Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Index Number: 468A.00-00, 461.00-00, 1012.06-00,1060.00-00,
Number: **200038007**
Release Date: 9/22/2000

Person to Contact:

Telephone Number:

Refer Reply To:
CC:DOM:P&SI:6-PLR-119102-99
Date:
June 13, 2000

Legend:

Seller/Taxpayer =

Parent =

Company =

Buyer 1 =
Buyer 2 =

Plant 1 =
Plant 2 =
Plant 3 =
Plant 4 =

District =

Commission A =
Commission B =
Commission C =
Commission D =

Trustee =

a =
b =
c =
d =
e =

This letter responds to your request, dated November 29, 1999, that we rule on certain tax consequences of the sale of the Plants from Seller to Buyers. As set forth below, you have requested rulings regarding the tax consequences under section 468A of the Internal Revenue Code to the Seller's qualified nuclear decommissioning fund as

well as rulings regarding the proper realization and recognition of gain and loss on the sale of the Plant.

The Taxpayer has represented the following facts and information relating to the ruling request:

The Seller owns and operates electric generation plants. The Seller is a wholly-owned subsidiary of the Parent and is under the audit jurisdiction of the District. The Seller owns an a percent interest in each of Plants 1 and 2. The Seller owns a c percent interest in each of Plants 3 and 4. The Seller has established, for each of the Plants, a qualified nuclear decommissioning fund maintained by the Trustee.

Rates charged by the Seller for electricity generated at the Plants have been under the jurisdiction of the Commissions. Commissions A, C, and D (and or their related states) have ordered the restructuring and deregulation of the electric industry. As part of this restructuring, the Seller will sell b percent of Plants 1 and 2 to Buyer 1. In addition, the Seller will sell all of its interest in Plants 3 and 4 and b percent of Plants 1 and 2 to Buyer 2. Buyer 1 currently owns a d percent interest in Plants 1 and 2 and an e percent interest in Plants 3 and 4. In each of these transactions, the applicable buyer will pay cash (plus other consideration) and assume the liabilities, including decommissioning, of the Seller with respect to the interest transferred. The Seller will transfer to the Buyers all of the assets associated with the Plants, including its qualified and nonqualified nuclear decommissioning funds. In the case of Buyer 1, these transferred funds would be combined with the existing funds maintained by Buyer 1 with respect to its interests in the Plants.

Concurrent with these transactions, the Company (also a wholly-owned subsidiary of the Parent) will sell its interest in Plants 1 and 2 to the Buyers and its interest in Plants 3 and 4 to Buyer 2. The sale of the Seller's interests in the Plants to the Buyers is conditional on the concurrent sale of the Company's interests in the Plants to the Buyers.

Requested Ruling #1: Neither the Seller nor its qualified funds will recognize any gain or loss or otherwise take into account any income or deduction by reason of the transfer of the qualified nuclear decommissioning fund assets to the Buyers at closing.

Section 468A(a) provides that a taxpayer may elect to deduct payments made to a nuclear decommissioning reserve fund (the qualified nuclear decommissioning fund). Section 468A(b) limits the annual deduction of the electing taxpayer to the lesser of the ruling amount or the amount of decommissioning costs included in the electing taxpayer's cost of service for ratemaking purposes for the taxable year.

Section 468A(d) provides that the ruling amount means the amount determined by the Service to be necessary to (A) fund that portion of the nuclear decommissioning cost with respect to the nuclear power plant that bears the same ratio to the total

nuclear decommissioning costs with respect to such nuclear power plant as the period for which the fund is in effect bears to the estimated useful life of the nuclear power plant, and (B) prevent any excessive funding of such costs or the funding of such costs at a rate more rapid than level funding.

Section 468A(e)(2) provides that the rate of tax on the income of a qualified nuclear decommissioning fund is 20 percent. Section 468A(e)(4) provides, in pertinent part, that the assets in a qualified nuclear decommissioning fund shall be used exclusively for satisfying the liability of any taxpayer contributing to the qualified nuclear decommissioning fund.

Section 1.468A-1(b)(1) of the Federal Income Tax Regulations provides that an eligible taxpayer is a taxpayer that possesses a qualifying interest in a nuclear power plant. Section 1.468A-1(b)(2) provides that a qualifying interest is a direct ownership interest or a leasehold interest meeting certain additional requirements. Section 1.468A-1(b)(4) provides, in part, that a nuclear power plant is any nuclear power reactor that is used predominantly in the trade or business of the furnishing or sale of electric energy, if the rates for such furnishing or sale have been established or approved by a public utility commission.

Section 1.468A-5(a) sets out the qualification requirements for nuclear decommissioning funds. It provides, in part, that a qualified nuclear decommissioning fund must be established and maintained pursuant to an arrangement that qualifies as a trust under state law. An electing taxpayer can establish and maintain only one qualified nuclear decommissioning fund for each nuclear power plant. Section 1.468A-5(c)(1)(i) provides that if, at any time during the taxable year, a nuclear decommissioning fund does not satisfy the requirements of section 1.468A-5(a), the Service may disqualify all or a portion of the fund as of the date that the fund does not satisfy the requirements. Section 1.468A-5(c)(3) provides that if a qualified nuclear decommissioning fund is disqualified, the fair market value (with certain adjustments) of the assets in the fund is deemed to be distributed to the electing taxpayer and included in that taxpayer's gross income for the taxable year.

Section 1.468A-6 generally provides rules for the transfer of an interest in a nuclear power plant (and transfer of the qualified nuclear decommissioning fund) where after the transfer the transferee is an eligible taxpayer. Under section 1.468A-6(g), the Service may treat any disposition of an interest in a nuclear power plant occurring after December 27, 1994, as satisfying the requirements of the regulations if the Service determines that such treatment is necessary or appropriate to carry out the purposes of section 468A.

Under the specific facts herein, the Service will generally treat these sales, under section 1.468A-6(g), as dispositions qualifying under the general provisions of section 1.468A-6. This exercise of discretion will apply to the provisions of 1.468-6, except those outlined in 1.468A-6(e) with respect to the calculation of a schedule of ruling amounts subsequent to a sale. Thus, under section 1.468A-6 the Seller's funds will not

be disqualified upon the sales when the funds are transferred to the Buyers.

Section 1.468A-6(c)(1) provides that neither a seller of an interest in a nuclear power plant nor the seller's fund will recognize gain or loss or otherwise take any income or deduction into account by reason of a sale. Accordingly, neither the Seller nor its qualified nuclear decommissioning funds will recognize gain or loss or otherwise take into account any income or deduction upon the transfer of the qualified nuclear decommissioning funds to the Buyers as a result of the sales.

Requested Ruling #2: Seller's gain or loss on the sale of the plant and associated assets will be the difference between seller's basis in such assets (excluding the assets contained in the qualified nuclear decommissioning fund) and its amount realized taking into account the allocation of consideration pursuant to section 1060.

Section 1001(a) provides that a taxpayer's gain from the sale of property shall be the excess of the amount realized over the taxpayer's adjusted basis provided in section 1011 for determining gain and that the taxpayer's loss from the sale of property shall be the excess of the taxpayer's adjusted basis provided in section 1011 for determining loss over the amount realized.

Section 1060 provides that, in the case of an "applicable asset acquisition," the consideration received shall be allocated among the acquired assets in the same manner as amounts are allocated to assets under section 338(b)(5). Section 1.1060-1T(a)(1) provides that, in the case of an applicable asset acquisition, sellers and purchasers must allocate the consideration under the residual method as described in sections 1.338-6T and 1.338-7T in order to determine, respectively, the amount realized from, and the basis in, each of the transferred assets.

Section 1060(c) defines the term "applicable asset acquisition" as the transfer of assets constituting a trade or business if the acquirer's basis in the transferred assets is determined wholly by reference to the consideration paid for such assets.

Section 1.1060-1T(c)(1) defines a seller's consideration as the amount, in the aggregate, realized from selling the assets in the applicable asset acquisition under section 1001(b). Section 1060 provides no independent basis for determining the amount a taxpayer realizes on the sale of assets or the time such amount may be taken into account. The amount realized and the time such amount is taken into account are determined solely under generally applicable tax accounting principles. See section 1001.

The residual method is based on a division of assets into seven classes: Class I (generally consisting of cash, and general deposit accounts held in banks, savings and loan associations, and other depository institutions), Class II (generally consisting of actively traded personal property like U.S. government securities and publicly traded stock, but also including certificates of deposit and foreign currency even if they are not actively traded personal property), Class III (accounts receivable, mortgages, and credit

card receivables from customers which arise in the ordinary course of business), Class IV (stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business), Class V (all assets other than Class I, II, III, IV, VI, and VII assets), Class VI (all section 197 intangibles, as defined in section 197, except goodwill and going concern value), and Class VII (goodwill and going concern value, whether or not it qualifies as a section 197 intangible).

Consideration is first reduced by the amount of Class I assets transferred by the seller. The remaining consideration is then allocated among the Class II assets (pro rata, to the extent of their fair market value), then among the Class III assets (pro rata, to the extent of their fair market value), then among the Class IV assets (pro rata, to the extent of their fair market value), then among the Class V assets (pro rata, to the extent of their fair market value), then among the Class VI assets (pro rata, to the extent of their fair market value), and, finally, any remaining consideration is allocated to the Class VII assets. Sections 1.1060-1T(c)(2), 1.338-6T(b)(1), and 1.338-6T(b)(2).

The following example illustrates the operation of section1060: On Date1, an applicable asset acquisition is made. The assets sold consist of Class I assets in the amount of $50; Class II assets with a fair market value of $250 and a basis in the hands of the seller of $100; Class III assets with a fair market value of $100 and a basis of $100; Class IV assets, with a fair market value of $150 and a basis of $50; Class V assets with fair market value of $100 and a basis of $100; and Class VI assets, with a fair market value of $50 and a basis of $0. The consideration consists of $375 cash and an assumed liability of $400 that, under applicable tax accounting principles, is taken into account at the time of the applicable asset acquisition.

The consideration will be first reduced by $50 (the amount of Class I assets). The remaining consideration will be allocated as follows: $250 to Class II assets (pro rata according to fair market value, resulting in a $150 gain); $100 to the Class III assets (pro rata according to fair market value, resulting in no gain or loss); $150 to the Class IV assets (pro rata according to the fair market value, resulting in a $100 gain); $100 to the Class V assets (pro rata according to the fair market value, resulting in no gain or loss); $50 to the Class VI assets (pro rata according to the fair market value, resulting in a $50 gain); and the remaining $75 to the Class VII assets (pro rata according to the fair market value, resulting in a $75 gain). The character of the amounts of gain or loss recognized by the seller, as well as any applicable holding periods, is determined by the nature of the underlying assets. Sections 1.1060-1T(a)(1), 1.1060-1T(c)(2), and 1.338-6T.

If under general tax principles there is a subsequent adjustment to the consideration, that amount is allocated in a manner that produces the same allocation that would have been made at the time of the acquisition had such amount been paid or incurred on the acquisition date. Sections 1.1060-1T(a)(1), 1.1060-1T(c)(2), and 1.338-7T.

With respect to the Plants' qualified funds, the federal tax treatment of the transaction is determined exclusively under section 468A and the regulations thereunder. With respect to the plants, equipment, operating assets, and assets of the nonqualified funds, however, these assets comprise a trade or business in Seller's hands and the basis Buyers take in those assets will be determined wholly by reference to the Buyers' consideration. Thus, Seller's transfer of the plants, equipment, operating assets, and assets of the nonqualified funds to Buyers in exchange for cash and the assumption of the decommissioning liability (except to the extent funded by the qualified funds) is an applicable asset acquisition as defined in section 1060(c). As such, its federal tax treatment is determined under section 1060 and the regulations thereunder.

