Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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Person to Contact:

Telephone Number:

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Legend:

Taxpayer =

Division =
Plant =
Commission A =
Commission B =
State =
Law =

a =
b =
c =
d =
e =
f =
g =
h =
i =
j =
k =
l =
m =
n =
o =
p =
q =

NuclearCo =
Company 1 =
Company 2 =
Partnership =
New Name =
Holding =
Parent =

Dear :

This letter responds to your request, dated September 28, 2001, that we rule on certain tax consequences, under section 468A of the Internal Revenue Code, of the transfer of the Plant in the context of a tax-free reorganization intended to qualify under section 351. As set forth below, you have requested rulings regarding the tax consequences to Taxpayer and NuclearCo and their qualified nuclear decommissioning funds.

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

Within Taxpayer, the Division conducts Taxpayer's regulated electric utility business, providing generation, transmission, distribution and retail sales of electric power to industrial and retail customers in the State. Taxpayer is under the regulatory jurisdiction of Commission A and Commission B. Taxpayer owns a percent of the Plant.

In b, the State enacted Law in order to allow full retail competition beginning on c. Pursuant to Law, Taxpayer is required to separate its generation, transmission and distribution, and retail activities into three segments under either common or separate ownership. Beginning on c, all existing retail electric customers of Taxpayer will have the option of selecting a different retail electric provider, or become a customer of Taxpayer's affiliated retail electric provider. Taxpayer's affiliated retail electric provider is required by Law to offer to sell electricity to residential and small business customers in its traditional service territory at a specified price until d unless Commission A determines before that date that e percent of the power consumed by that class of consumers is being served by other non-affiliated retail electric providers. Taxpayer's affiliated retail electric provider is also required to sell at auction f percent of the output of its installed electric generating capacity. The first auction was held in g for power delivered after h. This obligation continues until i unless Commission A determines before that date that e percent of the power consumed by residential and small business customers in its traditional service territory is being served by other non-affiliated retail electric providers.

Commission A allowed stranded costs to be recovered by means of a non-bypassable transmission and distribution charge beginning in j. In the event that actual revenues attributable to the generating assets exceed the forecasted revenues used in Commission A's stranded cost model, the excess will be returned to ratepayers. With respect to nuclear decommissioning costs, the amount that Commission A previously allowed Division to collect will continue to be collected by Taxpayer from retail customers as part of the non-bypassable charge from k through l. Law subjects any nuclear decommissioning costs remaining after this period to cost-of-service rate regulation, and includes such costs as a non-bypassable charge imposed on all retail customers.

Taxpayer filed with Commission A a business separation plan in m, with amendments in n, outlining a comprehensive restructuring of Taxpayer's operations into a group of companies predominantly subject to traditional cost-of-service rate regulation and a group of companies that either are unregulated or have been given pricing flexibility to compete in competitive markets. In o, Commission A approved the Taxpayer's comprehensive restructuring proposal, as amended. A new version of the business separation plan was filed with Commission in p.

As part of the restructuring, Taxpayer will transfer the ownership of the Plants and associated qualified and nonqualified decommissioning funds to NuclearCo in a transaction intended to qualify for nonrecognition under section 351. NuclearCo will assume the decommissioning liability for the Plants. NuclearCo will also be the 100% owner of Company 1 and Company 2, which will in turn be the sole partners of Partnership. Taxpayer represents that Company 1, Company 2, and Partnership will be disregarded for tax purposes and treated as divisions of NuclearCo. NuclearCo subsequently will transfer the ownership of the Plants, the liability for decommissioning the Plants, and the associated qualified and nonqualified decommissioning funds to Company 1 and Company 2, which will in turn contribute such assets and liabilities to Partnership. In addition, under the terms of the restructuring, Taxpayer will be converted to a q and will be renamed New Name. Following the reorganization Taxpayer/New Name and NuclearCo will be owned by Holding, and Holding will be owned by Parent. Taxpayer represents that Holding will be disregarded for tax purposes and treated as a division of Parent.

Taxpayer/NewName will continue to collect decommissioning expenses through the non-bypassable transmission and distribution charge and is required under the business separation plan approved by Commission A to transfer the funds collected to Partnership. Taxpayer represents that it is legally required under State law to undertake the decommissioning aspects of the business separation plan approved by Commission A, including the transfer to Partnership of amounts collected for decommissioning expenses.

Requested Ruling #1: Neither Taxpayer, NuclearCo, 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 transfer of Taxpayer's qualified nuclear decommissioning trust funds to NuclearCo. The NuclearCo's qualified nuclear decommissioning funds will have a basis in the assets held equal to the basis of such assets in Taxpayer's qualified nuclear decommissioning funds immediately prior to the transfer.

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 Taxpayer, including Taxpayer's representation that Partnership is properly treated as a division of NuclearCo for tax purposes and Taxpayer's representation that the business separation plan approved by Commission A requires Taxpayer/NewName to collect from its customers the decommissioning costs on behalf of Partnership and transfer all collected amounts to Partnership, the Service will treat these transfers as dispositions qualifying under the general provisions of section 1.468A-6. Commission A's approval of the business separation plan and the legal requirement that such plan and its provisions be followed enables the Service to treat these transfers as decommissioning costs included in cost of service that are directly or indirectly charged to customers of NuclearCo by reason of electric energy furnished by NuclearCo, within the meaning of sections 88 and 468A and the corresponding regulations. Thus, under section 1.468A-6 Taxpayer's funds will not be disqualified upon the transfer of the Plants and the funds to NuclearCo.

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 Taxpayer, NuclearCo, 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 NuclearCo.

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

Requested Ruling #2: Following the transfer of the Plant and nuclear decommissioning funds to NuclearCo, NuclearCo will be treated as the "eligible taxpayer" and the "electing taxpayer" with respect to the NuclearCo qualified nuclear decommissioning funds and therefore, NuclearCo may make deductible contributions to its qualified nuclear decommissioning funds in an amount equal to the lesser of (1) the amount of nuclear decommissioning costs allocable to the funds that are included in NuclearCo's cost of service for ratemaking purposes for such taxable year, or (2) the ruling amount

applicable to such taxable year.

Section 1.468A-1(b)(1) defines an eligible taxpayer as any taxpayer that possesses a qualifying interest in a nuclear power plant. Section 1.468A-1(b)(2) defines a qualifying interest to include a direct ownership interest. Pursuant to section 1.468A-2(a) an eligible taxpayer that elects the application of section 468A is an electing taxpayer. Section 1.468A-6(e)(2) provides rules for the determination of a schedule of ruling amounts for a transferee of a nuclear power plant. Section 468A(b) limits the deductible contribution to the lesser of the ruling amount or the nuclear decommissioning costs allocable to the fund which is included in a taxpayer's cost of service for ratemaking purposes for the taxable year.

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.

Based on the information submitted by Taxpayer, and based on Taxpayer's representation that Partnership is properly treated as a division of NuclearCo for tax purposes, NuclearCo satisfies the requirements for being an eligible taxpayer under section 1.468A-1(b) and an electing taxpayer under section 1.468A-2. In addition, as part of the restructuring plan approved by Commission A, the liability to decommission the Plants has been transferred to a division of NuclearCo. Because Taxpayer/NewName is legally required to transfer to a division of NuclearCo amounts collected from ratepayers for decommissioning expenses, NuclearCo has satisfied the requirement of having decommissioning costs included in its cost of service for ratemaking purposes for the year for which the deductible contribution is made. NuclearCo may rely on the provisions of section 1.468A-6(e)(2) for a determination of the ruling amount in the year of transfer. Pursuant to section 1.468A-6(e)(2)(ii), NuclearCo must request a revised schedule of ruling amounts for any tax year subsequent to the tax year in which the Plants are transferred. Finally, section 468A(b) limits the deductible contribution to the lesser of the ruling amount or the nuclear decommissioning costs allocable to the fund which is included in a taxpayer's cost of service for ratemaking purposes for the taxable year.

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 concerning whether the non-bypassable transmission and distribution charge is includible in the gross income of, and deductible by, any entity other than Partnership. In addition, no opinion is expressed or implied concerning whether Company 1, Company 2, and Partnership are properly disregarded for tax purposes and treated as divisions of NuclearCo.

The rulings expressed, herein, are expressly conditioned on Commission A's approval of the business separation plan relating to the collection and contribution of decommissioning costs as described in this letter, e.g., Taxpayer's collection of costs from ratepayers, the transfer of amounts collected to Partnership, and Partnership's contribution of the authorized amounts to its funds. In addition, these rulings are expressly conditioned on the continued direct or indirect ownership and control of Taxpayer, NuclearCo, and Partnership by Parent. Specifically, as continuing conditions to Requested Ruling #2, 1) Taxpayer and NuclearCo must be part of the same affiliated group (or be treated as a division of a member of the same affiliated group) as Parent (and Parent must satisfy the ownership requirement of section 1504(a)(2)(A) with respect to Taxpayer and NuclearCo); 2) NuclearCo must continue to be able, under the Internal Revenue Code and regulations, to treat Partnership as a division for tax purposes; and 3) Parent, Taxpayer, and NuclearCo must file a consolidated tax return (or must be treated for tax purposes as divisions of entities that file a consolidated return with Parent) for each year for which a deductible payment is made under 468A. If any of these conditions are no longer applicable no further contributions may be made to the qualified nuclear decommissioning funds with respect to the units of the Plant that are the subject of Requested Ruling #1.

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 power of attorney on file with this office, the original of this letter is being sent to Taxpayer's authorized representative. We are also sending a copy of this letter ruling to Taxpayer and to the Industry Director, Natural Resources (LM:NR).

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