Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Number: **200107007**
Release Date: 2/16/2001
Index Number: 468A.00-00, 461.00-00, 1012.06-00,1060.00-00

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:6-PLR-117909-99
Date:
November 8, 2000

Legend:

Taxpayer =

Parent =

Company 1 =
Company 2 =
Company 3 =
Company 4 =

Plant 1 =
Plant 2 =
Plant 3 =
Plant 4 =
Plant 5 =

District =

Commission A =

Commission B =

a =

b =

c =

This letter responds to your request, dated November 5, 1999, that we rule on certain tax consequences of the transfer of the Plants from Taxpayer to Company 3. As set forth below, you have requested rulings regarding the tax consequences under section 468A of the Internal Revenue Code to the Taxpayer and its qualified nuclear decommissioning fund as well as rulings regarding the tax treatment of the transfer of nonqualified funds on the transfer of the Plants.

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

The Taxpayer owns and operates electric generation plants and a distribution network to carry power to industrial and retail customers. The Taxpayer is under the regulatory jurisdiction of Commission A and Commission B. The Taxpayer owns interests in a nuclear generating Plants and is a wholly-owned subsidiary of the Parent.

Pursuant to an order, dated c, from Commission A, the Taxpayer is in the process of withdrawing from the electric power generation business and will transfer all of its generation assets and liabilities to affiliated companies. Pursuant to the order, the Taxpayer will collect a nonbypassable Societal Benefits Charge (SBC) as a mechanism, in part, for recovering nuclear decommissioning costs.

Pursuant to the order of Commission A, the Taxpayer will reorganize its business as follows. Company 1 will be a wholly owned subsidiary of Parent that will own all of the shares of Companies 2, 3, and 4. Company 1 will supply administrative services to its subsidiaries and will be responsible for financing their operations. Company 2 will hold and operate the non-nuclear generating facilities formerly owned by the Taxpayer and will sell all of its generation capacity to Company 4. Company 3 will hold and operate the nuclear Plants formerly owned by the Taxpayer and will sell all of its generation capacity to Company 4. Company 4 will market energy purchased from Companies 2 and 3 (and other sources) and engage in the wholesale marketing, brokering and trading of energy. Until b, Company 4 will sell capacity and energy to the Taxpayer in order to support the Taxpayer's basic generation service obligation to its customers. After b, Company 4 may compete to sell capacity and energy to the Taxpayer subject to review by the Commissions.

In connection with the reorganization, Company 3 will assume all liabilities associated with the interests in the nuclear power plants it receives including the liabilities to decommission those interests in the Plants. The Taxpayer will assign the licenses to operate the Plants and will transfer to Company 3 the right to receive the proceeds from the SBC relating to decommissioning. In connection with the transfer of the Plants, the Taxpayer will transfer to Company 3 its qualified and nonqualified

nuclear decommissioning funds.

Requested Ruling #1: Neither the Taxpayer, Company 3, nor the 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 to Company 3 of the qualified nuclear decommissioning funds. The qualified nuclear decommissioning funds will have a basis in the assets held equal to the basis of such assets prior to the transfer of the funds to Company 3.

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 transfers, 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 Taxpayer's funds will not be disqualified upon the transfer of the Plants and the funds to Company 3 but will also not be able to accept additional contributions from the Taxpayer or Company 3 unless Company 3 were to request and receive a new schedule of ruling amounts under section 468A.

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. 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 Company 3.

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 Company 3 will have a basis in their assets equal to the basis in their assets prior to the transfer from the Taxpayer.

Requested Ruling #2: With respect to the Taxpayer's transfer of the Plants and associated nonqualified funds to Company 3 in exchange for consideration and the assumption of the obligation to decommission the Plants, Company 3 will not recognize any gain or otherwise take any income into account by reason of the transfer of the nonqualified funds.

Generally, a taxpayer does not realize 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, Company 3 cannot acquire the Taxpayer's interests in the Plants without assuming the associated decommissioning liabilities, which are inextricably associated with the ownership and operation of the Plants, and there is no indication that the transaction is other than a bona fide purchase of Taxpayer's interests in the Plants and the 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, Company 3 will not realize income from its acquisition of Taxpayer's interests in the Plants and in the assets in the non-qualified funds except to the extent that, under the rules of section 1060, the amount of cash and other Class I assets received by Company 3 (not including the assets in the qualified funds) surpasses the amount of consideration provided by Company 3 and taken into account in the year of the acquisition. Further, to the extent that Company 3 is entitled to take into account other consideration paid, Company 3 will make appropriate adjustments to reflect any income previously recognized by virtue of having acquired Class I assets in excess of the consideration taken into account in the year of the acquisition. See sections 1.1060-1T(c)(2); 1.338-6T(b)(1) and -7T(b).

Our conclusion above is conditioned on Company 3 including in basis only the cash paid to Taxpayer and any liabilities that are otherwise incurred for federal income tax purposes, and allocating this consideration pursuant to the residual method under section 1060 and the regulations thereunder. Pursuant to section 461(h) and the regulations thereunder, Company 3 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 liabilities assumed in the transactions.

Finally, 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 section 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 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 and 461(h).

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 they qualify as section 197 intangibles).

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 among the Class VII assets (pro rata, according to their fair market value). 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, are 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, e.g., if it is later determined that the actual amount of the liability assumed differs from the value that the parties assigned to such liability on the date of the applicable asset acquisition, 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 Plant, equipment, operating assets and nonqualified fund assets, these assets comprise a trade or business in Taxpayer's hands and the basis Company 3 takes in those assets will be determined wholly by reference to Company 3's consideration. Thus, Taxpayer's transfer of Plant, equipment, operating assets and nonqualified fund assets to Company 3 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, Taxpayer must allocate the consideration to the applicable assets in accordance with the provisions of section 1060 and the regulations thereunder. Specifically, Taxpayer 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 fund). To the extent Taxpayer'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; allocating 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 the character and other attributes of the underlying assets.

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 representative. 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 Associate Chief Counsel
Passthroughs and Special Industries