Accordingly, Seller must allocate the consideration to the applicable assets in accordance with the provisions of section 1060 and the regulations thereunder. Specifically, Seller will first reduce the consideration received by the amount of Class I assets it transfers in the transaction (including any Class I assets held in the nonqualified funds). To the extent Seller's consideration exceeds the Class I assets it transfers, such excess will be allocated to the Class II assets, then to the Class III assets, then to the Class IV assets, then to the Class V assets, then to the Class VI assets, and finally to the Class VII assets. Such consideration is allocated to each class of assets pro rata according to the fair market value of those assets, up to their total fair market value. The character and other attributes of the amounts of gain and loss are determined by that of the underlying assets.

Accordingly, on the sale of the Plants and Taxpayer's interests in the assets in the decommissioning trust funds (other than the assets in the qualified funds), Taxpayer's gain or loss on each transferred asset will be the difference between the basis of the asset and the amount realized with respect to that asset, taking into account the allocation of consideration pursuant to section 1060 and the corresponding regulations.

Requested Ruling #3: Seller's amount realized on each of the sales of a Plant and associated assets will include the cash received from the Buyers and the amount of the liabilities assumed by the Buyer, including the liability to decommission the plant (reduced by the amount of such liability to be funded by the qualified nuclear decommissioning fund) to the extent such liabilities are taken into account for federal income tax purposes.

Section 1001(b) provides that a seller's amount realized from the sale of property is the sum of any money received plus the fair market value of the property (other than money) received.

Section 1.1001-2(a)(1) provides that a seller's amount realized from the sale of property includes the amount of liabilities from which the seller is discharged as a result of the sale. This may include debt and non-debt liabilities. See Fisher Co. v. Commissioner, 84 T.C. 1319, 1345-47 (1985) (assumption of lessee's repair liability

was part of amount realized on sale of leasehold). As discussed with respect to ruling request 4, below, the decommissioning liabilities from which Taxpayer will be relieved are fixed and determinable. As an owner and operator of nuclear plants, Taxpayer is required by law to provide for eventual decommissioning. See 10 CFR sections 50.33, 50.75.

Because the transfers of the qualified funds by Taxpayer to Buyers will not be taxable transfers, the amount of the liabilities assumed by Buyers that are included in Taxpayer's amount realized will not include the portion of the liability to decommission each of the Plants attributable to the qualified funds on the date of the transfers.

Accordingly, Taxpayer's amount realized from the sale of the Plants and the assets in the decommissioning trust funds will include the cash received from Buyers and the assumed liabilities, to the extent these liabilities are taken into account for federal income tax purposes. This would include the amount of the decommissioning liability assumed by Buyers with respect to each of the Plants, not including the portion of the liability to decommission the Plants attributable to the Plants' qualified funds on the date of the transfer.

Requested Ruling #4: Seller will be entitled to a deduction equal to the total of any amounts treated as realized by the Seller, or otherwise recognized as income by the Seller, as a result of the Buyers' assumption of the liability to decommission the Plants.

Section 1.446-1(c)(1)(ii)(A) provides that under an accrual method of accounting, a liability is incurred and generally taken into account for federal income tax purposes in the year in which all the events have occurred that establish the fact of the liability, the amount of the liability can be determined with reasonable accuracy, and economic performance has occurred with respect to the liability.

Section 461(h) makes clear that generally the all events test is not treated as having been met any earlier than the taxable year in which economic performance has occurred with respect to a liability. See also section 1.461-(4)(a)(1).

Section 461(h)(2)(B) provides that in the case of a liability that requires the taxpayer to provide services, economic performance occurs as the taxpayer provides the services. Section 1.461-4(d)(4) provides that economic performance occurs with respect to such service liabilities as the taxpayer incurs costs in connection with the satisfaction of the liability.

