Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:Br.6-PLR-160087-01
Date:
July 23, 2002

Legend:

Seller =

Buyer =

Parent =
Subsidiary =
Operator =
Plant =
Commission 1 =
Commission 2 =
Location =
State =
Trust =
State 2 =
State 3 =
Statute =

A =
B =
C =
D =
E =
F =
G =
H =
I =
J =
K =
L =
M =

Dear :

This letter responds to the request submitted by your authorized representative dated October 31, 2001, and subsequent communications, for a private letter ruling concerning the tax consequences of the sale to Buyer of Seller's interest in the Plant and associated assets and liabilities, including the assets and liabilities associated with decommissioning the Plant. Specifically, 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 nuclear power plant and associated assets and the proper allocation of basis among the assets received by Buyer.

The Seller and Buyer, in a jointly-filed ruling request, have represented the following facts and information relating to the ruling request:

Seller, a regulated public utility company, files its corporate return on a calendar year basis using the accrual method of accounting. Seller is under the audit jurisdiction of the Industry Director, Natural Resources (LM:NR).

Buyer is a third-tier subsidiary of Parent, a public utility holding company. Buyer is a member of Parent's consolidated group and joins Parent in filing a consolidated return on a calendar year basis using the accrual method of accounting. Buyer owns Subsidiary, which will be the legal purchaser of Plant and the associated assets and liabilities. Buyer represents that Subsidiary is a disregarded entity for federal income tax purposes. Buyer, through Subsidiary and its affiliate Operator, will be engaged in the business of operating nuclear power plants for the generation and sale of electric power. Buyer and Parent are under the audit jurisdiction of the Industry Director, Natural Resources (LM:NR).

Commission 1 has established and regulated the rates charged by Seller for the electricity generated by the Plant, including the recovery of nuclear decommissioning costs. Seller is also subject to the jurisdiction of Commission 2. Buyer will operate as an exempt wholesale generator under the jurisdiction of Commission 1 as to the terms and conditions of its wholesale electric power sales and of the Nuclear Regulatory Commission (the "NRC") as to the requirements and conditions of the ownership and operation (including decommissioning) of the Plant; however, Buyer's sales of electric power are not subject to regulation by a public utility commission or by the Rural Electrification Administration. Along with Buyer (through Subsidiary), Operator will be a named licensee on the license issued by the NRC. Operator will be the employer of all personnel and act as agent for Buyer, pursuant to an operating agreement with Buyer, to operate the Plant.

The Plant is located in Location, and consists of a reactor, internal piping systems, turbines, recirculating piping systems, cooling towers, a spent nuclear fuel storage pool, a transformer, on-site low-level radioactive waste storage facilities, and ancillary facilities, as well as the existing inventory of nuclear fuel and spent nuclear fuel. In A, B investor-owned utilities organized Seller as a utility company under State law. The Plant began commercial operation in C. Seller sells all of the electrical power generated by the Plant to the B utility owners.

Trust, established by Seller on D to fund the decommissioning of the Plant, maintains two separate funds: a fund qualifying under section 468A ("Qualified Fund") and a fund that did not meet the requirements of section 468A ("Non-qualified Fund"). The Non-qualified Fund is treated as a grantor trust for federal income tax purposes under sections 671 through 677. The level of funding in the decommissioning funds are estimates of the future costs that the owner of the Plant will incur upon the decommissioning of the Plant. The cost of disposing of low-level radioactive waste upon decommissioning is part of this calculation.

On E, Buyer entered into an Asset Purchase Agreement with Seller to purchase seller's entire F percent interest in the Plant. The agreement contemplates that Buyer, through Subsidiary, will pay $G to Seller in cash and assume all decommissioning liabilities associated with the Plant, including the costs of disposing of low-level nuclear waste[1], in addition to other Plant-related liabilities. The parties have structured the

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[1] Pursuant to the Low-Level Radioactive Waste Policy Act of 1980, State accepted responsibility for providing a low-level radioactive waste facility for waste produced in the state. In 1985, Congress passed the Low-Level Radioactive Waste Policy Amendments Act, which encouraged states that had accepted such responsibility to meet that responsibility by participating in interstate compacts.

In H, State established a Fund, which held amounts to be used by State to provide a disposal site for low-level radioactive waste within the state. The Fund was funded by assessments by State on generators of radioactive waste within the state. Seller was assessed and paid about $I to the Fund between H and J; however, all but $K of this amount was used by State for administrative expenses and engineering studies. Seller took a deduction for the amount contributed to the Fund. To date, State has not developed a waste facility.

In L, Congress approved a multi-state compact among State, State 2, and State 3 (the "Compact"), by passing the Statute. Under the Compact, State 2 is required to develop and operate a storage facility for low-level radioactive waste for use by State and State 3. Once certain contingencies occur, State and State 3 will each be required to pay certain amounts to State 2 and to the county within State 2 in which the disposal

transaction as a sale of assets, subject to section 1060, and the Service is not disputing that characterization of the transaction.

The Asset Purchase Agreement (the "Agreement") obligates Seller to transfer to Subsidiary at the closing of the transaction all the assets of the Qualified Fund and the Non-qualified Fund. Seller is obligated under the agreement to continue to make contributions to the funds until the closing of the transaction. However, to the extent that the fair market value of the assets in the Trust at closing is less than the minimum funding requirement required by the Nuclear Regulatory Commission (up to a specified dollar amount), Seller is obligated to contribute adequate funds to Seller's Non-qualified Fund on or before the closing date. Buyer is further obligated under the Agreement to sell electric power to Seller through M.

Prior to the closing of the transaction, Buyer will execute a Master Trust Agreement that will establish a qualified nuclear decommissioning fund and a non-qualified nuclear decommissioning fund. At the closing of the transaction, Seller will transfer all assets of the Qualified Fund to Buyer's qualified fund, and all assets of the Non-qualified Fund to Buyer's non-qualified fund.

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facility is located. To fund its obligations under the Compact, State passed a statute creating a low-level radioactive waste disposal fund ("Compact Fund"), pursuant to which generators of radioactive waste in State may be assessed the full administrative cost of State's membership and participation in the Compact. The State statute also provides that amounts that were held in the Fund are to be transferred to the Compact Fund. Accordingly, the Compact Fund now holds the $K that formally was held by the Fund.

State 2 has not located a site for the waste facility, much less begun construction, and may never do so. As a consequence, State does not have a current liability, and may never have a liability, to State 2 pursuant to the Compact. Accordingly, Seller does not currently, and may never have, an obligation to State to fund the Compact Fund, beyond the amount rolled over from the Fund. Upon sale of the Plant, Buyer will acquire Seller's right, title, and interest in the $K contributed to the Compact Fund by Seller and currently held by State. If State 2 does not site and build a waste facility pursuant to the Compact, then responsibility for providing an alternative disposal location for low-level radioactive waste generated in State falls back to State under its agreement with the federal government.

Requested Ruling #1: *Seller's qualified nuclear decommissioning trust will not be disqualified upon the sale of the Plant and the transfer of the assets in Seller's qualified nuclear decommissioning fund to Buyer's qualified nuclear decommissioning fund, and after the transfer Buyer's qualified nuclear decommissioning fund will be treated as a qualified fund satisfying the requirements of section 468A.*

Section 468A(a) provides that a taxpayer may elect to deduct payments made to a nuclear decommissioning reserve fund (the qualified 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 fund is 20 percent. Section 468A(4) provides, in pertinent part, that the assets in a qualified fund shall be used exclusively for satisfying the liability of any taxpayer contributing to the qualified 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 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 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 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 fund) where the transferee is an eligible taxpayer after the transfer. 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 exercise its discretion under section 1.468A-6(g) to treat this transaction as a disposition qualifying under the general provisions of section 1.468A-6. Thus, under section 1.468A-6, the qualified nuclear decommissioning fund of Seller will not be disqualified upon the transfer of the assets to Buyer's qualified nuclear decommissioning fund, and Buyer's qualified nuclear decommissioning fund, after receiving the transferred assets, will be treated as a qualified nuclear decommissioning fund for purposes of section 468A.

Requested Ruling #2: *Neither Seller's qualified nuclear decommissioning fund nor Buyer's qualified nuclear decommissioning fund will recognize gain or loss or otherwise take any income or deduction into account upon the transfer of the assets of Seller's qualified nuclear decommissioning fund to Buyer's qualified nuclear decommissioning fund as a result of the sale of the Plant.*

Requested Ruling #3: *Neither Buyer nor Seller will recognize gain or loss or otherwise take any income or deduction into account by reason of the transfer of the assets of Seller's qualified nuclear decommissioning fund to Buyer's qualified nuclear decommissioning fund as a result of the sale of the Plant.*

Section 1.468A-6(c)(1) provides that neither a transferor nor its fund will recognize gain or loss or otherwise take any income or deduction into account by reason of the transfer of the assets from a transferor's qualified fund to a transferee's qualified fund. Thus, neither Seller nor the qualified nuclear decommissioning fund maintained by Seller will recognize gain or loss or otherwise take any income or deduction into account by reason of the transfer of the qualified nuclear decommissioning fund assets to Buyer's qualified nuclear decommissioning fund.

Similarly, section 1.468A-6(c)(2) provides that neither a transferee nor its fund will recognize gain or loss or otherwise take any income or deduction into account by reason of the transfer of the assets from a transferor's qualified fund to a transferee's qualified fund. Thus, neither Buyer nor its qualified nuclear decommissioning fund will recognize gain or loss or otherwise take any income or deduction into account by

reason of the transfer of Seller's qualified nuclear decommissioning fund assets to Buyer's qualified nuclear decommissioning fund.

Requested Ruling #4: *Buyer's qualified nuclear decommissioning fund will have a basis in the assets received from Seller's qualified nuclear decommissioning fund that is the same as the basis of those assets in Seller's qualified nuclear decommissioning fund immediately before the close of the transaction.*

Section 1.468A-6(c)(3) provides that transfers of assets of a qualified fund to which section 1.468A-6 applies do not affect basis. Accordingly, under section 1.468A-6(c)(3), Buyer's qualified nuclear decommissioning fund will have a basis in the assets received that is the same as the basis of those assets in Seller's qualified nuclear decommissioning fund immediately before the transfer.

Requested Ruling #5: *Seller will be allowed current ordinary deductions for federal income tax purposes for any amounts treated as realized by Seller, or otherwise recognized as income to Seller, as a result of Buyer's assumption of Seller's decommissioning liabilities related to the Plant.*

Section 1.446-1(c)(1)(ii)(A) of the Income Tax Regulations 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) of the regulations.

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) of the regulations 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) of the regulations 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, Seller clearly has an obligation to decommission the Plant. The fact of the obligation arose many years ago, at the time Seller obtained its license to operate the Plant. See 10 C.F.R. §§ 50.33 and 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 sections 461(h) and 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 that the amount of the liability be reasonably determinable. Section 1.461-1(a)(2)(ii) of the regulations. This prong is also satisfied. In the instant case, the amount of 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 and the Federal Energy Regulatory Commission. 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 also must 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 Seller's amount realized. At that time, Seller will be entitled to a deduction for the amount of its otherwise deductible decommissioning liability associated with the Plant expressly assumed by Buyer and included in Seller's amount realized.

Requested Ruling #6: *Buyer will not recognize any income for federal income tax purposes by reason of any transfer of the assets of Seller's non-qualified fund to Buyer's non-qualified find or the transfer to Buyer from Seller of any rights in funds held by State for the disposal of low-level radioactive waste during decommissioning, except to the extent that the amount of cash and other Class 1 assets (as such term is defined in section 1.338-6T) received by Buyer exceeds the amount of consideration paid by Buyer (as determined under section 1060).*

Before specifically making a determination with respect to Requested Ruling #6, several preliminary determinations must be made.

1. Section 1012 provides in part that the basis of property shall be the cost of such property. Therefore, Buyer's basis in the assets purchased from Seller will include the cash paid to Seller. However, the assumed decommissioning liability cannot be treated as incurred with respect to Buyer for any federal income tax purpose -- including basis -- until economic performance occurs with respect to that liability. The legislative history underlying the enactment of section 461(h) makes it clear that Congress intended to exclude an item from being taken into account for tax purposes until economic performance occurs. This treatment applies to capital as well as non-capital transactions. H.R. Rep. No. 432, Pt. 2, 98th Cong., 2d Sess., 1252, 1255 (1984); S. Prt. No. 169, Vol. 1, 98th Cong., 2d Sess. 266-267 (1984). Despite criticism from some commentators that the Service lacks authority to apply the economic performance rules broadly enough to include the calculation of basis and cost of goods sold, the Service explicitly stated in the preamble to the final regulations implementing section 461(h) that the Service and Treasury believe the intended scope of the statutory provision is indeed broad enough to apply in this manner. Preamble to T.D. 8408, 57 Fed. Reg. 12411 (Apr. 10, 1992) [1992-1 C.B. 155, 156].

Consistent with this position, the Service amended the regulations under section 446 to clarify that a liability is incurred, and generally is taken into account for federal income tax purposes, in the taxable year in which the all events test is satisfied and economic performance has occurred with respect to the item. Section 1.446-1(c)(1)(ii)(A) of the regulations. The regulations further clarify that applicable provisions of the Code, the regulations, and other guidance published by the Secretary prescribe the manner in which a liability that has been incurred is taken into account, and specifically cite to the capitalization provisions of section 263 as an example of a Code provision subordinate to the economic performance requirement. Specifically, the regulations state, "For example, an amount that a taxpayer expends or will expend for capital improvements to property must be incurred before the taxpayer may take the amount into account in computing its basis in the property." Section 1.446-1(c)(1)(ii)(B) of the regulations.

Thus, critical to determining whether Buyer is entitled to treat the future decommissioning liability as a component of its cost basis in the assets purchased from Seller is deciding whether the liability will be incurred for tax purposes as of the closing. It will not. Economic performance does not occur with respect to a service liability such as the decommissioning liability until and to the extent that costs are incurred in satisfaction of that liability. Section 1.461-4(d)(4) of the regulations. Because Buyer will not have performed any services relating to the decommissioning liability at the time of the Plant's purchase, economic performance will not have occurred, and the liability will not have been incurred at that time for any purpose under the Internal Revenue Code, including the cost basis provisions of section 1012.

Accordingly, at the time of closing, Buyer will have a cost basis in the assets purchased from Seller equal to the cash paid to Seller, as well as any liabilities that are

otherwise incurred for federal income tax purposes at the time of the closing date. Buyer will not be entitled to treat as a component of its cost basis at the time of the closing any amount attributable to the future decommissioning liability not taken into account as a liability for federal income tax purposes as of the closing date. The Buyer's cost basis in the assets purchased from Seller, including all assets held in the Non-qualified Fund and the Compact Fund, must be allocated among all such assets in accordance with the residual method provided in section 1060 and section 1.1060-1T(d), (e) of the regulations.

2. 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 1.1060-1(a)(1) provides that, in the case of an applicable asset acquisition, the seller and the purchaser each must allocate the consideration paid or received in the transaction under the residual method as described in sections 1.338-6 and 1.338-7 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 1.1060-1(c)(1) defines a purchaser's consideration as the amount, in the aggregate, of its cost of purchasing the assets in the applicable asset acquisition that is properly taken into account in basis. Section 1060 provides no independent basis for determining a taxpayer's cost of acquired assets; cost is determined solely under generally applicable tax accounting principles. Section 1.1060-1(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 also 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 that section, except goodwill and going concern value), and Class VII (goodwill and going concern value, whether or not it qualifies as a section 197 intangible). Section 1.338-6.

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

The following examples illustrate the operation of section 1060 from a seller's and a buyer's perspective, respectively:

A) On Date1, an applicable asset acquisition is made. 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 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 first will be 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 1.338-6, 1.1060-1(a)(1), and 1.1060-1(c)(2).

B) On Date1, an applicable asset acquisition is made. The consideration consists of $150 cash and an assumed liability for which economic performance has not occurred. The assets acquired consist of Class I assets in the amount of $50, Class II assets with a fair market value of $350, Class III assets with a fair market value of $100, Class IV assets with a fair market value of $150, and

Class V assets with a fair market value of $100. There are no Class VI or VII assets. On Date1, the purchaser has provided $150 of consideration that may be allocated as basis; it first will be reduced by $50 (the amount of Class I assets); the remaining $100 will be allocated to Class II assets (pro rata according to fair market value); nothing is allocated to Class III or below. On Date2, economic performance occurs with respect to the liability to the extent of $300; at that time, the purchaser has an additional $300 of basis that may be taken into account. Of that amount, $250 is allocated to Class II assets (which will then have been allocated their full $350 fair market value – as determined on the acquisition date), and the remaining $50 is allocated to the Class III assets (pro rata according to fair market value – as determined on the acquisition date). On Date3, economic performance occurs to the extent of an additional $400, which is then taken into account as basis. Of that amount, $50 will be allocated to the Class III assets (which will then have been allocated their full $100 fair market value – as determined on the acquisition date), $150 will be allocated to the Class IV assets (which will then have been allocated their full $150 fair market value – as determined on the acquisition date), $100 will be allocated to the Class V assets (which will then have been allocated their full $100 fair market value – as determined on the acquisition date), and the remaining $100 will be allocated to the Class VII (as goodwill). The last amount is allocated to goodwill even though goodwill was not identified as a separate asset having value on Date1. If, on Date3, instead of an addition to purchaser's consideration, there is a $100 decrease in consideration, the consideration previously allocated to the Class III assets ($50) would be reduced to zero, and the consideration previously allocated to the Class II assets would be reduced by the remaining $50 (pro rata according to fair market value).

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 1.338-7, 1.1060-1(a)(1), and 1.1060-1(c)(2).

The Plant (including equipment and operating assets) and the assets of the Non-qualified Fund comprise a trade or business in Seller's hands and the basis Buyer takes in these assets will be determined wholly by reference to the Buyer's consideration. Thus, Seller's transfer of the Plant (including equipment and operating assets) and assets of the Non-qualified Fund to Buyer in exchange for cash and the assumption of the decommissioning liability (except to the extent funded by the Qualified Fund) 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 in 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 Non-qualified Fund). 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.

Additionally, on the acquisition date, Buyer's basis in the assets acquired must be determined by allocating its cost (i.e., the consideration provided by Buyer on the acquisition date, which includes the cash but not the assumption of the decommissioning liability) among the acquired assets in accordance with the provisions of section 1060 and the regulations thereunder. Specifically, Buyer will first reduce its consideration by the amount of the Class I assets it receives in the transaction (including any Class I assets held in the Non-qualified Fund); to the extent the Class I assets received exceed the consideration Buyer provides, Buyer will recognize income. To the extent Buyer's consideration exceeds the Class I assets it receives, such excess will be allocated in accordance with the provisions of section 1060 and the regulations thereunder, as described above. When and to the extent additional amounts are paid or incurred for the assets acquired in the applicable asset acquisition (e.g., when and to the extent the Buyer's non-qualified fund pays or incurs decommissioning expenses), such amounts will be taken into account as increases to Buyer's consideration and allocated in the same manner and subject to the same conditions as though they were paid or incurred on the acquisition date. Sections 1.338-6, 1.338-7, 1.1060-1(a)(1), and 1.1060-1(c)(2).

3. Finally, a taxpayer generally does not realize gross income upon its purchase of a business' assets, even where those assets include cash or marketable securities and, in connection with the purchase, the taxpayer assumes liabilities of the seller. See Commissioner v. Oxford Paper, 194 F.2d 190 (2d Cir. 1952); Rev. Rul. 55-675, 1955-2 C.B. 567. In this case, Buyer cannot acquire the Plant without assuming the decommissioning liability, which is inextricably associated with ownership and operation of Plant, and there is no indication that the transaction is other than a bona fide purchase of the business and its associated assets and liabilities. The exception to the general rule set forth in Rev. Rul. 71-450, 1971-2 C.B. 78, does not apply. In Rev. Rul. 71-450, unlike the present situation, the purchaser agreed to assume the prepaid subscription liability in return for a separate cash payment, and the liability was not reflected in the sales price of the business.

Accordingly, Buyer will not realize income from its purchase of the Plant and Seller's interests in the assets in the decommissioning funds. The Buyer will realize income from its purchase of the Plant and related assets to the extent that the amount

of cash and other Class I assets (as defined in section 1.338-6(b)(1)) received exceeds its total cost determined under section 1012 (which will be the sum of its cash consideration and the fair market value of any other consideration it provides to Seller that is, under applicable tax principles, taken into account on the date of the applicable asset acquisition). If Buyer is thus required to take an amount into account as income, then, when, under general principles of tax law, Buyer is permitted to take additional consideration into account (e.g., when it satisfies the economic performance requirement with respect to the decommissioning liability assumed), Buyer will be entitled to deduct currently (and will not be required to capitalize) such amount. Arrowsmith v. Commissioner, 344 U.S. 6 (1952).

Except as specifically determined above, no opinion is expressed or implied concerning the Federal income tax consequences of the transaction described above. This ruling is directed only to the taxpayers who requested it. Section 6110(k)(3) of the Code provides it may not be used or cited as precedent.

In accordance with the power of attorney you submitted with the request, we are sending copies of this ruling to your authorized representatives. We are also sending a copy of this letter ruling to the Industry Director, Natural Resources (LM:NR).

Sincerely,

Peter C. Friedman
PETER C. FRIEDMAN
Senior Technician Reviewer, Branch 6
Office of Associate Chief Counsel
Passthroughs and Special Industries

cc: