Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Number: **200042006**
Release Date: 10/20/2000
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-100495-00
Date:
July 11, 2000

Legend:

Seller/Taxpayer =

Parent =

Buyer =

Company 1 =

Company 2 =

Plant =

District =

Commission =

Trustee =

State =

a =

b =

c =

d =

Dear :

This letter responds to your request, dated December 30, 1999, that we rule on

certain tax consequences of the sale of the Plant from Seller to Buyer. As set forth below, you have requested rulings regarding certain tax consequences to the Seller and the Seller's qualified nuclear decommissioning fund as a result of the sale.

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

The Seller is the owner of the Plant and is a member of an affiliated group of corporations, the common parent of which is Parent. The Seller is a public utility engaged in the generation, transmission, distribution, and sale of electricity to customers in State and is under the audit jurisdiction of the District Director of District. The Seller maintains a qualified and a nonqualified nuclear decommissioning fund with respect to the Plant managed by the Trustee.

As a result of legislation in State, as well as recent restructuring orders by the Commission, the Seller's retail customers became deregulated beginning on a. The Seller has been able to continue to collect costs for decommissioning the Plant through a non-bypassable charge to all customers to whom the Seller delivers electricity whether the energy is generated by the Seller or another energy supplier. In anticipation of deregulation, the Seller had made a strategic decision to divest itself of its generation business. To this end, on b, Seller entered into an agreement to sell the Plant to the Buyer.

Pursuant to the agreement, Seller will transfer to the Buyer the Plant and its related assets and all of the assets of the Seller's qualified and nonqualified nuclear decommissioning funds. As consideration the Buyer will pay c and will assume all liabilities and obligations to decommission the Plant (as well as certain other liabilities related to the Plant). The agreement requires that the assets of the qualified and nonqualified nuclear decommissioning funds have an aggregate fair market value at closing of d. The assets of the Seller's funds will be transferred to a qualified and nonqualified nuclear decommissioning fund established by the Buyer.

Requested Ruling #1: Neither the Seller nor its qualified nuclear decommissioning fund will recognize any gain or otherwise take into account any income by reason of the transfer of the qualified nuclear decommissioning fund assets to the Buyer's qualified nuclear decommissioning fund at closing.

Section 468A(a) of the Internal Revenue Code 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.

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.

Under the specific facts herein, the Service will generally 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 will apply 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 Seller's qualified nuclear decommissioning fund will not be disqualified upon the sale when the fund's assets are transferred to the Buyer's qualified nuclear decommissioning fund.

Section 1.468A-6(c)(1) provides that neither a seller of an interest in a nuclear power plant nor the seller's fund will recognize gain or loss or otherwise take any income or deduction into account by reason of a sale. Accordingly, neither the Seller nor its qualified nuclear decommissioning fund will recognize gain or loss or otherwise take into account any income or deduction upon the transfer of the qualified nuclear decommissioning fund asset to the Buyer's fund as a result of the sale.

Requested Ruling #2: Seller will be entitled to a current ordinary deduction (in the year of sale) equal to the total of any amounts treated as realized by the Seller, or otherwise recognized as income by the Seller, as a result of the Buyer's assumption of the liability to decommission 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 Seller clearly has the obligation to decommission its 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. section 50.33 and section 72.30, requiring the operator of a nuclear power plant to decommission it. Moreover, Congress recognized the existence of the decommissioning liability when, in 1984, it enacted section 461(h) and section 468A, noting that "[g]enerally, under Federal and State laws, utilities that operate nuclear power plants are obligated to decommission the plants at the end of their useful lives." H.R. Conf. Rep. No. 98-861, 877 (1984). See also S. Prt. No. 169, Vol. 1, 98th Cong., 2d Sess. 277 (1984).

The second prong of the all events test requires the amount of the liability to be reasonably determinable. See section 1.461-1(a)(2)(ii). This prong is also satisfied. In the instant case, the amount of the Seller's decommissioning liability has been determined by experts in the nuclear decommissioning industry. Their calculations have been reviewed and accepted by the Nuclear Regulatory Commission (NRC), which is charged with ensuring that sufficient funds are available to decommission the Plant. 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 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 the Buyer and included in the Seller's amount realized.

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). The decommissioning liability from which Taxpayer will be 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, the amount of Taxpayer's decommissioning liability (not including the portion of the liability attributable to the qualified fund on the date of the transfer) will be included in Transferor's amount realized.

Finally, section 1060 provides that, in the case of an "applicable asset acquisition," the consideration received shall be allocated among the acquired assets in the same manner as amounts are allocated to assets under section 338(b)(5). Section 1.1060-1T(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 section 1.338-6T and 1.338-7T 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 1.1060-1T(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 and 461(h).

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 they qualify as section 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 1.1060-1T(c)(2), 1.338-6T(b)(1), and 1.338-6T(b)(2).

The following example illustrates the operation of section1060: On Date1, an applicable asset acquisition is made. The assets sold consist of Class I assets in the amount of $50; Class II assets with a fair market value of $250 and a basis in the hands of the seller of $100; Class III assets with a fair market value of $100 and a basis of $100; Class IV assets, with a fair market value of $150 and a basis of $50; Class V assets with fair market value of $100 and a basis of $100; and Class VI assets, with a fair market value of $50 and a basis of $0. The consideration consists of $375 cash and an assumed liability of $400 that, under applicable tax accounting principles, is taken into account at the time of the applicable asset acquisition.

The consideration will be first reduced by $50 (the amount of Class I assets). The remaining consideration will be allocated as follows: $250 to Class II assets (pro rata according to fair market value, resulting in a $150 gain); $100 to the Class III assets (pro rata according to fair market value, resulting in no gain or loss); $150 to the Class IV assets (pro rata according to the fair market value, resulting in a $100 gain); $100 to the Class V assets (pro rata according to the fair market value, resulting in no gain or loss); $50 to the Class VI assets (pro rata according to the fair market value, resulting in a $50 gain); and the remaining $75 to the Class VII assets (pro rata according to the fair market value, resulting in a $75 gain). The character of the amounts of gain or loss recognized by the seller, as well as any applicable holding periods, are determined by the nature of the underlying assets. Sections 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, 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 1.1060-1T(a)(1), 1.1060-1T(c)(2), and 1.338-7T.

With respect to the Plant, equipment, operating assets and nonqualified fund assets, these assets comprise a trade or business in Seller’s hands and the basis Buyer takes in those assets will be determined wholly by reference to Buyer’s consideration. Thus, Seller’s transfer of Plant, equipment, operating assets and nonqualified fund assets to Buyer in exchange for cash and the assumption of the decommissioning liability (except to the extent funded by the qualified 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, Seller must allocate the consideration to the applicable assets in accordance with the provisions of section 1060 and the regulations thereunder. Specifically, Seller will first reduce the consideration received by the amount of Class I assets it transfers in the transaction (including any Class I assets held in the Nonqualified fund). To the extent Seller's consideration exceeds the Class I assets it transfers, such excess will be allocated to the Class II assets, then to 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; allocating 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 the character and other attributes of the underlying assets.

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 powers of attorney, we are sending a copy of this ruling to your authorized representative. We are also sending a copy of this letter ruling to the District Director of District.

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