Section 1.461-4(d)(5) provides an exception to the general economic performance rule for services where the taxpayer sells a trade or business. Where the purchaser expressly assumes a liability arising out of the taxpayer's trade or business that the taxpayer but for the economic performance requirement would have been entitled to incur as of the date of the sale, economic performance with respect to the liability occurs as the amount of the liability is properly included in the amount realized on the sale by the taxpayer.

The first prong of the all events test requires that the fact of the liability be established at the time of the deduction. This prong of the all events test is satisfied in the instant case. Here, the Seller clearly has the obligation to decommission each of its Plants. The fact of the obligation arose many years ago, at the time the Seller obtained its license to operate each of the Plants. See 10 C.F.R. section 50.33 and section 72.30, requiring the operator of a nuclear power plant to decommission it. Moreover, Congress recognized the existence of the decommissioning liability when, in 1984, it enacted section 461(h) and section 468A , noting that "[g]enerally, under Federal and State laws, utilities that operate nuclear power plants are obligated to decommission the plants at the end of their useful lives." H.R. Conf. Rep. No. 98-861, 877 (1984). See also S. Prt. No. 169, Vol. 1, 98th Cong., 2d Sess. 277 (1984).

The second prong of the all events test requires the amount of the liability to be reasonably determinable. See section 1.461-1(a)(2)(ii). This prong is also satisfied. In the instant case, the amount of the Seller's decommissioning liability has been determined by experts in the nuclear decommissioning industry. Their calculations have been reviewed and accepted by both the Nuclear Regulatory Commission (NRC), which is charged with ensuring that sufficient funds are available to decommission the Plants, and the Federal Energy Regulatory Commission (FERC), which is charged with ensuring that the ratepayers are not overcharged for their share of the decommissioning costs. In addition, there is also support in the Code for finding that the amount of the decommissioning liability is reasonably determinable at the time of sale. Section 468A(d) generally permits a current deduction for a "ruling amount," based on estimated future decommissioning expenses. To the extent the decommissioning costs are sufficiently determinable to entitle the utility to a deduction under section 468A, it is reasonable to conclude that the costs must also be sufficiently determinable to satisfy the second prong of the all events test.

Given that the two prongs of the all events test are satisfied, economic performance with respect to the decommissioning liability occurs as of the date of the sale to the extent the liability is included in the Seller's amount realized. At that time, the Seller will be entitled to a deduction for the amount of its decommissioning liability associated with the Plants expressly assumed by the Buyers and included in the Seller's amount realized.

Accordingly, to summarize the conclusions set forth above, we reach the following conclusions in response to the Taxpayers' requested rulings:

1. Neither the Seller nor its qualified nuclear decommissioning funds will recognize gain or loss or otherwise take into account any income or deduction upon the transfer of the qualified nuclear decommissioning funds to the Buyers as a result of the sales.

2. Accordingly, on the sale of the Plants and Taxpayer's interests in the assets in the decommissioning trust funds (other than the assets in the qualified funds), Taxpayer's gain or loss on each transferred asset will be the difference between

the basis of the asset and the amount realized with respect to that asset, taking into account the allocation of consideration pursuant to section 1060 and the corresponding regulations.

3. The Taxpayer's amount realized from the sale of the Plants and the assets in the decommissioning trust funds will include the cash received from Buyers and the assumed liabilities, to the extent these liabilities are taken into account for federal income tax purposes. This would include the amount of the decommissioning liability assumed by Buyers with respect to each of the Plants, not including the portion of the liability to decommission the Plants attributable to the Plants' qualified funds on the date of the transfer.

4. Given that the two prongs of the all events test are satisfied, economic performance with respect to the decommissioning liability occurs as of the date of the sale to the extent the liability is included in the Seller's amount realized. At that time, the Seller will be entitled to a deduction for the amount of its decommissioning liability associated with the Plants expressly assumed by the Buyers and included in the Seller's amount realized.

This letter ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) provides that this ruling may not be used or cited as precedent. In accordance with the powers of attorney, we are sending a copy of this ruling to your authorized representatives. We are also sending a copy of this letter ruling to the District Director of District.

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