Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:6 PLR-130089-02
Date:
August 8, 2002

Legend:

Transferor =

Parent =

Transferee =
Subsidiary =

Plant =
State =
Commission A =
Commission B =
Commission C =
Charge =

a =
b =
c =
d =
e =
f =
g =
h =
i =

Dear :

This letter responds to a request from Transferor, dated May 31, 2002, that we rule on certain tax consequences regarding the transfer of Plant from Transferor to Subsidiary. More specifically, as set forth below, rulings have been requested regarding the tax consequences under section 468A of the Internal Revenue Code to Transferor, Subsidiary, and the qualified nuclear decommissioning funds for Plant.

Transferor and Subsidiary represent the facts and information relating to its request as follows:

Parent is a publicly traded holding company and is the common parent of an affiliated group that files a consolidated Federal income tax return. Transferor is a wholly owned subsidiary of Parent. Transferor is a utility in State and is engaged in the electric generation, transmission, and distribution businesses. Transferor is under the regulatory jurisdiction of Commission A, Commission B, and Commission C.

Plant consists of three Units. Transferor has a direct ownership interest of a percent in Units 1 and 3 of Plant. Transferor also has a direct ownership interest of b percent and a lessee ownership interest of c percent for a total ownership interest of a percent in Unit 2 of Plant. Transferor maintains both qualified and nonqualified nuclear decommissioning funds with respect to its interests in each Unit of Plant.

In d, Commission A adopted rules for retail electric competition requiring various utilities to open a portion of their electric load for retail competition by e. Commission A also allowed utilities to recover stranded costs (the difference between the value of jurisdictional assets used to provide electric service acquired prior to d and the assets' market value in a competitive regime). In f, Commission A adopted revised rules for retail electric competition that required various utilities to legally separate all competitive generation assets and services from noncompetitive assets and services through divestiture either to an unaffiliated party or to a separate corporate affiliate or affiliates by g. A final modified version of the rules was adopted a year later. The final version provides that decommissioning costs will continue to be collected from consumers as part of Charge, a pro-rata non-bypassable charge imposed on retail consumers. Proposed rates for the collection of Charge must be filed and reviewed by Commission A at least every three years.

On h, Transferor executed a settlement agreement with several major consumer groups. The settlement agreement extended the date for divestiture by Transferor of all generation and other competitive services to i. It also fixed the level of Transferor's stranded costs subject to recovery, approved unbundled rate schedules, and granted Transferor and Parent certain waivers from Commission A's more general rules on affiliate transactions and holding company restructuring. Commission A subsequently approved the settlement agreement.

As part of the divestiture plan for the generation assets, Transferor will transfer all of its generation assets (including Plant and the associated qualified and nonqualified nuclear decommissioning funds) to Transferee in exchange for all of the outstanding stock of Transferee and an assumption by Transferee of a portion of the debt of Transferor. Next, Transferor will distribute all of the stock of Transferee to Parent. Following the distribution, Parent will own 100 percent of the issued and outstanding stock of both Transferor and Transferee. Then, Transferee will merge with and into Subsidiary, with Subsidiary surviving the merger. Subsidiary is also a wholly owned subsidiary of Parent. Through the merger, a transfer of the generation assets from Transferee to Subsidiary will occur and Subsidiary will succeed Transferee as

beneficiary and grantor of the qualified and nonqualified nuclear decommissioning funds. After the divestiture plan is completed, Transferor will continue to engage in the electric transmission and distribution businesses. Subsidiary will: 1) become the licensee on the operating license for Plant; 2) be liable for its portion of the decommissioning costs for Plant; and 3) be the beneficiary and grantor of the qualified and nonqualified nuclear decommissioning funds.

Pursuant to the final version of rules for retail electric competition, Transferor will continue to collect decommissioning expenses through Charge directly from consumers.

Requested Ruling #1: Neither Transferor, Transferee, Subsidiary, nor their respective qualified nuclear decommissioning funds will recognize any gain or loss or otherwise take any income or deduction into account by reason of the divestiture plan.

Requested Ruling #2: The Subsidiary's qualified nuclear decommissioning funds will have a basis in the assets equal to the basis of such assets in Transferor's qualified nuclear decommissioning funds immediately prior to the divestiture plan.

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-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.

Based on the information submitted by Transferor and Subsidiary, the Service will treat the transfer as a disposition qualifying under the general provisions of section 1.468A-6. Commission A's approval of the divestiture plan and the legal requirement that such plan and its provisions be followed enables the Service to treat the transfer of Plant and the related decommissioning costs as included in cost of service that are directly or indirectly charged to customers of Subsidiary by reason of electric energy furnished by Subsidiary, within the meaning of sections 88 and 468A and the corresponding regulations. Thus, under section 1.468A-6, Transferor's funds will not be disqualified upon the transfer of Plant and the funds to Subsidiary.

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. Section 1.468A-6(c)(2) provides that neither a transferee of an interest in a nuclear power plant nor the transferee'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 Transferor, Subsidiary, nor their respective 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 Subsidiary.

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 Subsidiary will have a basis in their assets equal to the basis in their assets prior to the transfer from Transferor.

Please note, however, that 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. Since Transferor is under no legal obligation to contribute on behalf of Subsidiary into the qualified and nonqualified nuclear decommissioning funds the decommissioning expenses it collects directly from consumers through Charge, future decommissioning costs are not considered to be included in Subsidiary's cost of service for ratemaking purposes and no further contributions may be made to the qualified nuclear decommissioning funds with respect to Plant.

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.

In accordance with the powers of attorney, a copy of this letter ruling is being sent to your authorized representative. A copy of this letter ruling also is being sent to the appropriate Industry Director, LMSB.

Sincerely,

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