
23 (Schneider's total credits, see Ex. 3881-R at 9)
24 times .05).
25 Third, on the basis of its license of the

1 Technology from Chem-Mod, AJGC entered into an License
2 agreement with Cross to sublicense the Technology to
3 Cross (Ex. 38-J). Section 3.1 provided that the
4 royalty that Cross would pay AJGC was 85 cents per a
5 given quantity of coal sold (stated in the coal's
6 ability to yield a dollar of credit) "less the actual
7 capital and operating expenses of Licensee ...
8 provided, however, that the Royalty Payment shall in
9 no event exceed" 55 cents. (The royalty
10 term also had a floor.) In sum, if expenses (which the
11 members had to pay) increased to more than 30 cents
12 per unit, then the royalty to AJGC decreased, thereby
13 incentivizing AJGC to reduce expenses; but if the
14 expenses were reduced further to less than 30 cents
15 per unit, then the royalty was unaffected (but of
16 course the partners benefitted from having to pay only
17 those lower expenses).
18 Fourth, pursuant to section 10.12 of the LLC
19 Agreement (Ex. 27-J), "Major Decisions" required the
20 "prior written approval of all the members". There
21 were 26 decisions listed in that section, and Fidelity
22 and Schneider Electric had taken an active role in
23 creating the list. Among those 26 were such decisions
24 as: approving the budget; approving "any expenditure
25 or commitment to make expenditures in excess of Five

1 Thousand Dollars ($5,000) except to the extent
2 provided for in the Approved Budget"; hiring an
3 accountant; hiring and firing the manager (an action
4 in which USARC and Schneider later participated); and
5 purchasing insurance.
6 Fifth, the Membership Interest Purchase Agreement
7 between Fidelity and AJGC included a "liquidated
8 damages" provision, which allowed Fidelity to exit
9 USARC (and its 51% interest in Cross) upon the
10 occurrence of various triggers, such as failure to
11 conduct testing of emissions reduction levels or to
12 achieve required emissions reductions to qualify for
13 section 45 credits; changes in law that adversely
14 affect the value of the tax credits with respect to
15 more than fifty percent of the refined coal produced
16 and sold; violations or noncompliance with
17 environmental laws; bankruptcy of any counterparty to
18 a coal purchase agreement; and subminimal production
19 of refined coal based on minimum quarterly
20 projections. See Ex. 69-J, sec. 12.4. If Fidelity
21 exercised that right, it would receive from AJGC a
22 pro rata portion of its $4 million investment in
23 Cross. (In effect, the $4 million investment was
24 spread over the 120 months of the 10-year term of
25 Cross's agreement with Santee Cooper, and Fidelity's

1 exit payment would correspond to the number of months
2 remaining.) The liquidated damages provision did not
3 provide for any return of or reimbursement for
4 Fidelity's due diligence costs or its monthly
5 capital contributions for operating costs.
6 Schneider's agreement with AJGC (Ex. 79-J) did
7 not have any liquidated damages provision.
8 Consequently, the contract had no provision for any
9 payment to Schneider upon its exit from Cross.
10 Mitigating risks
11 Schneider Electric and Fidelity clearly sought to
12 identify the risks their subsidiaries might face as
13 co-owners of Cross, and they took reasonable steps to
14 mitigate those risks (in addition to Fidelity's
15 negotiating the liquidated damages provision to be
16 invoked when it wished to exit the arrangement).
17 Schneider and USARC were constituted as limited
18 liability entities subsidiary to other limited
19 liability subsidiaries of the parent company, in order
20 to shield their parent companies from liability as
21 much as possible.
22 They undertook a high level of effort to monitor
23 the operation of Santee Cooper and Cross and to
24 intervene when needed. They insisted on receiving, and
25 they reviewed, Cross's daily production reports. They

1 established a monthly checklist by which the manager
2 would confirm and report that all "Major Decisions"
3 had been duly referred to the members. (See Ex.
4 1006-P.) They conferred frequently with Cross
5 personnel and among themselves by email and phone;
6 and in 2010 and 2011 they held annual partner
7 meetings. They reviewed requests for funds and
8 financial statements. Dissatisfied with the manager of
9 the facility, they jointly decided to terminate his
10 employment (see Stips. 138-139; Ex. 303-J) and chose
11 his replacement (see Ex. 1201-P). These decisions were
12 made by personnel of all three members of Cross.
13 Compensation for the Cross members
14 Under their agreements for the Cross LLC (like
15 their agreements for Jefferies and Winyah), each Cross
16 member would incur its percentage share of the Cross
17 expenses--i.e., the cost of purchasing the coal from
18 Santee Cooper (incompletely offset by the revenue from
19 the discounted sale of the refined coal back to Santee
20 Cooper), maintaining the facilities, and paying
21 employee salaries, even during periods when coal was
22 not being refined. However, the resulting losses would
23 be mitigated -- and, they projected, much more than
24 offset -- by the section 45 tax credits
25 earned from producing and selling the refined coal.

