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Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B06
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Date:
July 27, 2004

Legend:

Seller =

Buyer =

Plant =
Seller's Parent =
Buyer's Parent =
Commission =
Location =
State =

a =
b =
c =
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f =
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Dear

This letter responds to a letter, dated December 30, 2003, requesting a private letter ruling concerning the tax consequences of the sale of a nuclear power plant and associated assets and liabilities, including nuclear decommissioning liability, between Seller and Buyer. Specifically, you have requested rulings regarding the tax consequences under section 468A of the Internal Revenue Code to Seller's nuclear decommissioning funds and Buyer's nuclear decommissioning funds as well as rulings regarding the proper realization and recognition of gain and loss on the sale of the nuclear power plant and associated assets.

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

Seller, a regulated public utility company, is a wholly-owned indirect subsidiary of Seller's Parent, a public company. Seller is a member of Seller's Parent's consolidated group and joins in filing a consolidated return on a calendar year basis using the accrual method of accounting. Seller and Seller's Parent are under the audit jurisdiction of the Industry Director, Natural Resources (LM:NR). Immediately prior to the transfer of the Plant to Buyer, Seller owns a a percent interest in the Plant.

Seller has established with respect to the decommissioning of Plant a nuclear decommissioning fund qualifying under section 468A, and a nuclear decommissioning fund that did not meet the requirements of section 468A. The level of funding in the nuclear decommissioning funds is based on estimates of the future costs that the owner of the Plant will incur upon the decommissioning of the Plant. The cost of disposing of low-level radioactive waste upon decommissioning is part of this calculation.

Buyer, a single-member limited liability company established to own the purchased interests in Plant, is a wholly-owned indirect subsidiary of Buyer's Parent, a publicly-owned holding company with energy-related subsidiaries. Buyer is a member of Buyer's Parent's consolidated group and will join in filing a consolidated return on a calendar year basis using the accrual method of accounting. Buyer and Buyer's Parent are under the audit jurisdiction of the Industry Director, Natural Resources (LM:NR). Following the transfer of the Plant to Buyer, Buyer's wholesale electric power sales will be subject to the jurisdiction of Commission and its ownership and operation of Plant will be subject to the jurisdiction of the Nuclear Regulatory Commission.

Plant is located in Location, in State, and consists of a single unit and associated assets located together on a single property. Plant began commercial service on b.

On c, Buyer entered into an Asset Purchase Agreement ("APA") with Seller. Under the APA, Seller is obligated to transfer to Buyer at closing of the transaction Seller's entire interest in Plant, including the real property**,** machinery and equipment, leasehold interests and subleases relating to the real property, all permits, certain contracts and agreements, certain documents, correspondence, books, and records, personnel records, intellectual property, Nuclear Regulatory Commission ("NRC") licenses, rights in nuclear fuel, all spent nuclear fuel, a certain escrow account and two

trust funds ("the Decommissioning Funds") maintained by the Sellers (including all income, interest and earnings accrued thereon, together with all related tax accounting, decommissioning studies and cost estimates, and all other books and records related thereto) in exchange for $d in cash and Buyer's assumption of Plant decommissioning and other related liabilities. Buyer shall also compensate the Sellers for nuclear fuel attributable to the Plant by a payment of $e.

Specifically, with respect to the Decommissioning Funds, Seller agrees to transfer all assets of the qualified nuclear decommissioning fund maintained by Seller with respect to Plant to a qualified nuclear decommissioning fund established by Buyer solely for the purpose of decommissioning Plant. In addition, to the extent necessary to comply with various regulatory approvals required under the APA, Seller agrees to transfer all or a portion of the assets of its nonqualified nuclear decommissioning fund to a nonqualified nuclear decommissioning fund established by Buyer, provided that the aggregate amount of the transferred assets of Seller's decommissioning funds will not be less than the amount to be determined to be the decommissioning target amount.

Seller and Buyer represent that they will treat the transaction as an asset purchase for tax purposes, subject to section 1060 of the Code, and will agree to an allocation of the Purchase Price among the Purchased Assets (excluding the assets comprising the qualified nuclear decommissioning funds) that is consistent with the allocation methodology provided by sections 1060 and 338 and the regulations thereunder. As part of the APA, Buyer has also agreed to enter into power purchase agreements with Seller. After the sale of Plant, Seller will no longer be engaged in the trade or business of nuclear generation at Plant or any other nuclear facility.

Under the terms of the APA, the aggregate amount transferred from Seller's qualified nuclear decommissioning fund to Buyer's qualified nuclear decommissioning fund may not be less than the Decommissioning Target, defined in the APA as f dollars adjusted for the difference between g and the actual Closing Date. On Closing Date, h will be transferred from Seller's qualified nuclear decommissioning fund to fund the Decommissioning Target, with the balance drawn from Seller's nonqualifying nuclear decommissioning fund. This amount h represents i percent of j, the estimated current cost of decommissioning Plant. Prior to the sale, the Seller had a qualifying percentage under section 1.468A-3(d) of k. Thus, the portion of the cost of decommissioning the Plant funded by the minimum transferred amount reasonably relates to the qualifying percentage of Seller prior to the sale.

The assets held by Seller in the nonqualified nuclear decommissioning fund, to the extent not transferred to Buyer's nonqualified nuclear decommissioning fund pursuant to the provisions of the APA will be retained by Seller.

Requested Ruling #1: *The transfer of assets from Seller's qualified nuclear decommissioning fund to Buyer's qualified nuclear decommissioning fund is a disposition that is treated as satisfying the requirements of §1.468A-6(b) of the Regulations pursuant to the Service's exercise of discretion under §1.468A-6(g)(1), and,*

accordingly, Buyer's qualified nuclear decommissioning fund established to hold the assets transferred from the Seller's qualified nuclear decommissioning fund will be treated as a qualified nuclear decommissioning fund that satisfies the requirements of section 468A of the Code and the regulations thereunder.

Section 468A(a) of the Code 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(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-5(a) of the Federal Income Tax Regulations 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 §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 §1.468A-6(g), the Service may treat any disposition of an interest in a nuclear power plant occurring after December 27, 1994, as satisfying the requirements of the regulations if the Service determines that such treatment is necessary or appropriate to carry out the purposes of section 468A.

Under the specific facts herein, the Service will exercise its discretion to treat this transaction, under §1.468A-6(g), as a disposition qualifying under the general provisions of §1.468A-6. This exercise of discretion, however, applies to the provisions of §1.468A-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 §1.468A-6, Buyer's qualified nuclear decommissioning fund will be treated as a qualified nuclear decommissioning fund as defined in section 468A.

Taxpayer has stated that pursuant to section 6.20 of the APA a certain portion of the qualified nuclear decommissioning fund could be returned to the Seller once certain decommissioning procedures are initiated. Should any funds be returned to the Seller from the qualified nuclear decommissioning fund prior to the substantial completion of decommissioning as defined in section 1.468A-5(d)(2) then the entire qualified nuclear decommissioning fund will disqualified under section 1.468A-5(a).

Requested Ruling #2: *Neither Buyer nor Buyer's qualified nuclear decommissioning fund will recognize any gain or loss or otherwise take any income or deduction into account by reason of the transfer of the assets of Seller's qualified nuclear decommissioning funds to Buyer's qualified nuclear decommissioning fund, and Buyer's qualified nuclear decommissioning fund will have a carryover basis in the assets received from Seller's qualified nuclear decommissioning fund.*

Section 1.468A-6(c)(2) provides that neither a transferee nor its fund will recognize gain or loss or otherwise take any income or deduction into account by reason of the transfer of the assets from a transferor's qualified fund to a transferee's qualified fund. Thus, neither Buyer nor Buyer's qualified nuclear decommissioning fund will recognize gain or loss or otherwise take any income or deduction into account by reason of the transfer of the assets of Seller's qualified nuclear decommissioning fund to Buyer's qualified nuclear decommissioning fund.

