

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

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Refer Reply To:
CC:PSI:6-PLR-155809-01
Date:
November 15, 2001

Legend:

Taxpayer =

Parent =

Plant 1 =

Plant 2 =

Commission =

State =

Company 1 =

Company 2 =

Company 3 =

Company 4 =

Company 5 =

Law =

a =

b =

c =

d =

e =

f =

g =

h =

Dear :

This letter responds to your request, dated October 8, 2001, that we rule on certain tax consequences under section 468A of the Internal Revenue Code of the transfer of Plant 1 and Plant 2 to Genco a limited partnership, and a soon to be created

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wholly owned subsidiary of Taxpayer. As set forth below, you have requested rulings regarding the tax consequences to the Taxpayer and its qualified nuclear decommissioning funds.

The Taxpayer represents the facts and information relating to the ruling request as follows:

The Taxpayer is an electric utility engaged in the generation, purchase, transmission, distribution, and sale of electric energy wholly within the State. The Taxpayer is under the regulatory jurisdiction of Commission and the Nuclear Regulatory Commission (NRC). The Taxpayer is a wholly-owned subsidiary of the Parent and files its federal income tax return as part of the Parent's consolidated return under the audit jurisdiction of the Industry Director, LMSB (Natural Resources).

The Taxpayer owns two nuclear-fueled generating units, Plant 1 and Plant 2. The NRC license for Plant 1 expires on a. The NRC license for Plant 2 expires on b. The Taxpayer maintains qualified nuclear decommissioning funds for each Plant and has, pursuant to approved schedules of ruling amounts, made contributions to the qualified nuclear decommissioning funds.

In c, the State enacted Law effective on d. Pursuant to Law, a traditionally vertically integrated State electric utility is required to separate its generation, transmission and distribution, and retail activities into three segments under either common or separate ownership. Law allows all retail electric customers of State investor-owned utilities (such as Taxpayer) to take action to select a new retail electric provider. Under Law, the new electric retail provider may begin providing services starting in e.

In f, Commission approved Taxpayer's business separation plan to separate Taxpayer's generation business and its transmission and distribution business. With respect to its transmission and distribution business, Taxpayer will form Company 1 as its wholly-owned subsidiary. Taxpayer will contribute all of the assets of its transmission and distribution business to Company 1 in exchange for all of the outstanding stock of Company 1 and the assumption of certain Taxpayer liabilities by Company 1. With respect to its generation business, Taxpayer will transfer its generation assets to Genco, a limited partnership, in exchange for all of the interests in Genco and the assumption by Genco of a portion of the debt of Taxpayer.

The asset transfer to Genco will consist of the following steps:

1. Taxpayer will form the following subsidiaries: (1) Genco, a limited partnership; (2) Company 2, a single member limited liability company and disregarded entity for Federal income tax purposes; (3) Company 3, a single member limited liability company and disregarded entity for Federal income tax purposes; (4) Company 4, a single member limited liability company and disregarded entity for Federal income tax purposes; and

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- (5) Company 5, a single member limited liability company.
2. As part of the formation of Genco, Company 2 will contribute cash to Genco in exchange for a g percent general partnership interest in Genco.
3. In compliance with the timing mandated by State law, Taxpayer will contribute its generation assets to Genco in exchange for all of the limited partnership interests in Genco, totalling h percent.
4. Taxpayer will then contribute its limited partnership interest in Genco to Company 3 in exchange for all of the membership interests in Company 3. As a consequence, Company 2 and Company 3 will collectively hold all of the partnership interests, general and limited respectively, in Genco.
5. Taxpayer will contribute its membership interests in Company 2 and Company 3 to Company 4 in exchange for all of the membership interests in Company 4.
6. Taxpayer will contribute its membership interests in Company 4 to Company 5 in exchange for all of the membership interests in Company 5.

After all of the contributions have been completed, Genco will hold all generation assets, as a fourth tier subsidiary of Taxpayer. Since the entities between Taxpayer and Genco (Company 2, Company 3, and Company 4) will be disregarded entities for tax purposes, Taxpayer will be treated as directly owning the generation assets held by Genco. Thus, ultimately, Taxpayer will have transferred its interests in Genco to Company 5 in exchange for all of the membership interests of Company 5.

Specifically, with regard to Plant 1 and Plant 2, Taxpayer will transfer and deliver to Genco its ownership interests in Plant 1 and Plant 2 and associated qualified and nonqualified decommissioning funds to Genco. The NRC license will be transferred to Genco and Genco will assume the decommissioning liability. Genco will have access to funds from ratepayers to recover, through a non-bypassable charge collected by the distribution utility, the cost of decommissioning Plant 1 and Plant 2. Thus, pursuant to an order issued by Commission, Company 1 will collect from its customers the decommissioning costs on behalf of Genco, and transfer all collected amounts to Genco. Genco will deposit all nuclear decommissioning collections to its nuclear decommissioning trust funds.

Requested Ruling #1: Neither the Taxpayer, Genco, nor their respective qualified nuclear decommissioning funds will recognize any gain or loss or otherwise take into account any income or deduction into account by reason of the transfer of the Taxpayer's qualified nuclear decommissioning trust funds to Genco's qualified nuclear decommissioning trust funds. Genco's qualified nuclear decommissioning funds will have a basis in the assets held equal to the basis of such assets in the Taxpayer's qualified nuclear decommissioning funds immediately prior to the transfer.

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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.

