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Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:
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Refer Reply To:
CC:DOM:P&SI:6-PLR-102425-99
Date:
JUL 21 1999

Legend:

Taxpayer/Seller =

Plant =

Subsidiary 1 =

Subsidiary 2 =

Subsidiary 3 =

Buyer =

Partner 1 =

Partner 2 =

Commission 1 =

Commission 2 =

Commission 3 =

District 1 =

District 2 =

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PLR-102425-99

State A =

State B =

a =

b =

c =

d =

e =

Dear :

This letter responds to your request, dated January 14, 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 the tax consequences of the sale under section 468A of the Internal Revenue Code to the Seller and its Subsidiaries and their qualified nuclear decommissioning funds. In addition, you have requested whether the Seller and its Subsidiaries would be entitled to a deduction for amounts realized by them as a result of the Buyer's assumption of the decommissioning liabilities associated with the Plant.

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

The Taxpayer is the parent holding company of Subsidiaries 1, 2, and 3. The consolidated federal tax return is under the audit jurisdiction of the District Director of District 1. Each Subsidiary is a regulated public utility engaged in the generation, transmission, distribution and sale of electricity and uses the accrual method of accounting.

The wholesale rates of the Subsidiaries are under the jurisdiction of Commission 3. The retail rates of Subsidiaries 1 and 2 are under the jurisdiction of Commission 2. The retail rates of Subsidiary 3 is under the jurisdiction of Commission 1. Subsidiary 1 owns a percent of the Plant, while Subsidiaries 2 and 3 each own b percent of the Plant. Each Subsidiary maintains both a qualified nuclear decommissioning fund and a non-qualified fund with respect to its interest in the Plant.

The Buyer is a limited liability company whose two members are Partner 1 and Partner 2. The Buyer is under the audit jurisdiction of the District Director of District 2.

Historically, the Taxpayer and its subsidiaries have conducted their electric utility business in a regulated monopoly environment. As a result of legislation enacted in State A and expected to be enacted in State B, the sale of electric generation in those states will become deregulated. In State A, Subsidiaries 1 and 2 will be permitted to recover stranded costs associated with their generation assets, including nuclear decommissioning costs, through a competitive transmission charge which will be a separate component of their bills to retail customers. Similarly, in State B, Subsidiary 3 will be able to recover stranded costs through a nonbypassable transmission charge.

In response to this changing environment, the Taxpayer made a decision to exit the generation business to focus solely on transmission and distribution. As part of this decision, the Taxpayer and Buyer entered into an agreement on c providing for the sale of the Subsidiaries' interests in the Plant to the Buyer.

The Taxpayer and its subsidiaries will transfer the Plant and its related assets, nuclear fuel, plant license, and all of the assets of the Subsidiaries' qualified and nonqualified nuclear decommissioning funds to the Buyer. In exchange, the Buyer will transfer to the Taxpayer d and will assume the decommissioning liabilities associated with the Plant. The purchase agreement requires the qualified and nonqualified funds to have a combined total of e as of the date of closing.

Requested Ruling #1. The Subsidiaries' qualified nuclear decommissioning funds will not recognize any gain or otherwise take into account any income for federal income tax purposes by reason of the transfer of the assets of the qualified fund to a qualified fund established by the Buyer to receive such assets.

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(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.

Thus, the applicable provisions of the Code and regulations set forth three general requirements for the establishment and maintenance of qualified funds. In order to establish and/or maintain a qualified nuclear decommissioning fund a taxpayer must be a regulated public utility (have cost of service ratemaking on a rate of return basis); have a qualifying ownership interest in a nuclear power plant; and, be liable for the decommissioning of the nuclear power plant.

Under the specific facts herein, the Service will exercise its discretion to treat this sale, under section 1.468A-6(g), as a disposition qualifying under the general provisions

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of section 1.468A-6. This exercise of discretion is specifically based on the continued general supervision of the qualified fund by the Nuclear Regulatory Agency and the Federal Energy Regulatory Commission. In addition, this exercise of discretion applies to those 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 Seller's fund will not be disqualified upon the sale when the fund withdrawal rights transfer to the Buyer.

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. Thus, because we are exercising our discretion not to disqualify the qualified funds, neither the qualified funds nor the Taxpayer and its Subsidiaries will recognize gain or loss or otherwise take any income or deduction into account upon the transfer of the qualified funds to the Buyer as a result of the sale.

Requested Ruling #2: The Taxpayer and its Subsidiaries will be allowed current ordinary deductions for federal income tax purposes for any amounts treated as realized by them, or otherwise recognized as income to them, as a result of the Buyer's assumption of the decommissioning liability associated with 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 Treas. Reg. § 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.

Under the general economic performance rules, the Taxpayer and its Subsidiaries would not be entitled to a deduction for their decommissioning liability until

the year in which they incur costs to decommission the Plant. Section 1.461-4(d)(5), however, creates an exception to this general rule. It allows a seller of a trade or business, in certain limited circumstances, to deduct in the year of sale liabilities that otherwise would have been deducted but for the failure to meet the economic performance requirement. Specifically, that section provides in part as follows:

> If, in connection with the sale or exchange of a trade or business by a taxpayer, the purchaser expressly assumes a liability arising out of the trade or business that the taxpayer but for the economic performance requirement would have been entitled to incur as of the date of sale, economic performance with respect to that liability occurs as the amount of the liability is properly included in the amount realized on the transaction by the taxpayer.

Under section 1.461-4(d)(5), the Taxpayer and its Subsidiaries are entitled to a deduction in the year of the sale for the decommissioning liability assumed by the Buyer if the all events test is otherwise satisfied and the amount of the assumed liability is properly included in the amount realized of the Taxpayer and its Subsidiaries.

The first prong of the all events test requires that the fact of the liability be established at the time of the deduction. This prong of the all events test is satisfied in the instant case. Here, the Taxpayer and its Subsidiaries clearly have the obligation to decommission the Plant. The fact of the obligation arose many years ago, at the time they obtained a 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, 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 Sellers' decommissioning liability has been determined by experts in the nuclear decommissioning industry. Their calculations have been reviewed and accepted by both the Nuclear Regulatory Commission (NRC), which is charged with ensuring that sufficient funds are available to decommission the Plant, and the Federal Energy Regulatory Commission (FERC), which is charged with ensuring that the ratepayers are not overcharged for their share of the decommissioning costs. 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 also 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, section 1.461-4(d)(5), will deem economic performance to be satisfied with respect to the decommissioning liability in the year of the sale to the extent the liability is included in the amount realized of the Taxpayer and its Subsidiaries. Thus, they will be entitled to a current deduction in such amount.

Accordingly, to summarize the conclusions set forth above, we reach the following conclusions in response to the Taxpayers' requested rulings:

1. Neither the qualified funds nor the Taxpayer and its Subsidiaries will recognize gain or loss or otherwise take any income or deduction into account upon the transfer of the qualified funds to the Buyer as a result of the sale. This ruling is limited to the federal income tax effect of the transfer of the qualified fund to the Buyer. No ruling is made with respect to the gain or loss of the Taxpayer and its Subsidiaries on the sale of the plant and associated assets other then the qualified fund.

2. The Taxpayer and its Subsidiaries will be allowed current ordinary deductions for federal income tax purposes for any amounts treated as realized by them, or otherwise recognized as income to them, as a result of the Buyer's assumption of the decommissioning liability associated with the Plant.

This letter ruling is directed only to the taxpayers 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, we are sending a copy of this ruling to your authorized representative. We are also send copies of this letter ruling to the District Director of the District 1.

Sincerely,

CHARLES B. RAMSEY
Chief, Branch 6
Office of the Assistant Chief Counsel
Passthroughs and Special Industries

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