1 AJGC would also receive royalties for the
2 Technology (both indirectly as owner of Chem-Mod and
3 directly as sublicensor). But for Fidelity and
4 Schneider, because they did not hold any interest in
5 the royalties for the Technology, the
6 section 45 tax credits earned from producing and
7 selling refined coal were the source of economic
8 return from the operation. Without the credits, the
9 operation would have always necessarily been a losing
10 proposition for all three members because of the
11 discount on sale of the refined coal to Santee
12 Cooper.
13 Production at the Cross facility
14 The Cross facility operated in 2010, 2011, 2012,
15 and 2013. By 2013 the Cross members had much more than
16 recovered the costs of their due diligence, their
17 initial investment, and their contributions toward
18 operating costs. From 2010 through the time of their
19 exits in 2013, Cross had generated after-tax profit
20 (including the tax credits and the tax benefit of
21 Cross's claimed losses that resulted from the discount
22 on sale of coal to Santee Cooper) totaling almost $19
23 million, shared among the three members.
24 Cross shutdowns
25 However, the operations in those years were not

1 without interruption. Rather, various issues impeded
2 or stopped production throughout these years (see
3 Stips. 61, 62, Exs. 236-J, 239-J, 242-J, 245-J,
4 248-J). Santee Cooper had the discretion to
5 shut down the refined coal operation, and its managers
6 did so with a frequency that frustrated Cross and its
7 owners. Some shutdowns were apparently reasonable
8 (such as when one of the Cross electricity-
9 generating units was taken offline due to lack of
10 demand for power, but others do seem questionable
11 (such as shutting the refined coal operation because
12 of "drizzle", or because of an overcast sky that
13 might mean rain would come in the future).
14 (See Ex. 239-J.) Every shutdown, however well or
15 poorly justified, meant that no refined coal could
16 be produced or sold and no tax credits could be
17 generated.
18 There were two interruptions of very substantial
19 duration: First, Cross began operating under temporary
20 construction permits that Santee Cooper had secured
21 (see Stips. 187-202), but issuance of the permanent
22 permits was delayed, so that Cross had to suspend
23 production for about nine months from November 2010 to
24 August 2011. Petitioner demonstrated that during this
25 shutdown the expenses that the members bore exceeded

1 the tax credits generated by about a million dollars.
2 (See Ex. 1918-P at 73, citing Exs. 102-J through
3 110-J.)
4 Second, in May 2012, Santee Cooper requested Cross
5 to suspend production because of allegations that the
6 operation was contributing to increased bromine
7 levels in the nearby lake into which its water drained
8 (Stip. 143). That lake was a source of drinking water
9 for nearby communities, and the lake drained into a
10 river that provided drinking water to additional
11 communities downstream. The bromine in turn had
12 evidently reacted with chlorine in the water treatment
13 process, which caused the presence of carcinogenic
14 trihalomethanes ("THMs") in the water source,
15 and Cross remained shut down for more than three years
16 until late 2015. Petitioner demonstrated that during
17 this shutdown, until the time of USARC's exit in late
18 2013, the expenses that the members bore exceeded the
19 tax credits generated by about 1.9 million dollars.
20 (See Ex. 1918-P at 70, citing Exs. 120-J through
21 127-J, 543-J through 552-J.)
22 During that shutdown in refined coal production
23 and sale, Santee Cooper operated the power plant with
24 its raw coal, not refined coal from Cross. During
25 longer shutdowns, some but not all of the Cross

1 employees were laid off, but during all of the
2 shutdowns, the members (AJGC, USARC, and Schneider)
3 were required to continue making contributions for
4 maintenance and upkeep of the facilities and for the
5 salaries of at least key employees and managers, but
6 the plant was not producing and selling refined coal,
7 so no section 45 tax credits were being generated
8 during such times.
9 At several points the trigger events occurred that
10 would have entitled Fidelity to exit Cross with its
11 liquidated damages, but Fidelity did not opt out
12 (until 2013, as described below).
13 Closing of Jefferies
14 In October 2012 the Santee Cooper Board of
15 Directors voted to shut down the Jefferies Generating
16 Station--not just to suspend the coal-refining
17 operation, but to shut down the electricity-generating
18 plant altogether. (Stip. 140-141.) There was
19 insufficient demand for the power produced by that
20 station. Santee Cooper later decided to convert the
21 Jefferies plant from coal to natural gas (after which
22 there would be no need for a refined coal operation).
23 Buyout of interests
24 The returns that Cross Refined coal operation had
25 Generated ($19 million after tax, as shown

1 above) was a far cry from the projections that they
2 had made in 2009. The shutdowns described
3 above had resulted in long periods of time with no
4 production and sale of refined coal, and no section
5 45 tax credits. In fact, petitioner demonstrated
6 that Cross's operating expenses exceeded all
7 revenues (including tax credits) more than half of
8 the months during which Fidelity owned its interest
9 (See Ex. 1918-P at 70, citing Exs. 104-J through
10 110-J, 120-J through 127-J, 543-J through 552-J.)

