Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:6-PLR-118387-99
Date:
November 20, 2000

Legend:

Taxpayer =

Seller 1 =
Seller 2 =
Company =
Plant 1 =
Plant 2 =
District =
Commission A =
Commission B =
a =
b =
c =
d =

This letter responds to your request, dated November 17, 1999, that we rule on certain tax consequences of the transfer of a portion of the Plants from Sellers to the Taxpayer and the Company. As set forth below, you have requested rulings regarding the tax consequences under section 468A of the Internal Revenue Code to the Taxpayer and its qualified nuclear decommissioning fund as well as rulings regarding the tax treatment of the transfer of nonqualified funds on the transfer of the Plants.

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

The Taxpayer is an investor owned public utility and is under the audit jurisdiction of the District Director of District. The Taxpayer is under the regulatory jurisdiction of Commission A, Commission B and the Nuclear Regulatory Commission.

Prior to the transaction at issue, the Taxpayer owned an undivided b percent interest in each of the Plants. On d, Taxpayer entered into two asset purchase agreements. In the first agreement (Agreement 1), Taxpayer and Company agreed to purchase from Seller 1 a a undivided interest (as tenants in common without the right of

partition) in each of the Plants with one-half of the purchased interest being acquired by each purchaser. In the second agreement (Agreement 2), Taxpayer and Company agreed to purchase from Seller 2 a a undivided interest (as tenants in common without the right of partition) in each of the Plants with one-half of the purchased interest being acquired by each purchaser. After these purchases, the Taxpayer will own a c percent interest in each of the Plants.

Taxpayer and Company will pay to the Sellers cash and will assume all liabilities with respect to decommissioning the transferred interests in the Plants. With respect to the Taxpayer, the Sellers will transfer their proportionate ownership interest in the Plants, nuclear fuel, real property, machinery, equipment, licenses, and the assets contained in the Sellers' qualified and nonqualified nuclear decommissioning funds. The Taxpayer currently maintains qualified and nonqualified nuclear decommissioning funds with respect to its pre-existing ownership interest in the Plants.

Requested Ruling #1: Neither the Taxpayer nor its qualified nuclear decommissioning funds will recognize any gain or loss or otherwise take into account any income or deduction into account by reason of the transfer of one-half of the assets of the Sellers' qualified nuclear decommissioning funds into the Taxpayer's respective existing qualified funds at closing. The Taxpayer's qualified nuclear decommissioning funds will have a basis in the assets received equal to the basis of such assets in the Sellers' funds immediately prior to closing.

Section 468A(a) provides that a taxpayer may elect to deduct payments made to a nuclear decommissioning reserve fund (the qualified nuclear decommissioning fund). Section 468A(b) limits the annual deduction of the electing taxpayer to the lesser of the ruling amount or the amount of decommissioning costs included in the electing taxpayer's cost of service for ratemaking purposes for the taxable year.

Section 468A(d) provides that the ruling amount means the amount determined by the Service to be necessary to (A) fund that portion of the nuclear decommissioning cost with respect to the nuclear power plant that bears the same ratio to the total nuclear decommissioning costs with respect to such nuclear power plant as the period for which the fund is in effect bears to the estimated useful life of the nuclear power plant, and (B) prevent any excessive funding of such costs or the funding of such costs at a rate more rapid than level funding.

Section 468A(e)(2) provides that the rate of tax on the income of a qualified nuclear decommissioning fund is 20 percent. Section 468A(e)(4) provides, in pertinent part, that the assets in a qualified nuclear decommissioning fund shall be used exclusively for satisfying the liability of any taxpayer contributing to the qualified nuclear decommissioning fund.

Section 1.468A-1(b)(1) of the Federal Income Tax Regulations provides that an eligible taxpayer is a taxpayer that possesses a qualifying interest in a nuclear power plant. Section 1.468A-1(b)(2) provides that a qualifying interest is a direct ownership

interest or a leasehold interest meeting certain additional requirements. Section 1.468A-1(b)(4) provides, in part, that a nuclear power plant is any nuclear power reactor that is used predominantly in the trade or business of the furnishing or sale of electric energy, if the rates for such furnishing or sale have been established or approved by a public utility commission.

Section 1.468A-5(a) sets out the qualification requirements for nuclear decommissioning funds. It provides, in part, that a qualified nuclear decommissioning fund must be established and maintained pursuant to an arrangement that qualifies as a trust under state law. An electing taxpayer can establish and maintain only one qualified nuclear decommissioning fund for each nuclear power plant. Section 1.468A-5(c)(1)(i) provides that if, at any time during the taxable year, a nuclear decommissioning fund does not satisfy the requirements of section 1.468A-5(a), the Service may disqualify all or a portion of the fund as of the date that the fund does not satisfy the requirements. Section 1.468A-5(c)(3) provides that if a qualified nuclear decommissioning fund is disqualified, the fair market value (with certain adjustments) of the assets in the fund is deemed to be distributed to the electing taxpayer and included in that taxpayer's gross income for the taxable year.

Section 1.468A-6 generally provides rules for the transfer of an interest in a nuclear power plant (and transfer of the qualified nuclear decommissioning fund) where after the transfer the transferee is an eligible taxpayer. Under section 1.468A-6(g), the Service may treat any disposition of an interest in a nuclear power plant occurring after December 27, 1994, as satisfying the requirements of the regulations if the Service determines that such treatment is necessary or appropriate to carry out the purposes of section 468A.

Under the specific facts herein, these dispositions qualify under the general provisions of section 1.468A-6. Thus, under section 1.468A-6 the Taxpayer's funds will not be disqualified upon the receipt of the Sellers' qualified funds.

Section 1.468A-6(c)(2) provides that neither a transferee of an interest in a nuclear power plant nor the transferee's fund will recognize gain or loss or otherwise take any income or deduction into account by reason of a sale. Accordingly, neither the Taxpayer nor its qualified funds will recognize gain or loss or otherwise take into account any income or deduction upon the receipt of the qualified nuclear decommissioning funds from the Sellers.

Section 1.468A-6(c)(3) provides that transfers to which section 1.468A-6 apply do not affect basis. Thus, the qualified funds in the hands of the Taxpayer will have a basis in their assets equal to the basis in their assets immediately prior to the transfer from the Sellers.

Requested Ruling #2: Subsequent to the transfer of one-half of the assets from the Sellers' qualified nuclear decommissioning funds, the Taxpayer's existing qualified funds will continue to be treated as qualified nuclear decommissioning funds satisfying

the requirements of sections 468A and 1.468A-5 and the Taxpayer will continue to be treated as an "eligible taxpayer" and an "electing taxpayer" with respect to its interests in the Plants.

Section 1.468A-1(b)(1) defines "eligible taxpayer" as any taxpayer that possesses a qualifying interest in a nuclear power plant. Section 1.468A-1(b)(2) defines, in part, a qualifying interest to include a direct ownership interest. Section 1.468A-5 sets out the qualification requirements for a qualified nuclear decommissioning fund and sets forth reason for disqualification of a qualified fund. Section 1.468A-6(c)(2) provides, in part, that, for purposes of section 468A, the transfer of assets from a seller's qualified fund to a transferee's qualified fund will not constitute a payment or contribution of assets by the transferee to its qualified fund.

The Taxpayer's qualified nuclear decommissioning funds qualified under section 468A prior to their receipt of one-half of the assets of the Sellers' respective qualified funds. Since, as determined above with respect to requested ruling #1, this transaction qualifies for treatment under section 1.468A-6, the Taxpayer's funds will not be disqualified upon the receipt of the proportionate amount of the Sellers' qualified funds. In addition, assuming the qualification requirements of section 1.468A-5 continue to be followed, receipt of the proportionate amount of the Sellers' qualified funds under these circumstances will not affect the qualification status of the Taxpayer's existing qualified nuclear decommissioning funds.

Requested Ruling #3: In the taxable year of closing, the Taxpayer will not currently recognize any gain or otherwise take any income into account by reason of the transfer of one-half the assets of the Sellers' nonqualified nuclear decommissioning funds to the Taxpayer's existing nonqualified nuclear decommissioning funds.

With respect to the Sellers' transfer of a portion of the Plants and associated nonqualified funds to the Taxpayer in exchange for consideration and the assumption of the obligation to decommission those portions of the Plants, Taxpayer will not recognize any gain or otherwise take any income into account by reason of the transfer of the nonqualified nuclear decommissioning funds.

Generally, a taxpayer does not realize 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, Company 3 cannot acquire the Taxpayer's interests in the Plants without assuming the associated decommissioning liabilities, which are inextricably associated with the ownership and operation of the Plants, and there is no indication that the transaction is other than a bona fide purchase of Taxpayer's interests in the Plants and the 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, Taxpayer will not realize income from its acquisition of one-half of the Sellers' interests in the Plants and in one-half the assets in the non-qualified funds except to the extent that, under the rules of section 1060, the amount of cash and other Class I assets received by Taxpayer (not including the assets in the qualified funds) surpasses the amount of consideration provided by Taxpayer and taken into account in the year of the acquisition. Further, to the extent that Taxpayer is entitled to take into account other consideration paid, Taxpayer 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 sections 1.1060-1T(c)(2); 1.338-6T(b)(1) and -7T(b).

Our conclusion above is conditioned on Taxpayer including in basis only the cash paid to Sellers and any liabilities that are otherwise incurred for federal income tax purposes, and allocating this consideration pursuant to the residual method under section 1060 and the regulations thereunder. Pursuant to section 461(h) and the regulations thereunder, Taxpayer 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 liabilities assumed in the transactions.

Finally, section 1060 provides that, in the case of an "applicable asset acquisition," the consideration received shall be allocated among the acquired assets in the same manner as amounts are allocated to assets under section 338(b)(5). Section 1.1060-1T(a)(1) provides that, in the case of an applicable asset acquisition, sellers and purchasers must allocate the consideration under the residual method as described in section 1.338-6T and 1.338-7T in order to determine, respectively, the amount realized from, and the basis in, each of the transferred assets.

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

Section 1.1060-1T(c)(1) defines a seller's consideration as the amount, in the aggregate, realized from selling the assets in the applicable asset acquisition under section 1001(b). Section 1060 provides no independent basis for determining the amount a taxpayer realizes on the sale of assets or the time such amount may be taken into account; the amount realized and the time such amount is taken into account are determined solely under generally applicable tax accounting principles. See section 1001 and 461(h).

The residual method is based on a division of assets into seven classes: Class I (generally consisting of cash, and general deposit accounts held in banks, savings and loan associations, and other depository institutions), Class II (generally consisting of actively traded personal property like U.S. government securities and publicly traded stock, but also including certificates of deposit and foreign currency even if they are not

actively traded personal property), Class III (accounts receivable, mortgages, and credit card receivables from customers which arise in the ordinary course of business), Class IV (stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business), Class V (all assets other than Class I, II, III, IV, VI, and VII assets), Class VI (all section 197 intangibles, as defined in section 197, except goodwill and going concern value), and Class VII (goodwill and going concern value, whether or not they qualify as section 197 intangibles).

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

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

The consideration will be first reduced by $50 (the amount of Class I assets). The remaining consideration will be allocated as follows: $250 to Class II assets (pro rata according to fair market value, resulting in a $150 gain); $100 to the Class III assets (pro rata according to fair market value, resulting in no gain or loss); $150 to the Class IV assets (pro rata according to the fair market value, resulting in a $100 gain); $100 to the Class V assets (pro rata according to the fair market value, resulting in no gain or loss); $50 to the Class VI assets (pro rata according to the fair market value, resulting in a $50 gain); and the remaining $75 to the Class VII assets (pro rata according to the fair market value, resulting in a $75 gain). The character of the amounts of gain or loss recognized by the seller, as well as any applicable holding periods, are determined by the nature of the underlying assets. Sections 1.1060-1T(a)(1), 1.1060-1T(c)(2), and 1.338-6T.

If under general tax principles there is a subsequent adjustment to the consideration, e.g., if it is later determined that the actual amount of the liability assumed differs from the value that the parties assigned to such liability on the date of

the applicable asset acquisition, that amount is allocated in a manner that produces the same allocation that would have been made at the time of the acquisition had such amount been paid or incurred on the acquisition date. Sections 1.1060-1T(a)(1), 1.1060-1T(c)(2), and 1.338-7T.

With respect to the Plant, equipment, operating assets and nonqualified nuclear decommissioning fund assets, these assets comprise a trade or business in Sellers' hands and the basis Taxpayer takes in those assets will be determined wholly by reference to Taxpayer's consideration. Thus, Sellers' transfer of Plant, equipment, operating assets and nonqualified fund assets to Taxpayer in exchange for cash and the assumption of the decommissioning liability (except to the extent funded by the qualified fund) is an applicable asset acquisition as defined in section 1060(c). As such, its Federal tax treatment is determined under section 1060 and the regulations thereunder.

Accordingly, on the acquisition date, Taxpayer's basis in the assets acquired must be determined by allocating its cost (i.e., the consideration provided by Taxpayer on the acquisition date, which includes cash and the issue price of any notes, but not the assumption of the decommissioning liability) among the acquired assets in accordance with the provisions of section 1060 and the regulations thereunder. Specifically, Taxpayer will first reduce its consideration by the amount of Class I assets it receives in the transaction (including any Class I assets held in the nonqualified fund). To the extent the Class I assets received exceed Taxpayer's consideration; the Taxpayer will recognize income. To the extent Taxpayer's consideration 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. Because the combined value of the Class I and II assets will exceed Taxpayer's consideration on the acquisition date, the total amount of consideration to be allocated to the Class II assets will be less than their fair market value and no consideration will be allocated to assets in Classes III, IV, V, VI, or VII. 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 non-qualified funds pay or incur decommissioning expenses), such amounts will be taken into account as increases to Taxpayer'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 1.1060-1T(a)(1), 1.1060-1T(c)(2), 1.338-6T, and 1.338-7T.

Requested Ruling #4: Pursuant to section 1.468A-6, the Taxpayer will not be required to file a request for a revised schedule of ruling amounts for its original b percent interest in the Plants as a result of the purchase of the additional a percent interest and the Taxpayer's current schedule of ruling amounts will not be affected by this purchase.

Section 1.468A-6(e)(2) provides rules for the determination of a schedule of ruling amounts for a transferee of an interest in a nuclear power plant. These rules provide for the determination of a schedule of ruling amounts for the interest in a nuclear power plant that is transferred. The rules do not affect the applicability of an

existing schedule of ruling amounts as it applies to a portion of a nuclear power plant owned by a transferee prior to an acquisition of an additional portion of a plant. Accordingly, until the occurrence of one of the mandatory review requirements of section 1.468A-3(i), the Taxpayer will not be required to file a request for a revised schedule of ruling amounts for its original b percent interest in the Plants as a result of the purchase of the additional a percent interest nor will Taxpayer's current schedule of ruling amounts be affected by this purchase.

However, with respect to the additional a percent interest in the Plants purchased by the Taxpayer, the rules of 1.468A-6(e)(2) would apply. The ruling amount for the year of acquisition will be the Sellers' ruling amount adjusted for the amount of the Sellers' interest acquired and percent of the taxable year remaining after the transaction. After the year of acquisition, Taxpayer would have to apply for a new schedule of ruling amounts with respect to the a percent interest in the Plants.

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

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

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