Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
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Date:
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Legend:

Buyer =

Seller 1 =

Seller 2 =

Seller 3 =

Seller 4 =

Seller 5 =

Seller 6 =

Seller 7 =

Seller 8 =

Seller 9 =

Seller 10 =

Seller 11 =

Seller 12 =

Plant =

State =

Commission =

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This letter responds to your request, dated October 6, 2000, and subsequent correspondence, on behalf of Seller 3, that we rule on certain tax consequences of the sale of the Plants from Sellers to Buyer. As set forth below, you have requested rulings regarding the tax consequences under section 468A of the Internal Revenue Code to the Sellers' qualified nuclear decommissioning funds as well as rulings regarding the proper realization and recognition of gain and loss on the sale of the Plant and the proper allocation of basis.

You have represented the following facts and information relating to the ruling request:

The Sellers are unregulated tax-exempt municipal utilities and utilities regulated by various state public utility commissions and the Federal Energy Regulatory Commission (FERC). As a result of deregulation encouraged by the state public utility commissions and the FERC, the Sellers are in the process of withdrawing from the electric power generation business and intend to sell the Plant and related assets to the Buyer.

Each Seller owns as tenant-in-common a fee simple ownership interest in one or more of the Plant's units and facilities and assets associated with the Plant. Sellers 1, 2, 9, and 12 are members of the same consolidated group. Seller 1 owns an a percent interest in each of Unit 1 and Unit 2 and a c percent interest in Unit 3. Seller 2 owns a b percent interest in each of Unit 1 and Unit 2 and a d percent interest in Unit 3. Sellers 3, 4, 5, 6, 7, 8, 9, 10, and 11 own respectively f, h, i, l, m, e, g, k, and j percent of Unit 3. Seller 12 operates all three units of the Plant, but does not have an ownership interest

in any of the units. Seller 12 owns some assets associated with the Plant that will be sold to the Buyer pursuant to several sales agreements.

Sellers 1, 2, 3, 4, 8, and 9, maintain nuclear decommissioning funds that qualify under section 468A. Each of the Sellers except Seller 12 maintain nonqualified nuclear decommissioning funds for each of the Units of the Plant which are trusts under the laws of State and which are considered grantor trusts under sections 671-677.

The three units of the Plant are generally managed on a site-wide basis. They share functions such as chemistry, corrective action programs, training, warehousing, contract management, communication, business services, facilities management, and engineering. Plant procedures, such as security, have been managed collectively for all three units. The Plant site is surrounded by a single security fence. The only significant functions that take place on a unit-by-unit basis are the operational functions that take place in the control rooms: this is necessary because of the technical differences between the units.

In carrying out the Sellers' divestiture plan, the Commission instructed the auction agent to solicit bids for each unit individually and for the three units on a consolidated basis in order to assure that the maximum value was realized. However, all bids submitted in the auction, including Buyer's bid, were bids for all three units together; no interested party bid on any of the units separately. Seller 1 believed that the Sellers interests were best served by including Unit 1 with Units 2 and 3 in the sale. The number of common facilities, common service requirements, and unit interdependencies would make ownership of Unit 1 by an unaffiliated entity undesirable from a management and safety standpoint. For example, Units 1 and 2 share a number of common walls, which are mutually dependent for resistance to seismic events. Therefore, the continued structural integrity of Unit 1 (necessitating a delay in the dismantling of Unit 1 until Units 2 and 3 are dismantled) is essential to Unit 2's design and license compliance. Similarly, control over Unit 1 by the owner of Units 2 and 3 is important because the spent nuclear fuel stored in Unit 1 could present a hazard if mishandled. Common ownership of the three units also is important for security reasons, because there is no practical way to construct an internal barrier within the shared security area to separate Unit 1 from Units 2 and 3. Finally, ownership of all three units would allow a site-wide decommissioning and spent fuel storage strategy that will provide economies of scale and greater assurances of adequacy of decommissioning funding.

Pursuant to several agreements dated n, the Sellers will transfer to the Buyer all the assets of the Plant including all the assets in the qualified and nonqualified nuclear decommissioning funds maintained by the various Sellers. The Buyer will hold both the qualified and nonqualified decommissioning funds solely for the purpose of decommissioning the Plant. The funds will be under the general supervision of the FERC and the Nuclear Regulatory Commission (NRC). The Buyer will not make

additional contributions to the qualified nuclear decommissioning funds unless permitted by future legislative changes to section 468A. Any funds that exceed the amount necessary to satisfy all decommissioning liabilities will be distributed to the Buyer. The Buyer will assume liabilities associated with the Plant including decommissioning and other environmental liabilities. Unit 1 of the Plant is currently being decommissioned and is not an operating asset in the hands of the Sellers and will not be an operating asset in the hand of the Buyer. The Buyer will pay the Sellers o, p, and q respectively for Units 1, 2, and 3. In addition, the Buyer will pay r and s respectively for nuclear fuel attributable to Units 2 and 3. Sellers and Buyer represent that they will treat the transaction as an asset purchase for tax purposes, subject to section 1060.

Apart from the purchase and sale agreements, as a result of prior legal actions, Sellers 1 and 2 entered into settlement agreements with certain of the other owners of Unit 3 to allocate on a non-pro-rata basis the cash consideration received by the other owners at the time of the sale and the amount that the other owners must contribute to their respective decommissioning trust funds at the time of the sale.

Requested Ruling #1: The Sellers' qualified nuclear decommissioning funds will not be disqualified on the date of closing when the assets in the funds are transferred to the Buyer's qualified nuclear decommissioning funds.

Requested Ruling #2: The Sellers' qualified nuclear decommissioning funds will not recognize gain or loss upon the transfer of their assets at closing to the Buyer's qualified nuclear decommissioning funds.

Requested Ruling #3: The Sellers will not recognize income attributable to the assets in the qualified nuclear decommissioning funds upon the transfer of the assets at closing to the Buyer's qualified nuclear decommissioning funds.

Requested Ruling #6: The Buyer's qualified nuclear decommissioning funds established to hold the assets transferred from the Sellers' qualified nuclear decommissioning funds will be treated as a qualified nuclear decommissioning fund under section 468A.

Requested Ruling #7: Neither the Buyer nor the Buyer's qualified nuclear decommissioning funds will recognize gain or loss or otherwise take any income or deduction into account by reason of the transfer of the assets from the Sellers' qualified nuclear decommissioning funds to the Buyer's qualified nuclear decommissioning funds and after closing the Buyer's qualified nuclear decommissioning funds will retain the same basis in the assets received as the Sellers' qualified nuclear decommissioning funds had prior to closing.

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 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 exercise its discretion to treat this sale, under section 1.468A-6(g), as a disposition qualifying under the general provisions of section 1.468A-6. This exercise of discretion is specifically based on the continued

general supervision of the qualified fund by the Nuclear Regulatory Agency and the Federal Energy Regulatory Commission. This exercise of discretion, however, applies 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 qualified nuclear decommissioning fund of the Sellers will not be disqualified upon the sale when the assets are transferred to the Buyer's qualified funds and those funds, holding the transferred qualified assets will be treated as qualified funds of the Buyer.

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, the Sellers will not recognize gain or loss or otherwise take any income or deduction into account by reason of the transfer of the Sellers' qualified funds assets to the Buyer's qualified funds.

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, the Buyer will not recognize gain or loss or otherwise take any income or deduction into account by reason of the transfer of the Sellers' qualified funds assets to the Buyer's qualified funds.

Finally, 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), the Buyer's qualified funds will have a basis in their assets that is the same as the basis of those assets in the qualified funds of the Sellers immediately before the sale. Thus, the Buyer's qualified funds will, after the sale, have a carryover basis in the assets after the sale.

Requested Ruling #4: Each Seller's gain or loss on the sale of the Plant and its associated assets (other than the qualified nuclear decommissioning funds) will be the difference between such Seller's basis in such assets and its amount realized.

Section 1001(a) provides that a taxpayer's gain from the sale of property is 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 is 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 1.1060-1(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 1.338-6 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 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 (most debt instruments, including receivables, and assets that the taxpayer marks to market at least annually for federal tax purposes), Class IV (stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the 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). Sections 1.338-6(b)(1) and 1.338-6(b)(2).

Consideration is first reduced by the amount of Class I assets. 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 1.1060-1(c)(2), 1.338-6(b)(1), and 1.338-6(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 1.1060-1(a)(1), 1.1060-1(c)(2), and 1.338-6.

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

With respect to the qualified nuclear decommissioning funds relating to the Plant, the federal tax treatment of the transaction is determined exclusively under section 468A and the regulations thereunder. With respect to the Plant, equipment, operating assets, and assets of the nonqualified nuclear decommissioning funds, however, these assets comprise a trade or business in the Sellers' hands and the basis Buyer takes in those assets will be determined wholly by reference to the Buyer's consideration. Thus, each Seller's transfer of its interest in the Plant, its equipment, operating assets, and assets of that Seller's nonqualified funds to Buyer (or, in the case of Seller 12, the sale of its assets to Buyer) in exchange for cash and the assumption of the decommissioning liability (except to the extent funded by the qualified nuclear decommissioning funds) is a separate applicable asset acquisition as defined in section 1060(c). As such, each Seller's federal tax treatment of the sales is determined under section 1060 and the regulations thereunder.

Thus, each Seller must allocate the consideration to the applicable assets in accordance with the provisions of section 1060 and the regulations thereunder. Specifically, each 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 any nonqualified fund it transfers). To the extent a Seller's consideration exceeds the Class

I assets it transfers, such excess will be allocated to the Class II assets it transfers, then to the Class III assets it transfers, then to the Class IV assets it transfers, then to the Class V assets it transfers, then to the Class VI assets it transfers, and finally to the Class VII assets it transfers. 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 Plant and each Sellers' interests in the assets in their respective decommissioning trust funds (other than the assets in the Sellers' qualified nuclear decommissioning funds), each Sellers' 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 as a result of the sale, taking into account the allocation of consideration pursuant to section 1060 and the corresponding regulations.
Requested Ruling #5: Each Seller's amount realized on the sale of the Plant and its associated assets will include the cash consideration received from the Buyer and the amount of its liabilities assumed by the Buyer, including its liability to decommission the Plant but reduced by the amount of such liability to be funded by such Seller's qualified nuclear decommissioning funds.

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 set forth with respect to Requested Ruling #8, the decommissioning liability from which Sellers will be relieved is fixed and determinable. As owners and operators of a nuclear plant, Sellers are required by law to provide for eventual decommissioning. See 10 CFR sections 50.33, 50.75.

Accordingly, each Seller's amount realized on the sale of its interests in the Plant and associated assets (not including the assets in the Sellers' qualified nuclear decommissioning fund) will include the cash consideration received by the Seller as a result of the sale and the liabilities from which the Seller is relieved as a result of the sale, to the extent these liabilities are taken into account for federal income tax purposes. The liabilities taken into account would include the appropriate amount of each Seller's decommissioning liability, not including any portion of the liability attributable to a Seller's qualified nuclear decommissioning fund.
Requested Ruling #8: Each Seller will be entitled to a deduction equal to the amount of its liability to decommission the Plant expressly assumed by the Buyer and included

in the Seller's income in the year the liability is assumed, reduced by the amount of the liability to be funded by such Seller's qualified nuclear decommissioning funds.

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, each of the Sellers clearly has the obligation to decommission the Plant. The fact of the obligation arose many years ago, at the time the Sellers obtained their license to operate the Plant. 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 Sellers' decommissioning liability has been determined by experts in the nuclear decommissioning industry. Their calculations have been reviewed and accepted by both the NRC, which is charged with ensuring

that sufficient funds are available to decommission the Plant, and, in some cases, by FERC. 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 Sellers' amount realized. At that time, each of the Sellers will be entitled to a deduction for the amount of its decommissioning liability associated with the Plant expressly assumed by the Buyer and included in that Seller's amount realized.

Requested Ruling #9: The Buyer will not recognize any gain or otherwise take income into account by reason of the purchase of the Plant and its associated assets except to the extent that the aggregate amount of cash and other Class I assets received from all Sellers exceeds the aggregate amount of consideration provided by the Buyer to all the Sellers.

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, Buyer cannot acquire the Plant without assuming the decommissioning liability, which is inextricably associated with the ownership and operation of the 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.

However, we have determined that, under the circumstances of this case, the Buyer must perform a separate allocation under section 1060 for the assets received from each Seller. Therefore, we do not agree that the aggregate amount of Class I assets received from all Sellers should be compared to the aggregate consideration provided by the Buyer to all Sellers in determining whether income is recognized.

Accordingly, with respect to the acquisition of interests in the Plant and its equipment and operating assets, and the assets in a nonqualified decommissioning fund, from a particular Seller, Buyer will not recognize income except to the extent the Class I assets (as defined in section 1.338-6(b)(1)) it receives from that Seller exceed

its total cost determined under section 1012 (which will be the sum of its cash consideration and the amount of any other consideration it provides to that Seller that is, under applicable tax principles, taken into account on the date of the applicable asset acquisition).

Requested Ruling #10: The Buyer will have a tax basis in the assets purchased (including the assets in the Buyer's nonqualified nuclear decommissioning funds but excluding the assets in the Buyer's qualified nuclear decommissioning funds) equal to the sum of the purchase price and the assumed liabilities and obligations that will be taken into account as liabilities for federal income tax purposes as of the closing date.

Section 1012 provides in part that the basis of property shall be the cost of such property. Buyer claims that its cost of acquiring the Sellers' interests in the Plant and the related assets (including the decommissioning funds) includes the amount of the assumed decommissioning liability. Buyer cites Crane v. Commissioner, 331 U.S. 1 (1947), and Commissioner v. Oxford Paper Co., 194 F.2d 190 (1952), as support for the proposition that for purposes of determining basis, the cost of property generally includes assumed liabilities to which the acquired property is subject to the extent such liabilities can be accurately valued and are not contingent at the time of purchase. Since the Buyer will pay cash and assume the liabilities and obligations of the Sellers, which includes the decommissioning liabilities in connection with the acquisition of the assets purchased, its total cost of the assets purchased (excluding the qualified nuclear decommissioning fund) will equal the cash paid plus the liabilities and obligations assumed. Consequently, its tax basis under section 1012 equals the sum of the cash paid and the amount of the liabilities and obligations assumed. The Service, however, rejects including the amount of the future assumed decommissioning liability in the Buyer's cost basis as of the closing.

The assumed decommissioning liability cannot be treated as incurred 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 and 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). 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).

Thus, critical to determining whether the Buyer is entitled to treat the future decommissioning liability as a component of its cost basis in the purchased assets at the time of the closing 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 obligation until and to the extent that costs are incurred in satisfaction of that liability. Section 1.461-4(d)(4). Because the 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.

As indicated above, a particular Seller's transfer of its interest in the Plant, its equipment, operating assets, and assets of that Seller's nonqualified decommissioning funds to Buyer (or, in the case of Seller 12, the sale of its assets to Buyer) in exchange for cash and the assumption of the decommissioning liability (except to the extent funded by the qualified nuclear decommissioning funds) is a separate applicable asset acquisition as defined in section 1060(c). As such, the Buyer's federal tax treatment of these acquisitions is determined under section 1060 and the regulations thereunder.

Accordingly, we rule that, on the acquisition date, the Buyer's basis in the assets acquired from a particular Seller must be determined by allocating its cost (i.e., the consideration provided by Buyer on the acquisition date allocable to that Seller, which includes the allocable portion of the cash, but not the assumption of any future decommissioning liability) among the assets acquired from that Seller (including the assets from that Seller's nonqualified decommissioning fund) 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 with that Seller; 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 to the Class II assets it receives from that Seller, pro rata according to the fair market value of those assets, up to their total fair market value. then among the Class III assets it receives from that Seller (pro rata, to the extent of their fair market value), then among the Class IV assets it receives from that Seller (pro rata, to the extent of their fair market value), then among the Class V assets it receives from that Seller (pro rata,

to the extent of their fair market value), then among the Class VI assets it receives from that Seller (pro rata, to the extent of their fair market value), and, finally, any remaining consideration is allocated to the Class VII assets it receives from that Seller. When and to the extent additional amounts are paid or incurred for the assets acquired in the applicable asset acquisitions (e.g., when and to the extent a nonqualified fund pays or incurs future decommissioning expenses), such amounts will be taken into account as increases to the 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 1.1060-1(a)(1), 1.1060-1(c)(2), 1.338-6, and 1.338-7.
Requested Ruling #11: The Buyer's nonqualified nuclear decommissioning funds will be treated as grantor trusts under section 671-678 and the Buyer will be treated as the grantor of such funds.

Section 671 provides that where it is specified in sections 673 through 678 that the grantor or another person shall be treated as the owner of any portion of a trust, there shall be included in computing the taxable income and credits of that person those items of income, deduction, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account in computing taxable income or credits against the tax of an individual.

Section 1.671-2(e)(1) provides that for purposes of part I of subchapter J, chapter 1 of the Internal Revenue Code, a grantor includes any person to the extent such person either creates a trust, or directly or indirectly makes a gratuitous transfer (within the meaning of section 1.671-2(e)(2)) of property to a trust. For purposes of section 1.671-2, the term *property* includes cash.

Section 1.671-2(e)(2)(i) provides that a gratuitous transfer is any transfer other than a transfer for fair market value.

Section 1.671-2(e)(2)(ii) provides that for purposes of section 1.671-2(e), a transfer is for fair market value only to the extent of the value of property received from the trust, services rendered by the trust, or the right to use property of the trust.

Section 677 provides that the grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such under section 674, whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a nonadverse party, or both, may be distributed to the grantor, or held or accumulated for future distribution to the grantor.

Section 1.677(a)-1(d) provides that under section 677 a grantor is, in general, treated as the owner of a portion of a trust whose income is, or in the discretion of the grantor or a nonadverse party, or both, may be applied in discharge of a legal obligation of the grantor.

Because Buyer is treated as purchasing the assets of Sellers' Nonqualified

Funds for federal income tax purposes, Buyer is treated as contributing those assets as grantor to the Buyer's nonqualified decommissioning funds. All income, as well as principal of the Buyer's nonqualified decommissioning funds, is held to satisfy Buyer's legal obligation to decommission the Plant and upon completion of the decommissioning any remaining assets will be distributed to Buyer. Accordingly, Buyer is treated as the owner of the entire Buyer's nonqualified decommissioning funds under section 677 and section 1.677(a)-1(d). Buyer shall include in computing its taxable income and credits all items of income, deduction, and credits against tax of the Buyer's nonqualified decommissioning funds to the extent that such items would be taken into account in computing taxable income or credits against the tax of Buyer.

This letter ruling is directed only to the taxpayer that requested it (Seller 3). Section 6110(k)(3) provides that this ruling may not be used or cited as precedent. Except as specifically determined above, no opinion is expressed or implied concerning the Federal income tax consequences of the transaction described above. In particular, no opinion is expressed or implied regarding the effect of the settlement agreements between Sellers 1 and 2 and certain other of the Sellers.

In accordance with the powers of attorney, the original of this letter is being sent to the authorized representative of Seller 3. In accordance with the powers of attorney, a copy is being sent to Seller 3, and we are sending an additional copy of this ruling letter to your additional authorized representative. We are also sending a copy of this letter to the appropriate Director of the Large and Mid-Size Business Division.

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