Internal Revenue Service

Department of the Treasury
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Person To Contact:
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Date:
April 11, 2008

Legend:

Taxpayer =

Subsidiary A

Subsidiary B =

Trustee =

Affiliate =

Trustee TIF =

Plants (Group A) =

Plants (Group B) =

Dear :

This letter responds to your request for private letter ruling dated October 5, 2007. You requested that we rule whether certain payments and investment activities, discussed below, constitute acts of self-dealing prohibited under section 468A(e)(5) of the Internal Revenue Code and section 1.468A-5T(b) of the temporary Income Tax Regulations.

Facts:

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

Taxpayer is the parent of an affiliated group of subsidiary corporations including Subsidiary A and Subsidiary B, wholly-owned subsidiaries of Taxpayer. Subsidiary A is engaged in the production, transmission, and distribution of electric energy. Subsidiary A owns an undivided interest in Plants (Group A) and maintains separate Qualified Nuclear Decommissioning Trusts (QNDT) with respect to each of those plants. Subsidiary B owns an undivided interest in Plants (Group B) and maintains separate QNDTs with respect to each of these plants. Trustee is the trustee for each of the QNDTs.

The trust agreements governing the QNDTs cited above are similar regarding the trustee's powers and related provisions. As a general matter, the Trustee holds the assets of each QNDT in trust, subject to the qualified fund requirements which are set forth in § 1.468A-5T(a). Subsidiary A and Subsidiary B have the authority to appoint one or more investment managers who have the power to direct the investment of the QNDTs. Also, to the extent that the assets of the QNDTs have not been invested by an investment manager on any given day, the Trustee may invest such un-invested assets as Subsidiary A or Subsidiary B may direct in writing, subject to a "self-dealing" prohibition. In this regard, Trustee may not authorize or carry out any sale, exchange or other transaction which would constitute an act of "self-dealing" within the meaning of § 4951 of the Code, as such section is made applicable to the qualified funds by § 468A(e)(5).

Similarly, while the various trust agreements grant Trustee broad discretion in the exercise of its powers under such agreement, the Trustee may not do any act or participate in any transaction which Trustee knew or should have known would disqualify the qualified funds from the application of § 468A except any disqualification (other than that arising from an act of "self-dealing") resulting from the Trustee following written directions or other instructions of Subsidiary A or Subsidiary B or an investment manager.

The QNDTs may enter into certain securities lending transactions ("Securities Lending Transactions"), encompassing all transactions undertaken pursuant to the Securities Lending Authorization Agreement ("Securities Agreement"). Such transactions would be undertaken by the Trustee, on behalf of the QNDTs, as authorized pursuant to the Securities Agreement. The Securities Agreement is between each QNDT and Affiliate, an affiliate of the Trustee.

The Securities Lending Transactions generally operate as follows. Trustee, as lending agent (in its capacity as trustee of the QNDTs), arranges for the lending of securities held by the Trustee to third-party borrowers. The borrowers will provide cash collateral to the Trustee as lending agent. Trustee invests the collateral as lending agent in accordance with investment guidelines agreed to by Subsidiary A or Subsidiary B, as applicable. Such investment guidelines specify that the cash collateral shall be invested in the Trustee TIF. The borrowers receive a negotiated rebate from investment of their collateral. After the subtraction of the borrower's rebate, the Trustee will receive for its own account a specified percent of the net revenue from the investment of collateral as compensation for its lending services. Taxpayer represents that the amount of fees to be received by the Trustee is consistent with compensation paid by customers other than QNDTs under similar agreements, and is competitive with common practice in the securities lending industry. The QNDTs receive the balance of the revenue from investment of the collateral as investment income.

Taxpayer has requested the following rulings:

> Requested Ruling #1: The payment of the trustee payments by the QNDTs to the Trustee will not constitute a prohibited act of self-dealing under § 468A(e)(5) or § 1.468A-5T(b).
>
> Requested Ruling #2: The Securities Lending Transactions will not constitute a prohibited act of self-dealing under § 468A(e)(5) or § 1.468A-5T(b).
>
> Requested Ruling #3: The Securities Lending Transactions will not result in disqualification of any of the QNDTs under § 468A(e)(6) or § 1.468A-5T(c).

Law and Analysis:

Section 468A(a) of the Code provides that a taxpayer may elect to deduct payments made to a nuclear decommissioning reserve fund that meets the requirements of section 468A (i.e. a fund that is a "qualified nuclear decommissioning fund").

Section 468A(e)(5) provides that, for purposes of section 4951, a qualified nuclear decommissioning fund is treated as a trust described in section 501(c)(21).

Section 1.468A-1T(b)(4) provides that a "qualified nuclear decommissioning fund" is a fund that satisfies the requirements of section 1.468A-5T.

Section 1.468A-5T(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.

Section 1.468A-5T(a)(1)(iii) provides that an electing taxpayer can establish and maintain only one qualified nuclear decommissioning fund for each nuclear power plant. If a nuclear power plant is subject to the ratemaking jurisdiction of two or more public utility commissions and any such public utility commission requires a separate fund to be maintained for the benefit of ratepayers whose rates are established or approved by the public utility commission, the separate funds maintained for such plant (whether or not established and maintained pursuant to a single trust agreement) shall be considered a single nuclear decommissioning fund.

Section 1.468A-5T(a)(3) provides that the assets of a qualified nuclear decommissioning fund are to be used exclusively (A) to satisfy, in whole or in part, the liability of the electing taxpayer for decommissioning costs of the nuclear plant to which the fund relates, (B) to pay administrative and other incidental costs of the trust fund, and (C) to the extent not currently required for the purposes described in (A) and (B) above, to make investments.

Section 1.468A-5T(b)(1) provides that, except as otherwise provided in section 1.468A-5T(b), the excise taxes imposed by section 4951 shall apply to each act of self-dealing between a disqualified person and a nuclear decommissioning fund.

Section 1.468A-5T(b)(2) defines “self-dealing” for purposes of § 468A and the temporary regulations thereunder as any act described in section 4951(d) except

(i) A payment by a nuclear decommissioning fund for the purpose of satisfying, in whole or in part, the liability of the electing taxpayer for decommissioning costs of the nuclear power plant to which the nuclear decommissioning fund relates;

(ii) A withdrawal of an excess contribution by the electing taxpayer pursuant to the rules of paragraph (c)(2) of this section;

(iii) A withdrawal by the electing taxpayer of amounts that have been treated as distributed under paragraph (c)(3) of this section;

(iv) A payment of amounts remaining in a nuclear decommissioning fund to the electing taxpayer after the termination of such fund (as determined under paragraph (d) of this section);

(v) Any act described in section 4951(d)(2) (B) or (C);

(vi) Any act that is described in §53.4951-1(c) and is undertaken to facilitate the temporary investment of assets or the payment of reasonable administrative expenses of the nuclear decommissioning fund; or

(vii) A payment by a nuclear decommissioning fund for the performance of trust functions and certain general banking services by a bank or trust company that is a disqualified person if the banking services are reasonable and necessary to carry out the purposes of the fund and the compensation paid to the bank or trust company for such services, taking into account the fair interest rate for the use of the funds by the bank or trust company, is not excessive.

Section 1.468A-5T(b)(3) provides that the term “disqualified person” includes each person described in § 4951(e)(4) and § 53.4951-1(d).

Section 1.468A-5T(c)(1)(i) provides that if at any time during the taxable year a qualified nuclear decommissioning fund does not satisfy a requirement of section 1.468A-5(a), the Service may, in its discretion, disqualify all or a portion of the fund as of the date that the fund does not satisfy such requirements.

Section 1.468A-5T(c)(3) provides that, if all or any portion of a qualified nuclear decommissioning fund is disqualified under section 1.468A-5T(c)(1), the portion of the qualified nuclear decommissioning fund that is disqualified is treated as distributed to the electing taxpayer on the date of the disqualification. Such a distribution shall be treated for purposes of section 1001 as a disposition of property held by the qualified nuclear decommissioning fund. In addition, the electing taxpayer must include in gross income for the taxable year that includes the date of disqualification an amount equal to the product of the fair market value of the assets of the fund determined as of the date of disqualification (reduced by certain amounts including any tax that is (1) imposed on the income of the fund, (2) is attributable to income taken into account before the date of the disqualification or as a result of the disqualification, and (3) has not been paid as of the date of the disqualification) and the fraction of the qualified nuclear decommissioning fund that was disqualified under section 1.468A-5T(c)(1).

Section 4951(a)(1) of the Code provides that there is a tax imposed on each act of self-dealing between a disqualified person and a trust described in section 501(c)(21) and that the rate of tax shall be equal to 10 percent of the amount involved with respect

to the act of self-dealing for each year (or part thereof) in the taxable period. The tax imposed by this paragraph shall be paid by any disqualified person (other than a trustee acting only as a trustee of the trust) who participates in the act of self-dealing.

Section 4951(d)(1)(A)-(E) of the Code provides that for purposes of this section, the term “self-dealing” means any direct or indirect:

(A) sales, exchanges, or leasing of real or personal property between a trust described in section 501(c)(21) and a disqualified person;
(B) lending of money or other extension of credit between such a trust and a disqualified person;
(C) furnishing of goods, services, or facilities between such a trust and a disqualified person;
(D) payment of compensation (or payment or reimbursement of expenses) by such a trust to a disqualified person; and
(E) transfer to, or use by or for the benefit of, a disqualified person of the income or assets of such a trust.

Section 4951(d)(2)(C) of the Code provides that the payment of compensation (and the payment or reimbursement of expenses) by such a trust to a disqualified person for personal services which are reasonable and necessary to carrying out the exempt purpose of the trust shall not be an act of self-dealing if the compensation (or payment or reimbursement) is not excessive.

Section 4951(e)(4) of the Code provides the term “disqualified person” means, with respect to a trust described in section 501(c)(21), a person who is--

(A) a contributor to the trust,
(B) a trustee of the trust,
(C) an owner of more than 10 percent of--
(i) the total combined voting power of a corporation,
(ii) the profits interest of a partnership, or
iii) the beneficial interest of a trust or unincorporated enterprise, which is a contributor to the trust,
(D) an officer, director, or employee of a person who is a contributor to the trust,
(E) the spouse, ancestor, lineal descendant, or spouse of a lineal descendant of an individual described in subparagraph (A), (B), (C), or (D),
(F) a corporation of which persons described in subparagraph (A), (B), (C), (D), or (E) own more than 35 percent of the total combined voting power,
(G) a partnership in which persons described in subparagraph (A), (B), (C), (D), or (E), own more than 35 percent of the profits interest, or
(H) a trust or estate in which persons described in subparagraph (A), (B), (C), (D), or (E), hold more than 35 percent of the beneficial interest.

For purposes of subparagraphs (C)(i) and (F), there shall be taken into account indirect stockholdings which would be taken into account under section 267(c), except that, for purposes of this paragraph, section 267(c)(4) shall be treated as providing that the members of the family of an individual are only those individuals described in subparagraph (E) of this paragraph. For purposes of subparagraphs (C)(ii) and (iii), (G), and (H), the ownership of profits or beneficial interest shall be determined in accordance with the rules for constructive ownership of stock provided in section 267(c) (other than paragraph (3) thereof), except that section 267(c)(4) shall be treated as providing that the members of the family of an individual are only those individuals described in subparagraph (E) of this paragraph.

Section 53.4951-1(a) of the Foundation and Similar Excise Tax Regulations provides that, in general, section 4951 of the Code contains provisions that correspond to provisions of section 4941 (relating to taxes on foundation self-dealing) and section 4946 (relating to definitions and special rules). Regulations and rulings under these corresponding provisions apply to section 4951 where appropriate.

Section 53.4941(d)-3(c)(1) provides that, in general, the payment of compensation (and the payment or reimbursement of expenses, including reasonable advances for expenses anticipated in the immediate future) by a private foundation to a disqualified person for the performance of personal services which are reasonable and necessary to carry out the exempt purpose of the private foundation shall not be an act of self-dealing if such compensation (or payment or reimbursement) is not excessive. For purposes of this subparagraph the term 'personal services' includes the services of a broker serving as agent for the private foundation, but not the services of a dealer who buys from the private foundation as principal and resells to third parties. For the determination whether compensation is excessive, see section 1.162-7 of this chapter (Income Tax Regulations). This paragraph applies without regard to whether the person who receives the compensation (or payment or reimbursement) is an individual. The portion of any payment which represents payment for property shall not be treated as payment of compensation (or payment or reimbursement of expenses) for the performance of personal services for purposes of this paragraph. For rules with respect to the performance of general banking services, see section 53.4941(d)-2(c)(4).

Section 53.4941(d)-3(c)(2) Example 2 of the regulations provides that C, a manager of private foundation X, owns an investment counseling business. Acting in his capacity as an investment counselor, C manages X's investment portfolio for which he receives an amount which is determined to be not excessive. The payment of such compensation to C shall not constitute an act of self-dealing.

Under section 4951(e)(4)(B) of the Code, a trustee of a trust is a “disqualified person.” Since the trustee is a disqualified person it must be determined whether the payments to the Trustee constitute a prohibited act of self-dealing. The payments to the Trustee from the income that is derived from the collateral invested in the Trustee TIF is

compensation for investment services provided to the qualified funds by the Trustee. Under §§ 4951(d)(1)(C)-(E), the services provided by the Trustee and the compensation being paid to the Trustee qualify as acts of self-dealing.

However, an exception applies under § 4951(d)(2)(C), in that the payment of compensation by a trust to the trustee for services which are reasonable and necessary to the carrying out of the exempt purpose of the trust does not constitute self-dealing, if the compensation is not excessive. For example, the payment of compensation by a private foundation to a disqualified person (employee) for investment counseling services, including portfolio management, provided by the disqualified person's (employee's) investment counseling business is not self-dealing, provided that the compensation is not excessive. Section 53.4941(d)-3(c)(2) Example 2. Therefore, we must first determine if the services are reasonable and necessary to carrying out of the exempt purpose of the trust, and secondly, whether or not the compensation is excessive.

The exempt purpose of the trust is to maintain separate qualified funds for the purpose of decommissioning the interests in each of the plants. Section 468A and accompanying temporary regulations provide that the assets of a qualified fund may be used to make investments. Thus, the making of investments qualifies as an exempt purpose of the QNDTs and the payments to the Trustee are not a prohibited act of self-dealing provided that the payments to the Trustee are not excessive.

Additionally, a private foundation may pay reasonable compensation to a disqualified person for personal services pursuant to § 4941(d)(2)(E). An exception is provided where a bank only performs trust functions and certain limited general banking services. The services must be reasonable and necessary to carry out the exempt purposes of the private foundations. The compensation must not be unreasonable. We have consistently strictly interpreted the term general banking services to include only checking accounts, saving accounts, and safekeeping activities. Trust functions historically include investment functions. Another exception to the rules prohibiting self-dealing is where the disqualified person only receives an incidental or tenuous benefit from the use by the foundation of its assets.

Based upon the information submitted, the management and investing of the qualified funds described herein is similar to trust and general banking services. Investment activity is a permissible use of trust assets entered into for the purpose of obtaining funds to be used to further exempt purposes. Such services are excluded from the definition of self-dealing by reason of the provision of §§ 53.4941(d)-2(c)(4) and 53.4941(d)-3(c).

The information submitted shows that Trustee follows the instructions provided to it by Subsidiary A or Subsidiary B and executes the investments. Additionally, regarding whether the compensation is reasonable, the Trustee has submitted

documentation representing that compensation it will receive is similar to what it would receive for providing the same services to clients of similar size and asset allocation. Based on these representations, we conclude that the services provided by the trustee are reasonable and necessary and that the compensation paid therefore is not excessive.

Regarding the self-dealing implications of the Securities Lending Transactions, the extensive list of possible borrowers consists of large, publicly-traded companies and that list is subject to change over time. Affiliate, as parent of Trustee and provider of the Trustee TIF, in which the collateral is invested, does not meet the definition of a "disqualified person" under section 4951(e)(4) of the Code. Affiliate is not a contributor to any of the QNDTs or a trustee of those trusts. In addition, the borrowers, as borrowers of the qualified fund securities, payers of collateral and interest into the Trustee TIF, and payees of rebates derived from the income generated by the collateral in the Trustee TIF do not meet the definition of "disqualified persons" pursuant to section 4951(e)(4). Borrowers are not contributors to the trust nor are they trustees of the trust. However, because the list of potential borrowers is extensive and subject to change, the issue is too factual for a categorical determination regarding all Securities Lending Transactions. The Service does not generally issue rulings in situations where the determination is too factual. See section 6.02 of Rev. Proc. 2008-1, 2008-1 I.R.B. 1, 14. Thus we are unable to conclude that any "borrowers" do not meet the definition of disqualified person under § 4951(e)(4). Generally, it is necessary to determine whether any of the borrowers is a "disqualified person" with respect to Taxpayer, Trustee, or Affiliate. If a borrower is not a disqualified person, then the Securities Lending Transaction involving that borrower is not a prohibited act of self-dealing. If, however, a borrower is a disqualified person, then the self-dealing analysis would be triggered and aspects of the transaction such as the purpose of the transaction, how money is being made, and how the qualified funds are benefiting, would be analyzed.

Conclusions:

Based on the information and specific factual representations submitted by Taxpayers, we reach the following conclusions:

The payment of the trustee payments by the QNDTs to the Trustee will not constitute a prohibited act of self-dealing under § 468A(e)(5) or § 1.468A-5T(b). In addition, to the extent that the borrower involved is not a disqualified person with respect to Taxpayer, the QNDTs, Trustee, or Affiliate, the Securities Lending Transactions will not constitute a prohibited act of self-dealing under § 468A(e)(5) or § 1.468A-5T(b) and the Securities Lending Transactions will not result in disqualification of any of the QNDTs under § 468A(e)(6) or § 1.468A-5T(c).

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

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

cc: