Internal Revenue Service

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Department of the Treasury

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Date: SEP 28 1999

Third Party Contact
July and August, 1999
Public Interest Group

Legend:

Taxpayer 1 (Seller) =

Taxpayer 2 (Buyer) =

Parent 1 =

Parent 2 =

Plant =

Location =

District 1 =

District 2 =

a =

4136

b =

c =

d =

e =

f =

g =

h =

i =

k =

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This letter responds to your request, dated December 17, 1998, as supplemented and modified, 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 under section 468A of the Internal Revenue Code to the Seller's qualified nuclear decommissioning fund as well as rulings regarding the proper realization and recognition of gain and loss on the sale of the Plant and the proper allocation of basis.

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

The Seller is a wholly-owned subsidiary of Parent 1 and files, with Parent 1, a consolidated federal income tax return on a calendar-year basis using the accrual method of accounting. Seller owns and operates electric generation plants and a distribution network that carries power to industrial and retail customers.

The Buyer is a second tier, wholly-owned, subsidiary of Parent 2 and files, with Parent 2, a consolidated federal income tax return on a calendar-year basis using the accrual method of accounting. Parent 2 conducts its business of power generation, purchase, transmission, distribution, and sale through six regulated subsidiaries. Buyer will be engaged in the business of acquiring and operating nuclear power plants for the generation and sale of electric power.

Historically, utilities generated, transmitted, distributed, and sold electric power at regulated rates designed to allow the recovery of all prudently incurred costs, plus a reasonable profit. Over the last several years a number of states have begun to approve plans to deregulate the electric power industry. Because market rates for generation of electricity are usually lower than the conventional cost of service rates, utilities owning power generation assets will have stranded or unrecovered costs, including capital costs and nuclear decommissioning costs (the FERC and state public utility commissions have encouraged utilities to sell power generation assets by permitting some recovery of stranded costs)..

As a result of this shift in the industry, Seller is in the process of withdrawing from the electric power generation business and will sell the Plant and related assets to the Buyer. Seller will transfer to Buyer the Plant and related assets, including nuclear decommissioning trusts in exchange for a cash payment and the assumption, by the Buyer, of the nuclear decommissioning and other Plant-related liabilities.

Seller maintains a Decommissioning Trust that contains a section 468A-qualified nuclear decommissioning fund and a non-qualified decommissioning fund (the "Funds") with respect to the Plant. The non-qualified fund has been treated as a grantor trust under the rules of section 677. Both funds are held solely for the purpose of decommissioning the Plant. As of a, the qualified fund held assets with a fair market value of c and a basis of d. As of b, the non-qualified fund held assets with a fair market value of e and a basis of f. An independent estimate determined that the cost of decommissioning the Plant is g. The Seller's tax basis in the Plant, as of h, was i, of which s relates to the Plant and land and the remainder to the non-qualified decommissioning fund.

The basic terms of the transaction are as follows. Seller will fully fund the Decommissioning Trust at the sale closing for the then-present value necessary to decommission the Plant in m. The present value has been determined as of l to be k. The two funds have a combined fair market value of n (e in the non-qualified fund, the remainder in the qualified fund) as of b. The additional amount required for full funding is o of which Seller will contribute p. The p will be funded through rate reduction bonds collateralized by pledging the proceeds of a special ratepayer surcharge approved by the local public utility commission. Seller will transfer the Plant and related facilities, inventory, contracts, licenses and other assets, including its rights in all the decommissioning funds. Buyer will assume the decommissioning liability and other liabilities associated with the Plant's operation and will pay Seller r (subject to certain adjustments) for the Plant and its related assets other than the decommissioning funds. In addition, Buyer is treated as purchasing all the assets of the Provisional Trust (less the u which will be distributed back to Seller). The assets of the Provisional Trust that Buyer is treated as purchasing include the income attributable to the u portion of the Provisional Trust.

Thus, in connection with the proposed sale, Seller will establish and contribute t cash to a Provisional Trust. All the assets in the Provisional Trust will be dedicated to decommissioning the Plant. Upon receipt of this private letter ruling the Seller will be entitled to a distribution from the Provisional Trust of u. In addition, should there be certain legislative or regulatory federal tax relief enacted or promulgated by q, some or all of the remaining corpus will be returned to Seller in accordance with a predetermined formula. If there is no such legislative or regulatory tax relief within the prescribed time, the trustee of the Provisional Trust will contribute all the trust assets to the Decommissioning Trust in accordance with the written instructions of the Buyer.

Requested Ruling #1: Seller's qualified fund will not be disqualified upon the sale when the fund withdrawal rights transfer to the Buyer.

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 fo 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 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 fund will not be disqualified upon the sale when the fund withdrawal rights transfer to the Buyer.

Requested Ruling #2: Seller's qualified fund will not recognize gain or loss upon its transfer to the Buyer as a result of the sale.

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, Seller's qualified fund will not recognize gain or loss upon its transfer to the Buyer as a result of the sale.

Requested Ruling #3: Seller will not recognize income attributable to the qualified fund assets upon the transfer of the qualified fund to the Buyer as a result of the sale.

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, the Seller will not recognize gain or loss upon the transfer of the qualified fund to the Buyer as a result of the sale.

Requested Ruling #4: Seller's gain or loss on the sale of the plant and associated assets will be the difference between seller's basis in such assets and its amount realized.

As discussed in response to Ruling Requests 1, 2, and 3, above, the proposed transaction will not result in the disqualification of the qualified fund and Seller will not recognize any gain or income as a result of the transfer to Buyer of Seller's interest in the assets of the qualified fund. Accordingly, our response to this ruling request concerns only Seller's gain or loss on the sale to Buyer of the Plant and of Seller's interests in the assets of the non-qualified fund.

Section 1001(a) provides that a taxpayer's gain from the sale of property shall be the excess of the amount realized over the taxpayer's adjusted basis provided in section 1011 for determining gain and that the taxpayer's loss from the sale of property shall be the excess of the taxpayer's adjusted basis provided in section 1011 for determining loss over the amount realized.

Section 1060(a) provides that in the case of any applicable asset acquisition, for purposes of determining the transferee's basis and the gain or loss of the transferor, the consideration received for the assets shall be allocated in the same manner as amounts are allocated under section 338(b)(5). See section 1.1060-1T. Under section 1060(c), an applicable asset acquisition means any transfer of assets which constitute a trade or business, and with respect to which the transferee's basis is determined wholly by reference to the consideration paid for such assets.

Accordingly, on the sale of Plant and Seller's interests in the assets in the decommissioning funds (other than those assets in the qualified fund), 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 section 1060 and the corresponding regulations.

Requested Ruling #5: Seller's amount realized on the sale of the plant and associated assets will include the cash received from the Buyer and the amount of the liabilities assumed by the Buyer, including the liability to decommission the plant (reduced by the amount of such liability to be funded by the qualified fund).

As discussed in response to Requested Rulings 1, 2, and 3, above, the proposed transaction will not result in the disqualification of the qualified fund and the Seller will not have any gain or income as a result of the transfer of Seller's interests in the assets of the qualified fund to Buyer. Accordingly, our response to this ruling request concerns Seller's amount realized on the sale of the Plant and its interests in the assets of the non-qualified fund to Buyer.

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 Seller will be relieved is fixed and quantifiable. As an 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. The amount in the Funds represents the present value of that liability, as established by decommissioning cost studies, and confirmed by regulatory approval and the terms of the Parties' transaction, under which the Funds will be transferred to Buyer in connection with Buyer's assumption of the liability. Cf. United States v. Davis, 370 U.S. 65 (1962) (amount realized as result of relief from liability presumed equal to value of property given up in arm's-length exchange).

As discussed above, the proposed transaction will not result in the disqualification of the qualified fund and Seller will not have any gain or income as a result of the transfer of Seller's interests in the assets of the qualified fund to Buyer. Because the transfer of the qualified fund by Seller to Buyer will not be a taxable transfer, the amount of the liabilities assumed by Buyer that are included in Seller's amount realized will not include the portion of the liability to decommission the Plant that is equal to the fair market value of the assets in the qualified fund on the date of the transfer (representing an allocable portion of the present value of the future decommissioning costs).

Accordingly, Seller's amount realized from the sale of Plant and its interests in the decommissioning funds to Buyer will include the cash received from Buyer and the amount of the liabilities assumed by Buyer, including the portion of the liability to decommission Plant equal to the fair market value of the assets in the non-qualified fund on the date of the transfer, but not including the portion of the liability to decommission Plant equal to the fair market value of the assets in the qualified fund on the date of the transfer (representing an allocable portion of the present value of the future decommissioning costs).

Requested Ruling #6: The qualified fund will retain the same basis in its investment assets after the sale.

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. Under section 1.468A-6(c)(3), the Buyer's qualified fund will have a basis in its assets that is the same as the basis of those assets in the Seller's qualified fund immediately before the disposition. Thus, the qualified fund will retain the same basis in its investment assets after the sale.

Requested Ruling #7: Seller will be entitled to a deduction equal to the amount of the liability (reduced by the amount of the liability to be funded by the qualified fund) to decommission the plant expressly assumed by the Buyer in the year the liability is assumed.

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 the all events test is generally 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.

Under the general economic performance rules, the Seller would not be entitled to a deduction for its decommissioning liability until the year in which it incurs 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 failure to meet the economic performance requirement. Specifically, that section provides that 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. See section 1.1001-2 for rules relating to the inclusion in amount realized from a discharge of liabilities resulting from a sale or exchange.

Under section 1.461-4(d)(5), the Seller is 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 Seller's amount realized.

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 concurrently enacted sections 461(h) and 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 independent 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). 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 generally permits a current deduction based, in part, on an estimated future decommissioning liability. 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, section 1.461-4(d)(5) will deem economic performance to be satisfied with respect to the decommissioning liability associated with the non-qualified fund in the year of the sale to the extent the liability is included in the Seller's amount realized. Thus, the Seller will be entitled to a current deduction in such amount.

Requested Ruling #8: Buyer will not realize income from its purchase of the plant and associated assets.

Generally, a taxpayer does not realize gross 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 cannot acquire Plant without assuming the decommissioning liability, which is inextricably associated with ownership and operation of 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.

Accordingly, Buyer will not realize income from its purchase of Plant and Seller's interests in the assets in the decommissioning funds. However, as discussed below in Requested Rulings #9 and #11, the Buyer will realize income from its purchase of Plant and related assets to the extent that the amount of cash and other Class I assets received exceed the amount of consideration provided by Buyer. To the extent the Buyer is entitled to take into account other consideration paid, Buyer will make appropriate adjustments to reflect any income previously recognized by virtue of having acquired Class I assets in excess of the consideration taken into account in the year of the acquisition. See section 1.1060-1T(f).

Requested Ruling #9: Buyer's basis in the purchased assets will equal its costs, including the cash transferred to the Seller and the amount of liabilities assumed by the Buyer, including the liability to decommission the plant (reduced by the amount of such liability to be funded by the qualified fund).

Section 1012 provides in part that the basis of property shall be the cost of such property. The Buyer claims that its cost of acquiring the Plant and the related assets (including the decommissioning funds) includes the amount of the assumed decommissioning liability. The Buyer also argues that because the assets held in the decommissioning funds are dedicated to and can be used for no purpose other than satisfaction of the assumed decommissioning liability, the assumed liability must be treated as the purchase price paid for the assets held in the funds. Similarly, the Buyer argues that the parties intend that the cash component of the purchase price is to be allocated entirely to the assets other than those held in the decommissioning funds -- e.g., the Plant itself. Accordingly, Buyer seeks to treat the cash payment as the purchase price – and the cost basis – of the Plant and related operating assets, and the future decommissioning liability as the purchase price – and cost basis – of the assets held in the decommissioning funds. We disagree.

First, the Buyer's argument does not recognize that the assumed decommissioning liability cannot be treated as incurred for <u>any</u> 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 as 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 of the Code, the Federal Income Tax 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 the Buyer is entitled to treat the future decommissioning liability as a component of its cost basis in the Plant assets at the time of the purchase is deciding whether the liability has been incurred for tax purposes. It has 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). The Buyer will not incur decommissioning costs until the Plant is removed from service and decommissioning operations begin. This is not expected to occur until sometime after the m expiration of the Plant's operating license and, under applicable NRC regulations, may not occur for up to 60 years following that date. 10 C.F.R. section 50.82(a)(3). Because the Buyer will not have incurred costs relating to the decommissioning liability at the time of the Plant's 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 the purchase the Buyer's basis will equal only the cash component of the purchase price.

Second, the Buyer's position that this cash component should be allocated to the Plant itself while the future decommissioning liability should be allocated to the assets held in the decommissioning fund is not supported by applicable authority. Instead, allocation of the allowable basis (i.e., the cash component of the purchase price) must be made in accordance with the residual method provided in section 1.1060-1T(d) and (e). The residual method does not permit the allocation suggested by the Buyer.

During its conference of right and in supplemental written submissions, the Buyer took the position that applicable provisions of the regulations provide only that an item "generally" is not incurred for tax purposes prior to satisfaction of the economic performance requirement. The Buyer also contended that failure to excuse application of the economic performance regulations in determining basis in this case would preclude clear reflection of the Buyer's income because it would prohibit the Buyer from claiming the depreciation deductions with respect to the generating assets to which it otherwise would be entitled and because it would result in the Buyer being taxed on "gross income" from the sale of the Decommissioning Trust assets. Finally, the Buyer called upon the Service to exercise its discretion to waive application of the regulations to this transaction given the important non-tax policy considerations involved.

The Service is not persuaded that use of the word "generally" is sufficient to permit a conclusion that the Buyer should be entitled to treat the decommissioning liability as an incurred item for purposes of section 1012. Instead, nuclear decommissioning expenditures represent one of the types of expenditures Congress intended to address in enacting section 461(h). Permitting current income tax effect for such a substantial expenditure which will not be incurred economically until many years in the future would clearly be at odds with the intent of the Code provision and regulations. Because delaying the tax effect until such time as the Buyer incurs an actual economic cost with respect to the liability is in fact precisely the intended operation of the economic performance rules, the Buyer's claim that this result fails to clearly reflect its income must be rejected. As the taxpayer acknowledged at its conference of right, an identical argument could be made by any taxpayer assuming a large service obligation in partial or full satisfaction of an asset's purchase price. As such, the Buyer is simply being treated in the same manner as all other asset purchasers whose purchase price includes an assumed service obligation.

Finally, the Buyer's appeal for the Service to exercise its discretion to waive application of the regulations in light of the important non-tax considerations does not recognize the critical distinction between the inherent authority of the Treasury and the Service to interpret provisions of the Code by means of promulgating – after public notice and comment – final Treasury regulations, and the ability of the Service to disregard those regulations once formally adopted. See generally Rogovin, "The Four R's: Regulations, Rulings, Reliance, and Retroactivity," 49 Fed'l Tax Guide Reports No. 8 (Dec. 3, 1965). Excusing the Buyer from compliance with the economic performance regulations in the instant matter would be contrary to the Service's responsibility to administer the internal revenue laws fairly and consistently to all taxpayers.

Accordingly, at the time of sale, the Buyer 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 Buyer will not be entitled to treat as a

component of its cost basis at the time of the purchase any amount attributable to the future decommissioning liability. The Buyer's cost basis in the purchased assets, including all assets held in the decommissioning funds (other than the qualified fund), must be allocated among all such assets in accordance with section 1060 and the regulations thereunder.

Requested Ruling #10: Buyer's rights with respect to the nonqualified fund after the sale will cause it to be treated as a grantor trust.

Section 671 provides that where it is specified in sections 673 through 678 that the grantor or another person shall be treated as the owner of any portion of a trust, there shall be included in computing the taxable income and credits of that person those items of income, deduction, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account in computing taxable income or credits against the tax of an individual.

Section 673(a) provides that the grantor shall be treated as the owner of any portion of a trust in which the grantor has a reversionary interest in either the corpus or the income therefrom, if, as of the inception of that portion of the trust, the value of such interest exceeds 5 percent of the value of such portion.

Section 1.671-3(b)(3) provides that if a grantor or another person is treated as the owner of a portion of a trust, that portion may or may not include both ordinary income and other income allocable to corpus. For example, both ordinary income and other income allocable to corpus are included by reason of an interest in or a power over both ordinary income and corpus, or an interest in or a power over corpus alone which does not come within section 1.671-3(b)(2). For example, if a grantor is treated under section 673 as the owner of a portion of a trust by reason of a reversionary interest in corpus, both ordinary income and other income allocable to corpus are included in that portion.

Section 677 provides that the grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such under section 674, whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a nonadverse party, or both, may be distributed to the grantor, or held or accumulated for future distribution to the grantor.

Section 1.677(a)-1(d) provides that a grantor is, in general, treated as the owner of a portion of a trust whose income is, or in the discretion of the grantor or a nonadverse party, or both, may be applied in discharge of a legal obligation of the grantor.

Because Buyer is treated as purchasing the assets of the nonqualified fund for federal income tax purposes, Buyer is treated as contributing those assets as grantor to the nonqualified fund. Because Buyer is treated as purchasing the assets of the Provisional Trust (less the u of corpus which will be distributed back to Seller) for federal income tax purposes, Buyer is treated as contributing those assets as grantor to the Provisional Trust. Seller is the grantor with respect to u.

Under the terms of the Master Decommissioning Trust Agreement, all income, as well as principal of the nonqualified fund, is held to satisfy Buyer's legal obligation to decommission the Plant and in the event any assets remain upon completion of decommissioning the Plant those assets will be distributed to Buyer. Accordingly, Buyer is treated as the owner of the entire nonqualified Fund under section 677 and section 1.677(a)-1(d). Buyer shall include in computing its taxable income and credits all items of income, deduction, and credits against tax of the nonqualified fund to the extent that such items would be taken into account in computing taxable income or credits against the tax of an individual.

Under the terms of the Provisional Decommissioning Trust Agreement and an Agreement Regarding Qualified Trust Rulings, u of the corpus will be distributed back to Seller after issuance of this letter ruling to Buyer and Seller. Accordingly, Seller has a reversionary interest in corpus and is treated as the owner of that portion of the Provisional Trust from v, the date of funding of the Provisional Trust, until the date the u is distributed back to Seller under section 673. Under the terms of the Provisional Decommissioning Trust Agreement and the Master Decommissioning Trust Agreement, w of the corpus and all income from that portion of the Provisional Trust is held to satisfy Buyer's legal obligation to decommission the Plant and in the event any assets remain upon completion of decommissioning the Plant those assets will be distributed to Buyer. Accordingly, Buyer is treated as the owner of that portion of the Provisional Trust from v, the date of funding of the Provisional Trust, until the date the u is distributed back to Seller. Under section 1.671-3(b)(3) of the regulations, both ordinary income and other income allocable to corpus are included in the respective portions of the Provisional Trust owned by the Buyer and Seller. Buyer and Seller shall include in computing their taxable income and credits all items of income, deduction, and credits against tax of their respective portions of the Provisional Trust to the extent that such items would be taken into account in computing taxable income or credits against the tax of an individual.

Under the terms of the Provisional Decommissioning Trust Agreement and the Master Decommissioning Trust Agreement, after the date the u is distributed back to Seller, all income and principal of the Provisional Trust is held to satisfy Buyer's legal obligation to decommission the Plant and in the event any assets remain upon completion of decommissioning the Plant those assets will be distributed to Buyer.

Accordingly, under section 677 and section 1.677(a)-1(d), Buyer is treated as the owner of the entire Provisional Trust after the date the u is distributed back to Seller. Buyer shall include in computing its taxable income and credits all items of income, deduction, and credits against tax of the Provisional Trust to the extent that such items would be taken into account in computing taxable income or credits against the tax of an individual.

Requested Ruling #11: The allocation of the consideration represented by the assumption of the liability to decommission the plant to the non-depreciable assets of the dedicated nonqualified fund is appropriate.

Section 1060(a) 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 consideration under the residual method in order to determine, respectively, the amount realized from, and the basis in, each of the transferred assets. It further provides that subsequent adjustments to consideration for the transferred assets must also be allocated under the residual method.

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 purchaser's consideration as its cost of the assets. 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.

The residual method under section 1.1060-1T(d) is based on a division of assets into five classes: Class I (generally consisting of cash, demand deposits and like accounts in banks and savings and loan associations), Class II (generally consisting of certificates of deposit, U.S. government securities, readily marketable stock or securities, and foreign currency), Class III (all assets that are not Class I, II, IV, or V assets), Class IV (all section 197 intangibles except those in the nature of goodwill and going concern value), and Class V (section 197 assets in the nature of goodwill and going concern value).

Consideration is first reduced by the amount of Class I assets received. 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), and finally any remaining consideration is allocated among the Class V assets. Sections 1.1060-1T(d) and (e).

Subsequent increases and decreases in consideration of both sellers and purchasers are allocated in a manner that effects 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. Section 1.1060-1T(f). Thus, for example, as Buyer satisfies the economic performance requirement with respect to the decommissioning liability assumed, additional consideration is taken into account. Under section 1.1060-1T(f)(2), the additional consideration is allocated among the acquired assets in the same manner as the consideration originally taken into account, with the same fair market value and other limitations as though it were taken into account on the original acquisition date.[1] Similar principles apply in the case of an increase or decrease in the consideration provided by the seller.

Since we have determined, above, that the tax treatment of the qualified fund is

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[1] The following example illustrates the operation of section1060: 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, and Class III assets with a fair market value of $100. The consideration consists of $150 cash and an assumed liability for which economic performance has not occurred. On Date1, the purchaser has $150 of consideration to allocate 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 Classes 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 the Class II assets acquired in the transaction (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 $100, which is then taken into account as basis. Of that amount, $50 will be allocated to the Class III assets (which then have been allocated their full $100 fair market value determined as of the acquisition date) and the remaining $50 will be allocated to Class V (as an asset in the nature of goodwill). The last amount is allocated to goodwill even though goodwill was not identified as a separate asset having value on Date1. If, instead of an addition to purchaser's consideration on Date3, 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).

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determined under section 468A and the regulations thereunder, the transfer of Seller's interest in the qualified fund to Buyer is not part of the applicable asset acquisition.

With respect to the Plant, its equipment and operating assets, the nonqualified assets, and the Buyer's Provisional fund assets, however, these assets comprise a trade or business in the Seller's hands. Further, Buyer's basis in those assets will be determined wholly by reference to the consideration Buyer provides for them. Seller's transfer of Plant, its equipment and operating assets, the nonqualified fund assets, and the Buyer's Provisional Fund Assets to Buyer in exchange for cash and Buyer's assumption of the decommissioning liability (to the extent funded by the nonqualified fund and Buyer's Provisional Fund Assets) is therefore an applicable asset acquisition within the meaning of section 1060(c). As such, Seller and Buyer must apply the residual method as described in the regulations under section 1060 in allocating, respectively, the amount realized and cost basis in this transaction.

Accordingly, we rule that, on the acquisition date, Buyer's basis in the assets acquired must be determined by allocating its cost (which, on the acquisition date, is limited to the cash Buyer provides) among the acquired assets in accordance with the provisions of section 1060 and the regulations thereunder. Specifically, Buyer 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 nonqualified fund and the Provisional Trust); to the extent the Class I assets received exceed the cash Buyer provides, Buyer will recognize income. To the extent the cash provided by Buyer 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. If Buyer's cash payment exceeds the combined value of the Class I and II assets on the acquisition date, Buyer allocates this excess to Class III, up to the fair market value of the Class III assets, and so on. If Buyer's cash payment does not exceed the combined fair market value of the Class I and II assets, Buyer can allocate no consideration to assets in Classes III, IV, or V. 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 nonqualified fund pays or incurs decommissioning expenses), such amounts will be taken into account as increases to Buyer's consideration and allocated in the same manner and subject to the same conditions as though they were paid or incurred on the acquisition date. Section 1.1060-1(f)(2). To the extent that Seller's consideration is increased or decreased under the terms of the Provisional Trust, such increases or decreases must be made taken into account in accordance with the principles of section 1.1060-1T(f).

Seller and Buyer's proposed allocation of specific consideration to specific assets is not in accordance with the foregoing, and, therefore, is neither appropriate nor permissible.

Requested Ruling #12: Buyer's gain or loss from the sale or exchange of a non-depreciable investment asset of the nonqualified fund will be the difference between the amount realized by the Buyer and the Buyer's basis in the asset.

Section 1001(a) provides that the gain or loss from the sale or other disposition of property shall be the excess of the amount realized therefrom over its adjusted basis.

As indicated above in response to ruling request #9, the Buyer's current basis in the purchased assets will not include the amount of the assumed decommissioning liabilities, but will be limited to the amount of the cash purchase price. It is understood that the decommissioning funds are comprised of Class I and Class II assets having a fair market value well in excess of the cash purchase price. Accordingly, the entire cash purchase price will be allocated to those assets in accordance with section 1060. The Buyer's gain or loss will be the difference between its amount realized on the sale or exchange of such asset and the amount of basis properly allocated to that asset under section 1060 and will be determined with reference to the basis at the time of the subsequent disposition (taking into account any adjustments to the initial basis).

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

1. 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.

2. Seller's qualified fund will not recognize gain or loss upon its transfer to the Buyer as a result of the sale.

3. The Seller will not recognize gain or loss upon the transfer of the qualified fund to the Buyer as a result of the sale.

4. On the sale of Plant and its interests in the assets in the 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 section 1060 and the corresponding regulations.

5. Seller's amount realized from the sale of Plant and its interests in the decommissioning funds to Buyer will include the cash received from Buyer and the amount of the liabilities assumed by Buyer, including the portion of the liability to decommission Plant equal to the fair market value of the assets in the

non-qualified fund on the date of the transfer, but not including the portion of the liability to decommission Plant equal to the fair market value of the assets in the qualified fund on the date of the transfer (each of the two amounts representing an allocable portion of the present value of the future decommissioning liability).

6. The qualified fund will retain the same basis in its investment assets after the sale.

7. 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 (reduced by the amount of such liability to be funded by the qualified fund) in the year of the sale to the extent the liability is included in the Seller's amount realized. Thus, the Seller will be entitled to a current deduction in such amount.

8. Buyer will not realize income from its purchase of Plant and related assets except to the extent that the amount of cash and other Class I assets received exceed the amount of consideration provided by Buyer.

9. At the time of sale, the Buyer 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 Buyer will not be entitled to treat as a component of its cost basis at the time of the purchase any amount attributable to the future decommissioning liability.

10. Buyer is treated as the owner of the entire non-qualified fund under section 677 and section 1.677(a)-1(d). Buyer is treated as the owner of the portion of the Provisional Trust consisting of w of corpus from v, until the date the u is distributed back to the Seller. After that date, the Buyer is treated as the owner of the entire Provisional Trust. Seller is treated as the owner of the portion of the Provisional Trust consisting of u corpus from v, until the date the u is distributed back to the Seller under section 673.

11. The Buyer's basis in the assets acquired must be determined by allocating its cost (which, on the acquisition date, is limited to the cash Buyer provides) among the acquired assets in accordance with the provisions of section 1060 and the regulations thereunder. Specifically, Buyer 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 nonqualified fund and the Provisional Trust); to the extent the Class I assets received exceed the cash Buyer provides, Buyer will recognize income. To the extent the cash provided by Buyer 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. If Buyer's cash payment exceeds the combined value of the Class I and II assets on the acquisition date, Buyer allocates this excess to Class III, up to the fair market value of the Class III assets, and so on. If Buyer's cash payment does not exceed the combined fair market value of the Class I and II assets, Buyer can allocate no consideration to assets in Classes III, IV, or V. 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 nonqualified fund pays or incurs decommissioning expenses), such amounts will be taken into account as increases to Buyer's consideration and allocated in the same manner and subject to the same conditions as though they were paid or incurred on the acquisition date. Section 1.1060-1(f)(2). To the extent that Seller's consideration is increased or decreased under the terms of the Provisional Trust, such increases or decreases must be made in accordance with the principles of section 1.1060-1(f). The Seller and Buyer's proposed allocation of specific consideration to specific assets is not in accordance with the foregoing, and, therefore, is neither appropriate nor permissible.

12. Buyer's gain or loss from the sale or exchange of a non-depreciable investment asset of the nonqualified fund or the Provisional Trust will be the difference between the amount realized by the Buyer and the Buyer's basis properly allocated to that asset under section 1060 and will be determined with reference to the basis at the time of the subsequent disposition (taking into account any adjustments to the initial basis).

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 powers of attorney, we are sending a copy of this ruling to your authorized representatives. We are also sending copies of this letter ruling to the District Directors of District 1 and District 2.

Sincerely,

(signed) Charles B. Ramsey

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

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