Moreover, the monitoring and supervising of the

12 project had involved more time and difficulty than
13 they had expected; and the environmental difficulties
14 that had arisen -- especially the bromine and THM
15 problem -- had heightened their concerns about the
16 ongoing risks of the operation.
17 Schneider had no liquidated damages provision that
18 would give it compensation upon its exit from the
19 arrangement, so Schneider engaged in a
20 negotiation with AJGC. On March 1, 2013, AJGC
21 purchased back Schneider's interest in each of the
22 Cross, Winyah, Jefferies, and Canadys facilities. As
23 to Cross, the arrangement included a $25,000 payment
24 to Schneider by AJGC for Schneider's interest in Cross

1 (as compared to the $1.8 million Schneider had paid
2 for that interest in March 2010). The arrangement also
3 included AJGC's forgiveness of a seven million
4 dollar -- $7,415,483 non-contingent note connected to
5 Schneider's interest in the Canadys project, but the
6 Commissioner does not contend, and the evidence does
7 not suggest, that any portion of that amount should be
8 attributed to the Cross transaction. The transaction
9 effectively released Schneider from any obligation to
10 participate further in the refined coal operations.
11 (Stips. 67, 161.)
12 On November 13, 2013, Fidelity provided a "Notice
13 of Opt-Out of Cross Refined Coal LLC" to AJGC.
14 Pursuant to the "liquidated damages" provision
15 discussed above, AJGC paid $2.5 million for Fidelity's
16 indirect interest (as compared to the $4 million that
17 Fidelity had paid for that interest in January 2010).
18 (Fidelity retained its interests in Jefferies and
19 Winyah until February 28, 2014, when AJGC purchased
20 those interests for $500,000. (Stips. 68, 162-163.))
21 In their exits from Cross, neither Schneider nor
22 Fidelity received any reimbursement of the due
23 diligence costs that they had incurred before
24 investing nor any of the operating costs that Cross
25 had incurred during their time in the LLC, nor

1 the “finder’s fee” that Schneider paid; nor did either
2 member receive any refund of any then-unspent portions
3 of their shares of the operating costs escrow account.
4 Tax returns
5 Cross timely filed Forms 1065, “U.S. Return of
6 Partnership Income,” for the 2011 and 2012 tax years
7 and issued Schedules K-1 to USARC, Schneider, and
8 AJGC. (Stips. 3-6.) The Commissioner timely issued the
9 FPAA dated June 20, 2017, to USARC as “Tax Matters
10 Partner” of Cross relating to the 2011 and 2012
11 tax years. (Stip. 7.) USARC timely filed a petition in
12 this Court on September 14, 2017. At that time, Cross
13 was no longer active.
14 OPINION
15 I. Burden of proof
16 As a general rule, the Commissioner’s
17 determinations in an FPAA are presumed correct, and a
18 party challenging an FPAA bears the burden of proving
19 that the Commissioner’s determinations are in error.
20 Rule 142(a); Welch v. Helvering, 290 U.S. 111, 115
21 (1933); Republic Plaza Props. Pship. V. Commissioner,
22 107 T.C. 94, 104 (1996).
23 Petitioner argues that the burden of proof shifts
24 to the Commissioner pursuant to section 7491(a), which
25 provides for such a shift on a factual issue where the

1 ''taxpayer introduces credible evidence with respect
2 to *** such issue.'' Sec. 7491(a)(1). However, in the
3 case of a partnership (like petitioner), section
4 7491(a)(2)(C) limits the application of this provision
5 to a "taxpayer ... described in section
6 7430(c)(4)(A)(ii)", which in turn limits relief to a
7 party that meets the requirements of section
8 2412(d)(2)(B) of ... title 28". That Title 28
9 provision limits relief to a "partnership ... the net
10 worth of which did not exceed $7,000,000 at the time
11 the civil action was filed, and which had not more
12 than 500 employees at the time the civil action was
13 filed." Petitioner did not put on evidence
14 of its qualification under this limitation. After
15 petitioner rested its case, we therefore denied its
16 request for a shift in the burden of proof.
17 However, a shift in the burden of proof ''has real
18 significance only in the rare event of an evidentiary
19 tie.'' Blodgett v. Commissioner, 394 F.3d 1030, 1039
20 (8th Cir. 2005), affg. T.C. Memo. 2003-212. We
21 perceive no factual issues as to which
22 the evidence is in equipoise, so we are able to decide
23 this case on the preponderance of the evidence, and
24 the burden of proof is not a factor in our analysis.
25 II. Refined Coal Credits

1 As part of the American Jobs Creation Act of 2004,
2 Congress expanded section 45 of the Code to provide
3 tax credits for refined coal that is "produced" and
4 "sold to an unrelated person" in a 10-year period, see
5 sec. 45(e)(8)(A), provided that the refined coal (1)
6 met certain emissions reduction requirements, and
7 (2) increased the market value of the coal by at least
8 50 percent. Pub. L. 108-357, Title VII, sec.
9 710(a)-(f). In 2008 Congress again modified section 45
10 and the refined coal credits by removing the
11 value-enhancement requirement and adopting
12 more stringent emissions-reduction requirements for
13 coal refinement facilities first placed in service
14 after December 31, 2008. Pub. L. 110-343, Div. B,
15 Title I, secs. 101(b), (f). As for the emissions
16 reductions, in order to qualify, the refined coal
17 must result in "a reduction of at least 20 percent of
18 the emissions of nitrogen oxide and at least 40
19 percent of the emissions of ... mercury". Sec.
20 45(c)(7)(B). Although the Commissioner offered expert
21 evidence challenging the effect of the refined coal
22 at Cross, he does not contend that the refined coal
23 failed to meet the standard of the statute for
24 purposes of entitlement to the credit.
25 The amount of the credit is $4.375 per ton of

1 refined coal, sec. 45(e)(8)(A), adjusted for
2 inflation, sec. 45(b)(2), (e)(2), and in 2009 the
3 amount as adjusted was $6.20 per ton. See Notice
4 2009-40, 2009-19 I.R.B. 931. The statute explicitly
5 anticipated that "more than one person [might have] an
6 interest in" a production facility and that, in such a
7 case, the credit would be "allocated among such
8 persons in proportion to their respective ownership
9 interests in the gross sales from such
10 facility". Sec. 45(e)(3).
11 III. Bona Fide Partnership
12 Where a partnership exists, the partnership itself
13 is not a taxpayer for income tax purposes. Sec. 701.
14 Instead, tax items (such as income, deductions,
15 losses, and credits) are passed through to the
16 partners. Sec. 702. At issue here is whether
17 USARC and Schneider are partners of Cross entitled to
18 claim the losses and section 45 credits that Cross
19 accrued.
20 A. Business purpose and intent
21 A partnership exists when two or more "parties
in
22 good faith and acting with a business purpose intend
23 to join together in the present conduct of the
24 enterprise." Commissioner v. Culbertson, 337 U.S. 733,
25 742 (1949); Commissioner v. Tower, 327 U.S. 280, 287

1 (1946) (holding that the proper test is whether the
2 partners "intended to join together for the purpose of
3 carrying on business and sharing in the profits or
4 losses or both"). In making this determination, courts
5 must look to the facts and circumstances to determine
6 whether a partner has a "meaningful stake in the
7 success or failure" of the enterprise. Culbertson, 337
8 U.S. at 742. The Supreme Court stated: "The question
9 is ... whether, considering all the facts -- the
10 agreement, the conduct of the parties in execution of
11 its provisions, their statements, the testimony of
12 disinterested persons, the relationship of the
13 parties, their respective abilities and capital
14 contributions, the actual control of income and the
15 purposes for which it is used, and any other facts
16 throwing light on their true intent -- the parties in
17 good faith and acting with a business purpose intended
18 to join together in the present conduct of the
19 enterprise." 337 U.S. at 742.
20 B. The eight LUNA factors
21 This Court further explained the test in Luna v.
22 Commissioner, 42 T.C. 1067, 1077-78 (1964),
23 identifying eight factors to be considered in
24 assessing the business purpose intent of the parties
25 to a purported partnership. The Commissioner

1 acknowledges those eight factors and states in his
2 pretrial memorandum ("PTM") that "Cross does not meet
3 the factors that require capital contributions and the
4 meaningful sharing in the profits and losses". Thus,
5 the Commissioner does not dispute that Cross fails to
6 satisfy the following six of the eight factors: "the
7 agreement of the parties and their conduct in
8 executing its terms"; "the parties' control over
9 income and capital and the right of each to make
10 withdrawals"; "whether business was conducted in the
11 joint names of the parties"; "whether the
12 parties filed Federal partnership returns or otherwise
13 represented to respondent or to persons with whom they
14 dealt that they were joint venturers"; "whether
15 separate books of account were maintained for the
16 venture"; and "whether the parties exercised mutual
17 control over and assumed mutual responsibilities for
18 the enterprise."
19 Rather, the two factors as to which the
20 Commissioner disputes Cross's status as a bona fide
21 partnership are, first, "the contributions, if any,
22 which each party has made to the venture", and,
23 second, "whether each party was a principal and
24 coproprietor, sharing a mutual proprietary interest in
25 the net profits and having an obligation to share

1 losses, or whether one party was the agent or employee
2 of the other, receiving for his services contingent
3 compensation in the form of a percentage
4 of income". We therefore consider further these two
5 disputed factors.
6 C. Contributions to the venture
7 When we consider the Luna factor of "the
8 contributions, if any, which each party has made to
9 the venture", we note that USARC and Schneider each
10 contributed the purchase price of their interests in
11 Cross (USARC's $4 million and Schneider's $1.18
12 million) and their additional contributions for
13 operating expenses in 2010 to 2013 (USARC's $22
14 million and Schneider's $10.5 million). We conclude
15 that these contributions make USARC and Schneider
16 to appear as bona fide partners. But the
17 Commissioner disputes the significance of these
18 amounts:
19 1. Initial contributions
20 As for Fidelity, its "liquidated damages"
21 provision entitled it, upon the occurrence of certain
22 triggers, to sell back its interest and receive, in
23 effect, a refund of a pro rata portion of its initial
24 investment (spread ratably over ten years). This
25 certainly reduced Fidelity's risk (compared to that of

1 an investor with no such option), but it by no means
2 eliminated the fact and economic reality of the
3 contribution. One 120th of the investment fell out of
4 reach as each month passed. When Fidelity ultimately
5 exited in 2013, it received back only $2.5 million and
6 left behind $1.5 million of its original investment.
7 Partnership agreements sometimes provide terms for a
8 partner's exit, and on the facts of this case we do
9 not find Fidelity's "liquidated damages" provision
10 inconsistent with its status as a partner.
11 As for Schneider, the Commissioner posited
12 before -- before trial (PTM at 21): "AJGC and
13 Schneider did not have an explicit buy back agreement,
14 but an implicit buy back agreement existed between
15 Schneider and AJGC." However, after trial the
16 Commissioner acknowledged that no evidence had been
17 admitted to support this hypothesis. Consequently,
18 Schneider was at risk for its entire $1.18 million.
19 2. Additional contributions
20 The Commissioner stated (PTM at 15-16): "Although
21 the members of Cross were required to continue making
22 capital contributions to fund ongoing operating
23 expenses during periods when the Cross Facility was
24 not producing refined coal, such amounts were de
25 minimis as 96% of Cross's operating costs were

1 required to be paid only during the Planned Processing
2 Dates thereby guaranteeing that the capital
3 contributions of the parties would increase only if
4 the refined coal was being produced and the Tax
5 Credits were being generated." (See also id. At 21.)
6 That is, the "contributions" factor should, in the
7 Commissioner's apparent view, disregard contributions
8 that were recovered promptly from business profits. We
9 doubt the correctness of that view, but even if it
10 were correct, it is inapplicable here. The evidence
11 shows that, during most months, operating expenses
12 were incurred in the absence of refined coal actually
13 being produced (and tax credits being generated).
14 During the 9-month shutdown starting November 2010,
15 the members bore expenses of about $1 million when no
16 credits were generated; and during the longer shutdown
17 that began in May 2012, the members bore expenses of
18 $1.9 million before their exit, when, again, no
19 credits were being generated.
20 3. The amounts of the contributions
21 It appears that the Commissioner's remaining
22 argument is simply that these contribution amounts,
23 when compared to the returns from the Cross project
24 (or perhaps when compared to the larger projected
25 returns) do not constitute a sufficient contribution

1 to be respected in the partnership analysis. However,
2 "[t]he question is not whether the ... capital
3 contributed by a partner [is] of sufficient importance
4 to meet some objective standard". Culbertson, 337 U.S.
5 at 742. Even for companies as large as Fidelity and
6 Schneider, these amounts (a total of $26 million for
7 USARC and $12.3 million for Schneider) are hardly
8 negligible–and in their oversight of Cross, they
9 showed themselves genuinely interested in expenditures
10 of much smaller amounts. We conclude that USARC and
11 Schneider made contributions to Cross commensurate
12 with their status as partners.
13 D. Sharing in profits and losses
14 When we consider the Luna factor of "whether each
15 party was a principal and coproprietor, sharing a
16 mutual proprietary interest in the net profits and
17 having an obligation to share losses", we conclude
18 that USARC and Schneider appear as bona fide partners.
19 (As a disqualifying alternative to sharing in profits
20 and losses, Luna posited a circumstance in
21 which the supposed partner is instead "the agent or
22 employee of the other, receiving for his services
23 contingent compensation in the form of a percentage of
24 income". As far as we can tell, that is not a
25 characterization that the Commissioner advances in

1 this case, and we do not see how the evidence
2 offered in this case could support it. We discuss
3 below in part V the possible alternative
4 characterization of the members' investments as debt
5 rather than equity. But in this discussion we simply
6 address the sharing of profits and losses.)
7 1. Sharing in profits
8 The evidence is clear that the profit that USARC
9 and Schneider might obtain from Cross would rise as
10 production and sale of refined coal rose (because the
11 profit-critical tax credits would rise with production
12 and sale).
13 The Commissioner sees it otherwise. He contends
14 that, for purposes of partnership analysis, this
15 increase does not constitute actual sharing in profit.
16 Rather, a rise in the production and sale of refined
17 coal will only and always result in increased
18 (pre-tax) losses, not profits.
19 This is true as far as it goes, since the
20 agreed-upon discount for sales of refined coal will
21 assure a loss on the sale of every ton of coal
22 refined. But it deliberately disregards the obvious
23 economic reality of the situation: The members
24 do share in increased profit—i.e., after-tax
25 profit—because of the section 45 credits that are a

1 necessary predicate for the entire arrangement. The
2 Commissioner disregards the credit because he looks
3 for the deal to justify itself in pre-tax terms,
4 finding an abuse where a deal is undertaken only for
5 tax benefits.
6 There are indeed abusive situations in which the
7 tax law will disregard transactions that lack
8 substance apart from tax manipulations, but this is
9 not such a circumstance. In Sacks v. Commissioner, 69
10 F.3d 982 (9th Cir. 1995), rev'g T.C. Memo. 1992-596,
11 the Ninth Circuit explained that when Congress creates
12 a tax credit for participating in a particular
13 activity that would otherwise be uneconomical without
14 the credit, the economic substance of the activity
15 should be evaluated to include the credit (i.e., the
16 profits of the enterprise must be considered to
17 include the tax credits). Id. at 991. The court
18 stated: "If the government treats tax-advantaged
19 transactions as shams unless they make economic sense
20 on a pre-tax basis, then it takes away with the
21 executive hand what it gives with the legislative. A
22 tax advantage such as Congress awarded for alternative
23 energy investments is intended to induce investments
24 which otherwise would not have been made." Id. at 992.
25 We agree. It is therefore insufficient to say (as

1 the Commissioner does, PTM at 23) that "there was no
2 opportunity for Fidelity or Schneider to earn any
3 pre-tax profit before or after the expiration year of
4 the Tax Credits in 2019". That was certainly true;
5 and, again, in some circumstances the lack of
6 opportunity for pre-tax profit could indeed be
7 evidence of a lack of real business purpose or intent;
8 but here the partners deliberately and conscientiously
9 pursued the economic goal that Congress incentivized
10 them to seek -- that is, an after-tax (and
11 after-tax-credit) profit. On the facts of this case
12 and given the nature and purposes of section 45, we
13 look to the post-tax profits that the members
14 anticipated, and we hold that they did indeed
15 share in the profits of the arrangement.
16 2. Sharing in losses
17 The Commissioner contends (PTM at 21) that the
18 members' initial contributions "were largely not at
19 risk" and that their additional contributions were
20 "limited and substantially contingent on the
21 availability of Tax Credits". We have already shown,
22 in part III.C above, that USARC and Schneider had made
23 actual contributions as to which the agreements did
24 not protect them from risk of loss, and we do not
25 repeat that discussion here. But the Commissioner

1 makes the additional contention that, in fact, there
2 were no substantial risks of loss for the investors in
3 Cross.
4 First, the Commissioner stresses that, before
5 Fidelity and Schneider acquired their interests,
6 everything essential to the refined coal operation was
7 already in place: the technology had been acquired
8 from Chem-Mod and had been qualified under section 45;
9 the lease and purchase agreements with Santee Cooper
10 had been finalized; the coal-refining unit had been
11 built. All that was needed was to flip the switch, put
12 the coal on the conveyor belts, and start receiving
13 the credits. The risk of loss was nonexistent.
14 (It is hard to reconcile that contention with the
15 Commissioner's Notice 2010-54, 2010 I.R.B. 403, sec.
16 5.01, which provides that "[t]he refined coal credit
17 is allowed . . . without regard to whether the taxpayer
18 owns the refined coal production facility in which the
19 refined coal is produced. Accordingly, a taxpayer
20 that leases . . . a facility owned by another person may
21 claim the credit for refined coal that the taxpayer
22 produces in the facility." It would seem that such a
23 lessee might be in a circumstance equivalent to
24 Cross's members, stepping into a facility
25 thought ready to commence operations.)

1 But if were true that risk of loss is necessarily
2 absent where a partner joins a partnership with a
3 facility that is placed or almost placed in service,
4 then that would make this case resemble Historic
5 Boardwalk Hall, LLC v. Commissioner, 694 F.3d 425 (3rd
6 Cir. 2012), rev'g 136 T.C. 1 (2011), which involved
7 Federal historic rehabilitation tax credits ("HRTCs")
8 under sec. 47 -- i.e., investment credits. The HRTCs
9 were available for a ratable share of 20% of qualified
10 rehabilitation expenditures ("QREs") and could be
11 claimed in the year that a rehabilitated
12 structure is placed in service. In Historic Boardwalk
13 a state agency (which did not pay Federal tax and
14 could not use tax credits) had already commenced a
15 rehabilitation project and then agreed with a
16 taxpayer to form a partnership, and allocate 99% of
17 the tax credits to the taxpayer-partner. The Court
18 of Appeals held that the latecomer taxpayer was not
19 a bona fide partner because it (1) did not have a
20 meaningful downside risk and (2) did not have
21 meaningful upside potential in the enterprise.
22 Historic Boardwalk, 694 F.3d at 448.
23 But this case is very unlike Historic Boardwalk
24 for many reasons. For example, it should be noted that
25 critical to the credit claims rejected in Historic

1 Boardwalk is the partnership agreement's special
2 allocation of 99% of the credits to the latecomer,
3 a fact completely absent in this case. But the
4 distinction from Historic Boardwalk that we wish
5 to stress here is that the act that qualifies a
6 taxpayer to receive an investment credit is an
7 investment. In such a circumstance, entitlement to
8 the credit is a fait accompli when the rehabilitated
9 building is placed in service. If one can enter the
10 deal at the eleventh hour, he truly has no risk
11 because of the nature of the credit, and the Fourth
12 Circuit denied the credit in a circumstance that
13 lacked economic reality.
14 But the section 45 credit at issue here is a
15 production credit, not an investment credit. For
16 purposes of the section 45 tax credit, the
17 placed-in-service date of a refined coal facility is
18 not the project’s eleventh hour but its first hour.
19 When the coal refining facility has been built, when
20 all the contractual arrangements have been put in
21 place, when the investors have invested, and when the
22 facility is ready to commence operations, the
23 investors are (so far) entitled to credits of exactly
24 zero. It remains to be seen whether tax credits will
25 ever be generated and in what amounts. Standing

1 between the investors and those credits are all of the
2 remaining risks that might impede the future
3 production and sale of refined coal.
4 The Commissioner would rejoin by contending that
5 there were no such risks, beyond de minimis or
6 speculative risks. That is an issue of fact as to
7 which we come to a very different conclusion. As we
8 found above, the members of Cross faced very
9 substantial risks that their coal refining operation
10 would be impeded and that they might suffer losses.
11 These risks are manifest even in the undisputed facts:
12 The Jefferies generating station was shut down
13 altogether for reasons unrelated to its coal-refining
14 operation. In its early years the Cross facility
15 itself suffered first a nine-month shutdown when
16 permits were delayed and then a 3-year shutdown when
17 an environmental problem arose—not to mention shorter
18 shutdowns brought on by the weather and other less
19 remarkable circumstances. Although not likely, it was
20 entirely within the realm of possibility that such
21 shutdowns would have occurred before the Cross members
22 had even recouped their initial investments.
23 (Fidelity's "liquidated damages" provision would not
24 have made it whole as to its "additional
25 contributions".)

1 And those are the undisputed facts. With multiple
2 credible witnesses, both lay and expert, and including
3 some of the Commissioner's own witnesses, petitioner
4 made a most convincing case that the arrangement with
5 Santee Cooper had its own risks, and that the Chem-Mod
6 technology, though well conceived and well tested,
7 had inherent risks that could be mitigated but not
8 eliminated. These included an environmental risk (from
9 bromine) that Fidelity's Gary Greenstein even seemed
10 to sense—but Fidelity made the decision that it was
11 reasonable to proceed. Those risks played out—not to a
12 disastrous extent, nor even to the extent of
13 preventing profits altogether, but to an extent that
14 made the Cross project more trouble than it was
15 worth. On these facts, it is difficult to make a
16 serious case that the members did not share risk and
17 the risk of loss.
18 The parties disagreed about whether there was any
19 significant risk that the parent companies of the
20 Cross members might be held liable for environmental
21 damages resulting from the coal refining operation
22 owned by their limited-liability subsidiaries. We
23 assume that the risk of such liability is speculative
24 and should not enter into our analysis; but we do not

1 set aside the related but distinct risk that the
2 parent companies might be sued for such alleged
3 damages. Cross was in a business that impacted the air
4 that people breath and the water that they drink. It
5 is not speculative to note that, if harm or injury did
6 occur, victims would look for deep pockets and attempt
7 to bring them in. Even if we assume that the parent
8 companies would ultimately prevail, they would prevail
9 not without cost, and that is a risk that the
10 investors bore when they signed on to this project.
11 The parties' expert witnesses disagreed about how
12 to quantify the risks, both because they disagreed
13 about how serious the risks were and because they
14 disagreed about the best methodology for computing and
15 expressing those risks. We conclude that we do not
16 need to numerically quantify the risks beyond finding
17 the fact, which we do find, that the risks were not de
18 minimis or remote but instead were serious risks. An
19 investor might not run shrieking from these risks, but
20 he would consider that he was bearing these risks as
21 he made his investment. And he
22 would be right.
23 We conclude that USARC and Schneider subjectively
24 believed that they bore, and that they did in fact
25 bear, risk of loss from the Cross coal-refining

1 operation.

2 IV. Sale of Tax Credits

3 In his pretrial memorandum (at 3), the

4 Commissioner states that the issue in this case is

5 whether "Cross was not formed to carry on a business

6 or for the sharing of profits and losses from the

7 production or sale of refined coal by its purported

8 members, but rather was formed as a vehicle for the

9 sale of Tax Credits from" AJGC to USARC and Schneider.

10 It is true that the credits were a critical feature of

11 the arrangement, that no rational actor would have

12 invested in the refined coal facility without the

13 credits, that the parties took every necessary effort

14 to assure their obtaining of the credits. It is also

15 true that their communications speak of the

16 obtaining of the credits as the desired outcome, and

17 that some of their communications used "purchasing" or

18 "selling" the credits as a shorthand for entering

19 into or acting under the contracts into which they had

20 entered. There may be circumstances in which such

21 facts might undermine the existence of a bona fide

22 partnership--but that is not the case here.

23 The Commissioner states (PTM at 17): "Barring

24 express statutory authorization, taxpayers may not

25 sell federal tax benefits. See Beck v. Commissioner,

1 85 T.C. 557, 579-580 (1985)." And in Beck we did hold
2 against a taxpayer whom we characterized as "marketing
3 tax benefits"; but we explained that tax credits were
4 "not intended ... to create a new economy consisting
5 of paper transactions having no relationship to the
6 real value of goods and services. Thus the mere
7 presence of a valid business enterprise at some levels
8 of a transaction does not automatically entitle
9 passive investors distant from day-to-day operations
10 of the enterprise to the associated tax benefits." Id.
11 At 580. In this case we do not have mere paper
12 transactions or distant, passive investors. Rather, we
13 see obviously real transactions with participants
14 substantially involved in the activity.
15 Congress created the refined coal credit for the
16 purpose of incentivizing the refined coal activity; it
17 did so because the market, unassisted by credits, was
18 not producing refined coal on the scale that Congress
19 thought beneficial. Congress manifestly decided that,
20 if refined coal was to be produced in sufficient
21 quantity, money beyond that which the market would
22 offer would need to be added to the mix. The intended
23 result of the credit was that investors, knowing they
24 could obtain the credits, made decisions to produce
25 refined coal -- decisions that they did not make and

1 would not make unless they could be sure that they
2 would receive the credits. And rational investors,
3 having made that decision, would of course work to
4 assure that they maintained the right to receive those
5 credits. Without the credits, the refined coal
6 activity was a losing proposition; but that fact
7 cannot mean that the activity, undertaken by someone
8 who gains by claiming the credits, lacks economic
9 substance; rather, that fact is the reason for the
10 credits.
11 V. Debt vs. Equity
12 If USARC's and Schneider's investments in Cross
13 were not equity and did not make them partners, then
14 what were those investments? One of petitioner's
15 experts observed that the investments must either be
16 debt or equity; and at closing argument, we asked the
17 Commissioner whether those are indeed the
18 alternatives—debt or equity—and, if so, whether he
19 contends that they were debt. Counsel responded that
20 those investments resemble debt more than equity.
21 By definition, a capital contribution is not a
22 debt for purposes of section 166. See 26 C.F.R. sec.
23 1.166-1(c). A bona fide debt arises from "a
24 debtor-creditor relationship based on a valid and
25 enforceable obligation to pay a fixed or

1 determinable sum of money." Kean v. Commissioner, 91
2 T.C. 575, 594 (1988); 26 C.F.R. sec. 1.166-1(c),
3 Income Tax Regs. The only aspect of this case that
4 bears any remote arguable relation to this definition
5 is the liquidated damages provision in Fidelity's
6 agreement. Under certain circumstances, AJGC had an
7 obligation to pay Fidelity a pro rata amount of its
8 initial contribution, which one could determine.
9 But the contention that this was debt collapses
10 with only a little more consideration. Section 385(b)
11 sets forth factors to be taken into account in issuing
12 regulations identifying bona fide debt, and the first
13 statutory factor is "a written unconditional promise
14 to pay on demand or on a specified date a sum certain
15 in money in return for an adequate consideration in
16 money or money's worth, and to pay a fixed rate of
17 interest". The liquidated damages provision lacks an
18 "unconditional promise" (rather, it is conditional on
19 the triggering events) and lacks "a fixed rate of
20 interest" (rather, it provides no interest).
21 To the extent the issue here is whether USARC's
22 and Schneider's initial contributions and their
23 additional contributions were debt or equity, it is
24 clear that they were equity.
25 //

1 VI. Conclusion
2 Cross was a bona fide partnership, and USARC and
3 Schneider were both bona fide partners.
4 Decision will be entered in favor of petitioner.
5 This concludes the Court's oral Findings of Fact
6 and Opinion in this case.
7 THE CLERK: All rise.
8 (Court adjourned at 3:33 p.m.)
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1 C E R T I F I C A T E
2
3 I hereby certify that the
4 foregoing trial testimony was reported, as
5 stated in the caption, and the questions
6 and answers thereto were reduced to the
7 written page under my direction; that the
8 foregoing pages represent a true and
9 correct transcript of the evidence given.
10 I further certify that I am not
11 in any way financially interested
12 in the results of this case. I have no
13 illegal written contract to provide reporting
14 services with any party to this case, any
15 counsel in the case, or any reporter or
16 reporting agency from whom a referral might
17 have been made to cover this trial.
18 I will charge my usual and customary
19 rates for the services provided to all parties
20 in the case.
21
22 This, the 15th day of August, 2019.
23
24 Steve S. Huseby
25 STEVE S. HUSEBY, CCR-B-1372
My Commission Expires
December 3rd, 2022.

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