Under section 1.468A-2(b)(2)(i) of the Income Tax Regulations, decommissioning costs are included in a taxpayer's cost of service for a taxable year to the extent such costs are directly or indirectly charged to customers of the taxpayer by reason of electric energy consumed during the taxable year or otherwise required to be included in the taxpayer's income under section 88 and the corresponding regulations.

Section 1.88-1(a) provides that decommissioning costs directly or indirectly charged to customers of the taxpayer include all decommissioning costs that consumers are liable to pay by reason of electric energy furnished by the taxpayer during the taxable year, whether payable to the taxpayer, a trust, State government, or other entity.

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-

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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.

Since Commission's order specifically requires Company 1 to collect from its customers the decommissioning costs on behalf of Genco and transfer all collected amounts to Genco, the Service will treat these transfers as dispositions qualifying under the general provisions of section 1.468A-6. Commission's order enables the Service to treat these transfers as decommissioning costs that are directly or indirectly charged to customers of Genco by reason of electric energy furnished by Genco, within the meaning of sections 88 and 468A and the corresponding regulations. Thus, under section 1.468A-6 the Taxpayer's funds will not be disqualified upon the transfer of Plant 1 and Plant 2 and the funds to Genco.

Section 1.468A-6(c)(1) provides that neither a transferor of an interest in a nuclear power plant nor the transferor's fund will recognize gain or loss or otherwise take any income or deduction into account by reason of a sale or other disposition. Accordingly, neither the Taxpayer nor its qualified 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 Genco.

Section 1.468A-6(c)(3) provides that transfers to which section 1.468A-6 apply do not affect basis. Thus, the qualified funds in the hands of Genco will have a basis in their assets equal to the basis in their assets prior to the transfer from the Taxpayer.

Requested Ruling #2: Following the transfer of Plant 1 and Plant 2 and the nuclear decommissioning funds to Genco, Genco will be treated as the "eligible taxpayer" and the "electing taxpayer" with respect to the Genco's qualified nuclear decommissioning funds and therefore, Genco may make deductible contributions to its qualified nuclear decommissioning funds in an amount equal to the lesser of (1) the amount of nuclear decommissioning costs allocable to such Funds which are included in Genco's cost of service for ratemaking purposes for such taxable year, or (2) the ruling amount applicable to such taxable year.

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Section 1.468A-1(b)(1) defines an eligible taxpayer as any taxpayer that possesses a qualifying interest in a nuclear power plant. Section 1.468A-1(b)(2) defines a qualifying interest to include a direct ownership interest. Pursuant to section 1.468A-2(a) an eligible taxpayer that elects the application of section 468A is an electing taxpayer. Section 1.468A-6(e)(2) provides rules for the determination of a schedule of ruling amounts for a transferee of a nuclear power plant. Section 468A(b) limits the deductible contribution to the lesser of the ruling amount or the nuclear decommissioning costs allocable to the fund which is included in a taxpayer's cost of service for ratemaking purposes for the taxable year.

Fundamental to making a deductible contribution to a qualified nuclear decommissioning fund pursuant to a schedule of ruling amounts under section 468A are four requirements. First, a taxpayer must be an eligible taxpayer. Second, a taxpayer must be liable for the decommissioning of the nuclear power plant. Third, a taxpayer must have decommissioning costs included in its cost of service for ratemaking purposes for the year for which the deductible contribution is made. Fourth, a taxpayer must request and receive a schedule of ruling amounts from the Service.

Based on the information submitted by the Taxpayer, Genco clearly satisfies the requirements for being an eligible taxpayer under section 1.468A-1(b) and an electing taxpayer under section 1.468A-2. In addition, as part of the business separation plan approved by Commission, the liability to decommission Plant 1 and Plant 2 has been transferred to Genco. Since Commission's order requires Genco to contribute all nuclear decommissioning collections to its nuclear decommissioning trust funds, Genco has satisfied the requirement of having decommissioning costs included in its cost of service for ratemaking purposes for the year for which the deductible contribution is made. Genco may rely on the provisions of section 1.468A-6(e)(2) for a determination of the ruling amount in the year of transfer. Pursuant to section 1.468A-6(e)(2)(ii), Genco must request a revised schedule of ruling amounts for any tax year subsequent to the tax year in which Plant 1 and Plant 2 are transferred. Finally, section 468A(b) limits the deductible contribution to the lesser of the ruling amount or the nuclear decommissioning costs allocable to the fund which is included in a taxpayer's cost of service for ratemaking purposes for the taxable year.

The rulings expressed, herein, are expressly conditioned on Commission's order regarding the collection and contribution of decommissioning costs, e.g., Company 1 collects costs from ratepayers, transfers the amounts collected to Genco, and Genco contributes the authorized amounts to its funds. In addition, these rulings are expressly conditioned on the continued direct or indirect ownership and control of Genco by the Taxpayer.

Except as specifically determined above, no opinion is expressed or implied concerning the Federal income tax consequences of the transaction described above. 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.

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Pursuant to section 1.468A-7(a) of the regulations, a copy of this letter must be attached (with the required Election Statement) to the Taxpayer's federal income tax return for each taxable year in which the Taxpayer claims a deduction for payments made to the Fund.

In accordance with the power of attorney, we are sending a copy of this ruling to your authorized representative. We are also sending a copy of this letter ruling to the Industry Director, LMSB (Natural Resources).

Sincerely,
PETER C. FRIEDMAN
Senior Technician Reviewer, Branch 6
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure:
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