Section 1.468A-6(c)(3) provides that transfers of assets of a qualified nuclear decommissioning fund to which §1.468A-6 applies do not affect basis. Thus, Buyer's qualified nuclear decommissioning fund will have a basis in the assets received from Seller's qualified nuclear decommissioning fund that is the same as the basis of those assets in Seller's fund immediately before the date of transfer.

Requested Ruling #3: *Neither Seller nor Seller's qualified nuclear decommissioning fund will recognize any gain or loss or otherwise take any income or deduction into account upon the transfer of the assets of the Seller's qualified nuclear decommissioning fund assets to Buyer's qualified nuclear decommissioning fund.*

Section 1.468A-6(c)(1) provides that neither a transferor nor its fund will recognize gain or loss or otherwise take any income or deduction into account by reason of the transfer of the assets from a transferor's qualified fund to a transferee's qualified fund. Thus, neither Seller nor the qualified nuclear decommissioning fund maintained by Seller for Plant will recognize gain or loss or otherwise take any income or deduction into account by reason of the transfer of the qualified nuclear decommissioning fund assets to Buyer's qualified nuclear decommissioning fund.

Requested Ruling #4: *Seller's gain or loss on the sale of the purchased assets (excluding Seller's qualified nuclear decommissioning fund) to Buyer will equal the difference between Seller's tax basis in each asset and the amount realized with respect to that asset, taking into account the allocation of consideration pursuant to Section 1060 of the Code and the regulations thereunder. Seller's amount realized from the sale of the purchased assets (excluding Seller's qualified nuclear decommissioning fund) will include the cash received from Buyer and the liabilities and obligations assumed by Buyer, including the liability to decommission Plant (reduced by the amount of the decommissioning liability to be funded by the qualified nuclear decommissioning fund), to the extent such liabilities and obligations are taken into account as liabilities for federal income tax purposes.*

Section 1001(a) provides that gain from the sale of property shall be the excess of the amount realized over the adjusted basis provided in section 1011 for determining gain and that loss from the sale of property shall be the excess of the adjusted basis provided in section 1011 for determining loss over the 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 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 1.1060-1(a)(1) provides that, in the case of an applicable asset acquisition, the seller and the purchaser each must allocate the consideration paid or received in the transaction under the residual method as described in sections 1.338-6 and 1.338-7 in order to determine, respectively, the amount realized from, and the basis in, each of the transferred assets.

Section 1060(c) defines the term "applicable asset acquisition" as the transfer of assets constituting a trade or business if the acquirer's basis in the transferred assets is determined wholly by reference to the consideration paid for such assets.

Section 1.1060-1(c)(1) defines a purchaser's consideration as the amount, in the aggregate, of its cost of purchasing the assets in the applicable asset acquisition that is properly taken into account in basis. Section 1060 provides no independent basis for determining a taxpayer's cost of acquired assets; cost is determined solely under generally applicable tax accounting principles. Section 1.1060-1(c)(1) defines a seller's consideration as the amount, in the aggregate, realized from selling the assets in the applicable asset acquisition under section 1001(b). Section 1060 also 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.

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 the 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 that section, except goodwill and

going concern value), and Class VII (goodwill and going concern value, whether or not it qualifies as a section 197 intangible). Section 1.338-6.

Consideration is first reduced by the amount of Class I assets transferred by the seller. The remaining consideration is then allocated to the Class II assets (pro rata, to the extent of their fair market value), then to the Class III assets (pro rata, to the extent of their fair market value), then to the Class IV assets (pro rata, to the extent of their fair market value), then to the Class V assets (pro rata, to the extent of their fair market value), then to the Class VI assets (pro rata, to the extent of their fair market value), and, finally, any remaining consideration is allocated to the Class VII assets. Sections 1.338-6(b)(1) and (2) and 1.1060-1(c)(2).

The following examples illustrate the operation of § 1060 from a seller's and a buyer's perspective, respectively:

1) On Date1, an applicable asset acquisition is made. 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 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 first will be 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, is determined by the nature of the underlying assets. Sections 1.338-6, 1.1060-1(a)(1), and 1.1060-1(c)(2).

2) On Date1, an applicable asset acquisition is made. The consideration consists of $150 cash and an assumed liability for which economic performance has not occurred. The assets acquired consist of Class I assets in the amount of $50, Class II assets with a fair market value of $350, Class III assets with a fair market value of $100, Class IV assets with a fair market value of $150, and Class V assets with a fair market value of $100. There are no Class VI or VII assets. On Date1, the purchaser has provided $150 of consideration that may be allocated as basis; it first will be reduced by $50 (the amount of Class I assets); the remaining $100 will be allocated to Class II assets (pro rata according to fair

market value); nothing is allocated to Class III or below. On Date2, economic performance occurs with respect to the liability to the extent of $300; at that time, the purchaser has an additional $300 of basis that may be taken into account. Of that amount, $250 is allocated to Class II assets (which will then have been allocated their full $350 fair market value as determined on the acquisition date), and the remaining $50 is allocated to the Class III assets (pro rata according to fair market value as determined on the acquisition date). On Date3, economic performance occurs to the extent of an additional $400, which is then taken into account as basis. Of that amount, $50 will be allocated to the Class III assets (which will then have been allocated their full $100 fair market value as determined on the acquisition date), $150 will be allocated to the Class IV assets (which will then have been allocated their full $150 fair market value as determined on the acquisition date), $100 will be allocated to the Class V assets (which will then have been allocated their full $100 fair market value as determined on the acquisition date), and the remaining $100 will be allocated to the Class VII (as goodwill). The last amount is allocated to goodwill even though goodwill was not identified as a separate asset having value on Date1. If, on Date3, instead of an addition to purchaser's consideration, there is a $100 decrease in consideration, the consideration previously allocated to the Class III assets ($50) 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).

If, under general tax principles, there is a subsequent adjustment to the consideration, 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 1.338-7, 1.1060-1(a)(1), and 1.1060-1(c)(2).

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

The Plant (including equipment and operating assets) and the assets of the nonqualified nuclear decommissioning fund comprise a trade or business in Sellers hands and the basis Buyer takes in these assets will be determined wholly by reference to the Buyer's consideration. Thus, Sellers transfer of the Plant (including equipment and operating assets) and assets of the nonqualified nuclear decommissioning fund to Buyer in exchange for cash and the assumption of the decommissioning liability (except to the extent funded by the qualified nuclear decommissioning 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, Sellers must allocate the consideration in the applicable assets in accordance with the provisions of section 1060 and the regulations thereunder. Specifically, Sellers 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 nuclear decommissioning 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. Such consideration is allocated 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 that of the underlying assets.

Additionally, we rule that, on the acquisition date, Buyer's basis in the assets acquired must be determined by allocating its cost (i.e., the consideration provided by Buyer on the acquisition date, which includes the cash but not the assumption of the decommissioning liability) among the acquired assets in accordance with the residual method as described in 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 nuclear decommissioning fund); to the extent the Class I assets received exceed the consideration Buyer provides, Buyer will recognize income. To the extent Buyer's consideration exceeds the Class I assets it receives, such excess will be allocated in accordance with the provisions of section 1060 and the regulations thereunder, as described above. When and to the extent additional amounts are paid or incurred for the assets acquired in the applicable asset acquisition (e.g., when and to the extent the nonqualified nuclear decommissioning 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. Sections 1.338-6, 1.338-7, 1.1060-1(a)(1), and 1.1060-1(c)(2).

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 determinable. As an owner and operator of a nuclear plant, Seller is required by law to provide for eventual decommissioning. See 10 C.F.R. §§ 50.33, 50.75.

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 Treas. Reg. §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 the Plants and Seller's interests in the assets in the decommissioning trust funds (other than those assets in the qualified 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.

The amount realized from the sale of the Plants and the assets in the decommissioning trust funds will include the cash received from Buyer and the Assumed Liabilities assumed by Buyer, to the extent these liabilities are taken into account for federal income tax purposes. This would include the amount of the decommissioning liability assumed by Buyer with respect to each of the Plants, not including the portion of the liability to decommission each of the Plants attributable to their respective qualified funds on the date of the transfer.

Requested Ruling #5: *For the taxable year that includes the closing date, Seller shall be entitled to a current deduction in an amount equal to the total of any amounts treated as realized by the Seller as a result of Buyer's assumption of the decommissioning liability for the Plant.*

Section 1.446-1(c)(1)(ii)(A) of the regulations 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 §1.461-4(a)(1) of the regulations.

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) of the regulations 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) of the regulations 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, Seller clearly has an obligation to decommission the Plant. The

fact of the obligation arose many years ago, at the time Seller obtained its license to operate 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 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 that the amount of the liability be reasonably determinable. Section 1.461-1(a)(2)(ii) of the regulations. This prong is also satisfied. In the instant case, the amount of Seller's decommissioning liability has been determined by experts in the nuclear decommissioning industry. Their calculations have been reviewed and accepted by both the Nuclear Regulatory Commission and the Commission. In addition, there is 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 also must 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 Seller's amount realized. At that time, Seller will be entitled to a deduction for the amount of its otherwise deductible decommissioning liability associated with Plant expressly assumed by Buyer and included in Seller's amount realized.

Requested Ruling #6: *In the taxable year of the closing, Buyer will not recognize any gain or otherwise take any income into account by reason of the transfer all or a portion of the assets of Seller's nonqualified nuclear decommissioning fund assets to Buyer's nonqualified nuclear decommissioning fund.*

Section 1012 of the Code provides in part that the basis of property shall be the cost of such property. In cases similar to the instant case, taxpayers have argued that the cost of acquiring the Seller's interests in a nuclear power plant and the related assets (including the decommissioning funds) includes the amount of the assumed decommissioning liability. In those similar cases, taxpayers have cited Crane v. Commissioner, 331 U.S. 1 (1947), and Commissioner v. Oxford Paper Co., 194 F.2d 190 (1952), as support for the proposition that for purposes of determining basis, the cost of property generally includes assumed liabilities to which the acquired property is subject to the extent such liabilities can be accurately valued and are not contingent at the time of purchase. Since Buyer will pay cash and assume the liabilities and obligations of the Sellers, which includes the decommissioning liabilities in connection with the acquisition of the Plant, its total cost of the purchased assets (excluding the

qualified nuclear decommissioning funds) will equal the cash paid plus the assumed liabilities and obligations.

However, the assumed decommissioning liability cannot be treated as incurred for any federal income tax purpose -- including basis -- until economic performance occurs with respect to that liability. Section 1.446-1(c)(1)(ii)(A). Thus, critical to determining whether Buyer is entitled to treat the future decommissioning liability as a component of its cost basis in the purchased assets at the time of the closing is deciding whether the liability will be incurred for tax purposes as of the closing. It will not. Economic performance does not occur with respect to a service liability such as the decommissioning obligation until and to the extent that costs are incurred in satisfaction of that liability. Section 1.461-4(d)(4). Because Buyer will not have performed any services relating to the decommissioning liability at the time of the purchase of the Plant, economic performance will not have occurred, and the liability will not have been incurred at that time for any purpose under the Code, including the cost basis provisions of section 1012.

Accordingly, at the time of closing, Buyer will have a tax basis in the assets purchased (excluding Buyer's qualified nuclear decommissioning funds) equal to the sum of the purchase price and the assumed liabilities that will be taken into account as liabilities for federal income tax purposes. The purchased assets and the liabilities incurred do not include the assets in the qualified nuclear decommissioning funds or the liability attributable to the qualified nuclear decommissioning funds, because the tax effect of the qualified nuclear decommissioning funds is determined under section 468A. Buyer will not be entitled to treat as a component of its cost basis at the time of the closing any amount attributable to the future decommissioning liability.

A taxpayer generally 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.

As discussed above, Buyer's basis attributable to the decommissioning liability is governed by section 461(h), and the consideration furnished by Buyer will be allocated pursuant to the residual method under section 1060 and the regulations thereunder. Accordingly, Buyer will not realize income from its acquisition of the Plant or of the interests in the assets in the nonqualified fund, except to the extent that, under the rules of section 1060, the amount of cash and other Class I assets (as defined in

§1.388-6(b)(1)) received by Buyer (not including the assets in the qualified fund) exceeds the total cost determined under section 1012 (the sum of the amount of cash consideration and the fair market value of any other consideration provided to Seller by Buyer that is, under applicable tax provisions, taken into account on the date of the acquisition). 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 Treas. Reg. §1.1060-1T(f). If Buyer is thus required to take an amount into account as income, then, when, under general principles of tax law, Buyer is permitted to take additional consideration into account (e.g., when it satisfies the economic performance requirement with respect to the decommissioning liability assumed), Buyer will be entitled to deduct currently (and will not be required to capitalize) such amount. Arrowsmith v. Commissioner, 344 U.S. 6 (1952).

Requested Ruling #7: *Buyer's nonqualified nuclear decommissioning fund established under the Post-Closing Decommissioning Trust Agreement to hold the transferred assets of Seller's nonqualified nuclear decommissioning fund is a grantor trust under section 671 of the Code, and Buyer will be treated as the grantor of the trust.*

Section 671 provides that where it is specified in sections 673 through 678 of the Code 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 1.671-2(e)(1) of the regulations provides that for purposes of part I of subchapter J, chapter 1 of the Code, a grantor includes any person to the extent such person either creates a trust, or directly or indirectly makes a gratuitous transfer (within the meaning of §1.671-2(e)(2)) of property to a trust. For purposes of §1.671-2, the term property includes cash.

Section 1.671-2(e)(2)(i) provides that a gratuitous transfer is any transfer other than a transfer for fair market value.

Section 1.671-2(e)(2)(ii) provides that for purposes of §1.671-2(e), a transfer is for fair market value only to the extent of the value of property received from the trust, services rendered by the trust, or the right to use property of the trust.

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 under section 677 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 Sellers' nonqualified nuclear decommissioning fund for federal income tax purposes, Buyer is treated as contributing those assets as grantor to the Buyer's nonqualified nuclear decommissioning fund. Under the terms of the Buyer's Post-Closing Decommissioning Trust Agreement, all income, as well as principal of the Buyer's nonqualified nuclear decommissioning fund is held to satisfy Buyer's legal obligation to decommission Plant and upon completion of the decommissioning any remaining assets will be distributed to Buyer. Accordingly, Buyer's nonqualified nuclear decommissioning fund is a grantor trust and Buyer is treated as the grantor and the owner of the entire Buyer's nonqualified nuclear decommissioning fund under section 677 and §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 Buyer's nonqualified nuclear decommissioning fund to the extent that such items would be taken into account in computing taxable income or credits against the tax of Buyer.

Requested Ruling #8: *Seller's net operating loss in the taxable year that includes the closing date attributable to the decommissioning obligations assumed by Buyer will qualify for specified liability loss treatment under Code section 172(f).*

Section 172(a) allows a net operating loss deduction equal to the aggregate of the net operating loss carryovers and net operating loss carrybacks to a taxable year. With certain modifications, section 172(c) defines a net operating loss as the excess of deductions permitted by Chapter 1 of the Internal Revenue Code over gross income.

Section 172(b)(1)(A) provides that generally, a net operating loss is carried back to each of the 2 taxable years preceding the year of the loss and carried forward to each of the 20 taxable years following the year of the loss. Section 172(b)(1)(C) provides that in the case of a specified liability loss, the loss is carried back to each of the 10 taxable years preceding the loss year, rather than 2 years.

Section 172(f)(1)(B)(i) defines a specified liability loss in part as any amount taken into account in computing the net operating loss for the taxable year and that is allowable as a deduction under Chapter 1 of the Code (other than sections 468(a)(1) or 468A(a)) which is in satisfaction of a liability under a federal or state law requiring the decommissioning of a nuclear power plant (or any unit thereof).

In Requested Ruling #5 we concluded that Seller will be entitled to a deduction in the year of sale for the amount of its decommissioning liability associated with Plant expressly assumed by Buyer and included in Seller's amount realized. To the extent Seller incurs a net operating loss in the taxable year of the sale that loss may be

attributable in whole or in part to Seller's deduction for its decommissioning liability assumed by Buyer and included in Seller's amount realized.

To generate a section 172(f)(1)(B)(i) specified liability loss the amount of Seller's deduction for the decommissioning liability assumed by Buyer must be in satisfaction of a liability under federal or state law requiring the decommissioning of a nuclear power plant. Prior to the sale, Seller has the obligation to decommission the plant. This obligation arose years ago when Seller obtained its license to operate the plant. In addition, the requirement to decommission the plant is imposed by the Nuclear Regulatory Commission (NRC) and thus arises under federal law. See 10 C.F.R. §§ 50.33, 50.82.

As part of the sale of Plant, the operating license for Plant will be transferred to Buyer, decommissioning funds held by Seller will be transferred to Buyer, and Buyer will expressly assume Seller's obligation to decommission the plant. The express assumption of the decommissioning liability by Buyer as part of the sale of Plant satisfies the economic performance requirement under Treas. Reg. § 1.461-4(d)(5), as discussed in Requested Ruling #5; consequently, this entitles Seller to a deduction for its decommissioning liability. In addition, as a result of the sale of the plant and Buyer's assumption of the decommissioning liability, Seller's liability under federal law to decommission Plant will be extinguished. Seller has represented that as part of the sale and NRC operating license transfer (including the transfer of assets of Seller's decommissioning funds), upon closing, the NRC will no longer look to Seller to decommission the plant. See Ruling Request, at 34. To the extent the Buyer's decommissioning funds are insufficient to decommission Plant, Buyer will be responsible for funding the shortage. Id.

Further, the deduction allowed to Seller for Buyer's assumption of the liability to decommission Plant is in satisfaction of Seller's liability under federal law requiring the decommissioning of a nuclear power plant. Black's Law Dictionary (Seventh Edition, 1999) defines the term "satisfaction" as, among other things, "the giving of something with the intention, express or implied, that it is to extinguish some existing legal or moral obligation." In this case, Seller has, as part of the sale of Plant, transferred the operating license and decommissioning funds to Buyer. As stated previously, the ruling request represents that because of this transfer and Buyer's assumption of the decommissioning liability, the NRC, the regulatory agency that imposes the legal obligation to decommission nuclear power plants will no longer look to Seller to decommission Plant. Seller's liability to decommission is thus "satisfied" because it has transferred certain assets to Buyer in order to extinguish this legal obligation. The amount of the decommissioning liability assumed by Buyer and included in Seller's amount realized is allowed as a deduction to Seller, as discussed in Requested Ruling #5. To the extent that deduction generates a net operating loss, that portion of the net operating loss will be a specified liability loss under section 172(f). That specified liability loss may be carried to each of the 10 taxable years preceding the loss year under section 172(b)(1)(C).

Note also that section 172(f)(3) generally provides that the portion of a specified liability loss that is attributable to amounts incurred in the decommissioning of a nuclear power plant (or any unit thereof) may be carried back to each of the taxable years during the period (i) beginning with the taxable year in which the plant (or unit thereof) was placed in service, and (ii) ending with the taxable year preceding the loss year. In this case, however, Taxpayers are not requesting a ruling under section 172(f)(3). Therefore, we make no determination as to whether any portion of the specified liability loss is attributable to amounts incurred in the decommissioning of a nuclear power plant (or any unit thereof) and thus eligible for the carryback provision set forth in section 172(f)(3).

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Except as specifically determined above, no opinion is expressed or implied concerning the Federal income tax consequences of the transaction described above. This ruling is directed only to the taxpayers who requested it. Section 6110(k)(3) of the Code provides it may not be used or cited as precedent.

In accordance with the powers of attorney, we are sending copies of this ruling to authorized representatives of Buyer and Seller. We are also sending a copy of this letter ruling to the Industry Director, Natural Resources (LM:NR).

Sincerely,

Peter C. Friedman
Senior Technician Reviewer, Branch 6
(Passthroughs & Special Industries)

cc: