Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Number: **200229009**
Release Date: 7/19/2002
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-130778-00
Date:
April 8, 2002

Legend:

Seller =

Buyer =

Seller's Parent =
Buyer's Parent =
Buyer's Subsidiary =
Plant =
Commission =
Location =
State =
Unit A =
Unit B =

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

Dear :

This letter responds to a letter, dated December 12, 2000, and subsequent submissions, requesting a private letter ruling concerning the tax consequences of the sale of a nuclear power plant and associated assets and liabilities, including nuclear

decommissioning liability, between Seller and Buyer. Specifically, you have requested rulings regarding the tax consequences under section 468A of the Internal Revenue Code to Seller's nuclear decommissioning funds and Buyer's nuclear decommissioning funds as well as rulings regarding the proper realization and recognition of gain and loss on the sale of the nuclear power plant and associated assets.

The Seller and Buyer, in a jointly-filed ruling request, have represented the following facts and information relating to the ruling request:

Seller, a regulated public utility company, is a subsidiary of Seller's Parent, a public utility holding company. Seller is a member of Seller's Parent's consolidated group and joins in filing a consolidated return on a calendar year basis using the accrual method of accounting. Seller and Seller's Parent are under the audit jurisdiction of the Industry Director, Natural Resources (LM:NR).

Buyer, an exempt wholesale generator, is a third-tier subsidiary of Buyer's Parent, a public utility holding company. Buyer is a member of Buyer's Parent's consolidated group and joins in filing a consolidated return on a calendar year basis using the accrual method of accounting. Buyer owns Buyer's Subsidiary, which is the legal purchaser of Plant and the associated assets and liabilities. Buyer represents that Buyer's Subsidiary is a disregarded entity for federal income tax purposes. Buyer and Buyer's Parent are under the audit jurisdiction of the Industry Director, Natural Resources (LM:NR).

Seller's retail sales of electric power are subject to the jurisdiction of Commission. Buyer's wholesale electric power sales are subject to the jurisdiction of FERC and its ownership and operation of Plant is subject to the jurisdiction of the Nuclear Regulatory Commission.

Plant is located in Location, in State, and consists of Unit A and Unit B and associated assets located together on a single property. Unit A began commercial service in a and was permanently shut down in b. It is currently in SAFESTOR mode. A portion of Unit A supports the operation of Unit B. Certain systems and buildings related to Unit A are required for the operation of Unit B, including the back-up electrical supplies, house service boilers, and associated fuel systems for providing heating system steam and for pulling vacuum in the condensers. The two units also share common administrative facilities, security features, emergency planning programs, fire protection, fuel oil, steam, city water, condensate, and sewage treatment systems. With the exception of the fuel-handling building which houses the Unit A spent fuel, all other major buildings, including the Unit A containment building, contain common facilities that will continue to be used to support Unit B operations throughout the life of Unit B. Unit B began commercial operations in c.

On d, Buyer entered into an Asset Purchase Agreement with Seller to purchase seller's e interest in the Plant. The agreement contemplates that Buyer, through Buyer's Subsidiary, pay f and assume all decommissioning liabilities associated with the

Plant. In addition, Buyer agreed to purchase, through Buyer's Subsidiary, nuclear fuel for g. Taxpayers' submission indicates that they will treat the transaction as an asset purchase for tax purposes, subject to § 1060.

With respect to each unit, Seller maintained a nuclear decommissioning fund qualifying under § 468A and a nuclear decommissioning fund that did not meet the requirements of § 468A. The assets in the qualified nuclear decommissioning funds are pooled for investment; the pooling arrangement is a partnership for federal income tax purposes. All members have elected under § 761(a)(1) to exclude this pooling partnership from the application of subchapter K of the Code. The non-qualified nuclear decommissioning funds are also pooled for investment, and the pooling arrangement is treated as a grantor trust for federal income tax purposes under sections 671 through 677. However, immediately prior to closing, each non-qualified nuclear decommissioning fund contributed its assets to the pooling partnership in exchange for an interest in the partnership. References in the request regarding the transfer by Seller to Buyer's Subsidiary of the assets of the qualified nuclear decommissioning funds and the non-qualified nuclear decommissioning funds mean the transfer of the partnership interests held by each fund.

The Asset Purchase Agreement obligates Seller to transfer to Buyer's Subsidiary at closing of the transaction all the assets of the qualified nuclear decommissioning funds associated with the Plant. To the extent that the fair market value of the assets in the qualified nuclear decommissioning funds at closing is less than h, Seller is obligated to transfer to Buyer's Subsidiary assets of the non-qualified nuclear decommissioning funds (and, if necessary, to contribute additional funds to the non-qualified nuclear decommissioning funds) such that the aggregate fair market value of the assets of the qualified nuclear decommissioning funds and the transferred assets of the non-qualified nuclear decommissioning funds is equal to h.

The sale of Plant closed on i. Seller transferred to Buyer's Subsidiary all of the assets of the Plant including the power plant, nuclear fuel, real property, machinery, equipment, licenses, and other associated property. In addition, Seller contributed j to the nonqualified nuclear decommissioning funds, and transferred to Buyer's Subsidiary all legal responsibility for decommissioning Plant and the assets of both the qualified nuclear decommissioning fund and the non-qualified nuclear decommissioning fund held by Seller for each unit of Plant.

As noted above, Unit A is in SAFESTOR mode. The current plan is to start final dismantlement of Unit A when the decommissioning of Unit B begins, such that the two units will be decommissioned at the same time. Once decommissioning begins, expenses will be paid directly by the qualified and non-qualified nuclear decommissioning funds. Units A and B were not offered for sale separately. The consideration provided by Buyer's Subsidiary is not separately stated for each unit.

Requested Ruling #1: *Seller's qualified nuclear decommissioning funds will not be disqualified upon the sale of the Plant and the transfer of the assets in the qualified*

nuclear decommissioning funds to Buyer's qualified nuclear decommissioning funds. Buyer's qualified nuclear decommissioning funds will be treated as qualified nuclear decommissioning funds upon receipt of the assets of Seller's qualified nuclear decommissioning funds.

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(e)(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 transaction, 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 section 1.468A-6 except those outlined in section 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 funds of Seller will not be disqualified upon the transfer when the assets are transferred to the respective qualified nuclear decommissioning funds of Buyer's Subsidiary and those funds, holding the transferred qualified assets will be treated as qualified nuclear decommissioning funds of Buyer's Subsidiary.

Requested Rulings #2 and #3: *Pursuant to the provisions of § 1.468A-6, Seller's qualified nuclear decommissioning funds will not recognize gain or loss upon the transfer of their assets to Buyer's qualified nuclear decommissioning funds as a result of the sale of the Plant, and neither Buyer nor Seller will recognize gain or loss or otherwise take any income or deduction into account by reason of the transfer of the assets of Seller's qualified nuclear decommissioning funds to Buyer's qualified nuclear decommissioning funds as a result of the sale of the Plant.*

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 Seller nor the qualified nuclear decommissioning funds maintained by Seller for Unit A or Unit B will recognize gain or loss or otherwise take any income or deduction into account by reason of the transfer of the qualified nuclear decommissioning funds assets to the qualified nuclear decommissioning funds of Buyer's Subsidiary.

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

Requested Ruling #4: *Seller's gain or loss on the sale of the Plant and associated assets will be the difference between the 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 § 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 § 1011 for determining loss over the amount realized.

Section 1060 provides that, in the case of an "applicable asset acquisition," the consideration received for such assets shall be allocated among the acquired assets in the same manner as amounts are allocated to assets under § 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 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 § 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 sections 1001 and 451. Section 1.1060-1(c)(1) defines a purchaser's consideration as the amount, in the aggregate, of its cost of purchasing the assets in the applicable asset acquisition that is properly taken into account in basis. Section 1060 provides no independent basis for determining a taxpayer's cost of acquired assets; cost is determined solely under generally applicable rules of tax accounting. See sections 1012 and 461.

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 § 197 intangibles, as defined in § 197, except goodwill and going concern value), and Class VII (goodwill and going concern value, whether or not they qualify as § 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 1.1060-1(c)(2), 1.338-6(b)(1), and 1.338-6(b)(2).

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

The Plant, equipment, operating assets and non-qualified nuclear decommissioning fund assets comprise a trade or business in Seller's hands and the gain or loss recognized by Seller with respect to those assets will be determined wholly by reference to Seller's amount realized. Thus, Seller's transfer of the Plant, equipment, operating assets and non-qualified nuclear decommissioning fund assets to Buyer's Subsidiary in exchange for cash and the assumption of the decommissioning liability (except to the extent funded by the qualified nuclear decommissioning funds) is an applicable asset acquisition as defined in § 1060(c). As such, its Federal tax treatment is determined under § 1060 and the regulations thereunder.

The following example illustrates the operation of § 1060 for a seller: 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, half of which are § 1231 assets with a fair market value of $60 and a basis of $70, and the other half of which are not § 1231 assets with a fair market value of $40 and a basis of $50; and Class VI assets, which are § 1231 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 $775 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 a $10 loss on the § 1231 assets and a $10 loss on the non § 1231 assets); $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). Sections 1.1060-1(a)(1), 1.1060-1(c)(2), and 1.338-6.

Accordingly, on the sale of Seller's interests in the Plant and assets in its nuclear decommissioning funds (other than the assets held by Seller's qualified nuclear decommissioning funds), Seller's 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, taking into account the allocation of consideration pursuant to § 1060 and the corresponding regulations.

Requested Ruling #5: *The amount realized by Seller on the sale of the Plant and associated assets will include the cash received from Buyer and the amount of liabilities assumed by Buyer, including the liability to decommission the Plant reduced by the amount of such liability to be funded by the 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 discussed below in connection with ruling request 7, the decommissioning liability from which Seller will be relieved is fixed and determinable. As owner and operator of a nuclear plant, Seller is required by law to provide for eventual decommissioning. See 10 CFR sections 50.33, 50.75.

Accordingly, Seller's amount realized on the sale of its interests in the Plant and associated assets (not including the assets held by Seller's qualified nuclear decommissioning funds) will include the cash consideration received by Seller and the liabilities from which Seller is relieved, to the extent those liabilities are taken into account for federal income tax purposes. The liabilities taken into account would include Seller's decommissioning liability, not including any portion of the liability attributable to Seller's qualified nuclear decommissioning funds.

Requested Ruling #6: *Buyer's qualified nuclear decommissioning funds will retain the qualified nuclear decommissioning fund's basis in its investments after the sale of the Plant and associated assets and the transfer of the assets in the qualified nuclear decommissioning funds to Buyer's qualified nuclear decommissioning funds.*

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 qualified nuclear decommissioning funds of Buyer's Subsidiary will have a basis in the assets received that is the same as the basis of those assets in the qualified nuclear decommissioning funds of Seller immediately before the transfer.

Requested Ruling #7: *Pursuant to the provisions of § 1.461-4(d)(5), Seller will be allowed current ordinary deductions for any amounts treated as realized by Seller, or otherwise recognized as income to Seller, as a result of Buyer's assumption of Seller's decommissioning liabilities related to the Plant.*

Treas. Reg. § 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) of the Code 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 Treas. Reg. § 1.461-(4)(a)(1).

Section 461(h)(2)(B) of the Code provides that in the case of a liability that requires the taxpayer to provide services, economic performance occurs as the taxpayer provides the services. Treas. Reg. § 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.

Treas. Reg. § 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 Seller clearly has the obligation to decommission the Plant. The fact of the obligation arose many years ago, at the time the Seller obtained its license to operate the Plant. See 10 C.F.R. § 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 of the Code, 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 Treas. Reg. § 1.461-1(a)(2)(ii). This prong is also satisfied. In the instant case, the amount of the Seller'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) and the Federal Energy Regulatory Commission (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) of the Code 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 § 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 Seller's amount realized. At that time, the Seller will be entitled to a deduction for the amount of its decommissioning liability associated with the Plant expressly assumed by Buyer's Subsidiary and included in the Seller's amount realized.

Requested Ruling #8: *Buyer will not recognize any income by reason of any transfer of the assets of Seller's non-qualified nuclear decommissioning funds to Buyer's non-qualified nuclear decommissioning funds, except to the extent that the amount of cash and other Class I assets (as such term is defined in § 1.338-6T) received by Buyer exceeds the amount of consideration paid by Buyer (as determined under § 1060).*

Before specifically making a determination with respect to Requested Ruling #8, several preliminary determinations must be made.

1. The transfer of the assets of the non-qualified nuclear decommissioning funds to the Pooling Partnership prior to the closing had no substantial business purpose, and was merely a device to attempt to change the allocation of the consideration paid for the Plant among the transferred assets under section 1060. Accordingly, the transfer of the assets of the non-qualified nuclear decommissioning funds to the Pooling Partnership prior to the closing will be disregarded for federal income tax purposes. Accordingly, for federal income tax purposes, Seller will be treated as selling, and Buyer's Subsidiary will be treated as buying, the underlying assets of the non-qualified nuclear decommissioning funds, and the Pooling Partnership will not be treated as holding such assets at the time of the closing.

2. Section 1012 provides in part that the basis of property shall be the cost of such property. In cases similar to the instant case, taxpayers have argued that the cost of acquiring the Seller's interests in the Plant and the related assets (including the decommissioning funds) includes the amount of the assumed decommissioning liability. In those similar cases, taxpayers have cited 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 Buyer's Subsidiary will pay cash and assume the liabilities and obligations of the Seller, which includes the decommissioning liabilities in connection with the acquisition of the Plant, its total cost of the purchased assets (excluding the qualified nuclear decommissioning funds) will equal the cash paid plus the assumed liabilities and obligations.

However, 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 , 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 Buyer's Subsidiary 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 Buyer's Subsidiary will not have performed any services relating to the decommissioning liability at the time of the Plants' purchase, economic performance will

not have occurred, and the liability will not have been incurred at that time for any purpose under the Code, including the cost basis provisions of section 1012 .

Accordingly, at the time of closing, Buyer's Subsidiary will have a cost basis in the purchased assets equal to the cash paid to the Seller, as well as any liabilities that are otherwise incurred for federal income tax purposes. The purchased assets and the liabilities incurred do not include the assets in the qualified nuclear decommissioning funds or the liability attributable to the qualified nuclear decommissioning funds, because the tax effect of the qualified nuclear decommissioning funds is determined under section 468A. Buyer's Subsidiary 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 liability. Buyer's Subsidiary's cost basis in the purchased assets, including all assets held in the non-qualified decommissioning funds, must be allocated among all such assets in accordance with the residual method provided in section 1060 and section 1.1060-1T(d) and (e).

3. Section 1.1060-1(c)(1) defines a purchaser's consideration as the amount, in the aggregate, of its cost of purchasing the assets in the applicable asset acquisition that is properly taken into account in basis. Section 1060 provides no independent basis for determining a taxpayer's cost of acquired assets; cost is determined solely under generally applicable rules of tax accounting.

Because the transfer of the Plants is an applicable asset acquisition on the acquisition date (as discussed above with regard to Requested Ruling #4), Buyer's Subsidiary's basis in the assets acquired must be determined by allocating its costs (i.e., the consideration provided by Buyer's Subsidiary on the acquisition date, which includes cash, but not the assumption of the decommissioning liability) among the acquired assets in accordance with the provisions of § 1060 and the regulations thereunder.

The following example illustrates the operation of § 1060 for a purchaser: On Date1, an applicable asset acquisition is made. The assets acquired consist of Class I assets in the amount of $50, Class II assets with a fair market value of $350, Class III assets with a fair market value of $100, Class IV assets with a fair market value of $150, and Class V assets with a fair market value of $100, there are no Class VI or VII assets. The consideration paid consists of $150 cash and an assumed liability for which economic performance has not occurred. On Date1, the purchaser has provided $150 of consideration that may be allocated as basis; it will be first reduced by $50 (the amount of Class I assets); the remaining $100 will be allocated to Class II assets (pro rata according to fair market value); nothing is allocated to Class III or below. On Date2, economic performance occurs with respect to the liability to the extent of $300; at that time, the purchaser has an additional $300 of basis that may be taken into account. Of that amount, $250 is allocated to Class II assets (which will then have been allocated their full $350 fair market value--as determined on the acquisition date), and the remaining $50 is allocated to the Class III assets (pro rata according to fair market value--as determined on the acquisition date). On Date3, economic

performance occurs to the extent of an additional $400, which is then taken into account as basis. Of that amount, $50 will be allocated to the Class III assets (which will then have been allocated their full $100 fair market value--as determined on the acquisition date), $150 will be allocated to the Class IV assets (which will then have been allocated their full $150 fair market value–as determined on the acquisition date), $100 will be allocated to the Class V assets (which will then have been allocated their full $100 fair market value–as determined on the acquisition date), and the remaining $100 will be allocated to the Class VII assets (as goodwill). The last amount is allocated to goodwill even though goodwill was not identified as a separate asset having value on Date1. If, on Date3, instead of an addition to purchaser's consideration, there is a $100 decrease in consideration, the consideration previously allocated to the Class III assets would be reduced to zero and the consideration previously allocated to the Class II assets would be reduced by the remaining $50 (pro rata according to fair market value).

With respect to the qualified nuclear decommissioning funds, the Federal tax treatment of the transaction is determined exclusively under section 468A and the regulations thereunder. The qualified nuclear decommissioning fund is, therefore, not addressed herein with respect to section 1060.

With respect to the Plant, equipment, operating assets, nuclear fuel, and non-qualified nuclear decommissioning fund assets, however, these assets comprise a trade or business in Seller's hands and the basis Buyer's Subsidiary takes in those assets will be determined wholly by reference to Buyer's Subsidiary's consideration. Thus, Seller's transfer of Plant, equipment, nuclear fuel, operating assets and non-qualified nuclear decommissioning fund assets to Buyer's Subsidiary in exchange for cash and the assumption of the decommissioning liability (except to the extent funded by the qualified nuclear decommissioning funds) 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, on the acquisition date, Buyer's Subsidiary's basis in the assets acquired must be determined by allocating its cost (i.e., the consideration provided by Buyer's Subsidiary on the acquisition date, which includes the cash and the issue price of its notes, but not the assumption of the decommissioning liability) among the acquired assets in accordance with the provisions of section 1060 and the regulations thereunder. Specifically, Buyer's Subsidiary will first reduce its consideration by the amount of the Class I assets it receives in the transaction (including any Class I assets held in the non-qualified nuclear decommissioning funds); to the extent the Class I assets received exceed the consideration Buyer's Subsidiary provides, Buyer's Subsidiary will recognize income. To the extent Buyer's Subsidiary's consideration paid exceeds the Class I assets it receives, such excess will be allocated to the Class II assets, 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 Seller (pro rata, to the extent of their fair market value); then among the Class IV assets it receives (pro rata, to the extent of their fair market value); then among the Class V assets it receives (pro rata, to the extent of their fair market value); then among the Class VI assets it receives

(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 Seller. When and to the extent additional amounts are paid or incurred for the assets acquired in the applicable assets acquisition (e.g., when and to the extent the non-qualified nuclear decommissioning funds pay or incur decommissioning expenses), such amounts will be taken into account as increases to Buyer's Subsidiary's consideration paid 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.

4. Finally, 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's Subsidiary 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.

As discussed above, Buyer's Subsidiary's basis attributable to the decommissioning liability is governed by § 461(h) and the consideration furnished by Buyer's Subsidiary will be allocated pursuant to the residual method under § 1060 and the corresponding regulations.

Accordingly, Buyer's Subsidiary will not realize income from its acquisition of the Plant, equipment, operating assets, and Seller's interests in the assets in the non-qualified funds except to the extent that, under the rules of § 1060, the amount of cash and other Class I assets (as defined in § 1.338-6(b)(1)) received by Buyer's Subsidiary (not including the assets held by Seller's qualified funds) exceed its total cost determined under § 1012 (which will be the sum of its cash consideration, if any, and the fair market value of any other consideration Buyer's Subsidiary provides to Seller, that is, under applicable tax principles, taken into account on the date of the applicable asset acquisition). If Buyer's Subsidiary is thus required to take an amount into account as income, then, when, under general principles of tax law, Buyer's Subsidiary is permitted to take additional consideration into account (e.g., when Buyer's Subsidiary satisfies the economic performance requirement with respect to the decommissioning liability assumed), Buyer's Subsidiary will be entitled to deduct (and will not be required to capitalize) such amount. Arrowsmith v. Commissioner, 344 U.S. 6 (1952).

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

This ruling is directed only to the taxpayers who requested it. Section 6110(k)(3) of the Code provides it may not be used or cited as precedent.

In accordance with the powers of attorney, we are sending copies of this ruling to authorized representatives of Buyer and Seller. We are also sending a copy of this letter ruling 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

cc: