Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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Person to Contact:

Telephone Number:

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Date:
May 11, 2001

Legend:

Taxpayer =

Buyer =

Parent 1 =
Parent 2 =
Parent 3 =

Company =

Commission A =
Commission B =

a =
b =
c =
d =
e =
f =

Plant =

This letter responds to your request that we rule on certain tax consequences of the sale of the Plant from Taxpayer to Buyer. As set forth below, 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 Plant and the proper allocation of basis.

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

The Taxpayer historically was a vertically integrated company that owned and operated electric power generation plants and a grid network that interconnected with

local distribution systems. As a public utility, the Taxpayer's rates were exclusively subject to the jurisdiction of Commission A. Nevertheless, for non-rate matters, the Taxpayer was also subject to the jurisdiction of Commission B. In addition, as the owner of a d percent interest in a nuclear power plant, the Plant, the Taxpayer was also subject to regulation by the Nuclear Regulatory Commission (NRC).

The Plant was placed in service on e with an operating license scheduled to expire on f. On a, Taxpayer sold its interest in the Plant to Buyer. As part of this transaction, Buyer assumed Taxpayer's entire decommissioning liability associated with the Plant and Taxpayer transferred to Buyer a qualified nuclear decommissioning fund and a nonqualified nuclear decommissioning fund (these funds were maintained as part of a state-regulated, Plant-wide master trust).

Taxpayer was a wholly-owned subsidiary of Parent 1 which in turn was a wholly-owned subsidiary of Parent 2. On b, subsequent to the Taxpayer's sale of its interest in the Plant, Parent 2 merged into Parent 3. Company is a wholly-owned subsidiary of Parent 3. On c, Taxpayer was merged into Company with Company surviving as Taxpayer's successor corporation.

Requested Ruling #1: The Taxpayer will not recognize gain or loss or otherwise take any income or deduction into account by reason of the transfer of the Taxpayer's qualified nuclear decommissioning fund to the Buyer upon the sale of the Plant.

Requested Ruling #2: The Taxpayer's qualified nuclear decommissioning fund will not recognize gain or loss or otherwise take any income or deduction into account by reason of the transfer of the Taxpayer's qualified nuclear decommissioning fund to the Buyer upon the sale of the Plant.

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 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, 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 Taxpayer will not be disqualified upon the sale when the fund is transferred to 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, neither the Taxpayer 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 the Taxpayer's qualified fund to the Buyer.

Requested Ruling #3: The Taxpayer's gain or loss on the sale of its interest in the Plant and other assets (excluding the qualified nuclear decommissioning fund) to the Buyer will equal the difference between its tax basis in such assets and the amount realized.

Section 1001(a) provides that a taxpayer's gain from the sale of property shall be 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 shall be the excess of the taxpayer's adjusted basis provided in section 1011 for determining loss over the amount realized.

Section 1060(a) provides that in the case of any applicable asset acquisition, for purposes of determining the transferee's basis and the gain or loss of the transferor, the consideration received for the assets shall be allocated in the same manner as amounts are allocated under section 338(b)(5). See section 1.1060-1T. Under section 1060(c), an applicable asset acquisition means any transfer of assets which constitute a trade or business, and with respect to which the transferee's basis is

determined wholly by reference to the consideration paid for such 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 1.1060-1T(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.

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 it qualifies as a section 197 intangible).

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 1.1060-1T(c)(2), 1.338-6T(b)(1), and 1.338-6T(b)(2).

The following example illustrates the operation of section1060: On Date 1, 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. Section 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, 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. Section 1.1060-1T(a)(1), 1.1060-1T(c)(2), and 1.338-7T.

The federal tax treatment of the qualified nuclear decommissioning fund is determined exclusively under section 468A and the regulations thereunder. The Plant (including equipment and operating assets) and the assets of the nonqualified decommissioning fund comprise a trade or business in Taxpayer's hands and the basis Buyer takes in these assets will be determined wholly by reference to the Buyer's consideration. Thus, Taxpayer's transfer of the Plant (including equipment and operating assets) and the nonqualified fund to Buyer in exchange for cash and the assumption of the decommissioning liability (except to the extent funded by the qualified nuclear decommissioning 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's gain or loss on the sale of its interests in the Plant and associated assets (not including the assets in the qualified nuclear decommissioning fund) will be the difference between the basis of each asset and the amount realized with respect to that asset, taking into account the allocation of consideration pursuant to section 1060 and the corresponding regulations.[1] Taxpayer's amount realized from the

[1] 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

sale of its interests in the Plant and associated assets (not including the assets in the qualified nuclear decommissioning fund) will include the cash received from Buyer and the liabilities assumed by Buyer, to the extent these liabilities are taken into account by the Taxpayer for federal income tax purposes. The liabilities taken into account would include the amount of the decommissioning liability assumed by Buyer, but not including the portion of the liability to decommission the Plant attributable to the qualified fund on the date of the transfer.

Requested Ruling #4: The Taxpayer's basis in the Plant and its associated assets was its adjusted basis in those assets.

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 1011 provides that the adjusted basis for determining the gain or loss from the sale or other disposition of property is the basis of the property as adjusted by section 1016.

Accordingly, Taxpayer's bases in the Plant and the assets in the non-qualified decommissioning fund associated with the Plant were its adjusted bases in those assets.

Requested Ruling #5: The Taxpayer's amount realized on the sale of its interest in the Plant and associated assets includes the cash received from the Buyer and the liabilities and obligations assumed by the Buyer, to the extent such assumed liabilities and obligations are taken into account as liabilities for Federal income tax purposes.

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 is discussed below in connection with Ruling Request #6, the decommissioning liability from which Taxpayer will be

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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.

relieved is fixed and determinable. As an owner and operator of a nuclear plant, Taxpayer is required by law to provide for eventual decommissioning. See 10 CFR sections 50.33, 50.75.

Accordingly, Taxpayer's amount realized from the sale of the Plant and the assets in the decommissioning trust funds included the cash received from Buyer and the assumed liabilities, to the extent these liabilities are taken into account for federal income tax purposes. The liabilities taken into account would include the amount of the decommissioning liability assumed by Buyer, not including the portion of the liability to decommission Plant attributable to the qualified nuclear decommissioning fund on the date of the sale.

Requested Ruling #6: In the year of sale the Taxpayer shall be entitled to a current deduction under section 1.461-4(d)(5) in an amount equal to the total of any amounts treated as realized by the Taxpayer as a result of the Buyer's assumption of liabilities with respect to the Plant.

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, the Taxpayer clearly has the obligation to decommission the Plant. The fact of the obligation arose many years ago, at the time the Taxpayer obtained its license to operate the Plant. See 10 C.F.R. sections 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 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 Taxpayer'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 (NRC), which is charged with ensuring that sufficient funds are available to decommission the Plant, and the Commissions. 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 Taxpayer's amount realized. At that time, the Taxpayer 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 the Taxpayer's amount realized.

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

In accordance with the powers of attorney, we are sending a copy of this ruling letter to your 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