Section 338.—Certain Stock Purchases Treated as Asset Acquisitions

26 CFR 1.338–6: Allocation of ADSP and AGUB among target assets.

T.D. 9158

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Treatment of Certain Nuclear Decommissioning Funds for Purposes of Allocating Purchase Price in Certain

Deemed and Actual Asset Acquisitions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final and temporary regulations relating to the allocation of purchase price in certain deemed and actual asset acquisitions under sections 338 and 1060. These regulations affect sellers and purchasers of nuclear power plants or of the stock of corporations that own nuclear power plants. The text of the temporary regulations also serves as the text of the proposed regulations (REG–169135–03) set forth in the notice of proposed rulemaking on this subject in this issue of the Bulletin.

DATES: *Effective Date:* These regulations are effective on September 15, 2004.

FOR FURTHER INFORMATION CONTACT: Richard Starke at (202) 622–7790 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

Sections 338 and 1060 and the regulations thereunder provide a methodology by which the purchase or sales price in certain actual and deemed asset acquisitions is computed and allocated among the assets acquired or treated as acquired. The purchase price generally includes liabilities of the seller that are assumed by the purchaser. Those liabilities, however, must be treated as having been incurred by the purchaser. In order to be treated as having been incurred by the purchaser, in addition to other requirements, economic performance must have occurred with respect to the liability.

Sections 338 and 1060 and the regulations promulgated thereunder employ a residual method of allocation under which assets are divided into seven classes and the consideration is allocated to each of the first six classes in turn, up to the fair market value of the assets in the class. The residual amount is allocated to assets in the last class. Accordingly, under the residual method of §1.338–6, the purchase or sales price is first allocated to Class I assets (cash and general deposit accounts other than certain certificates of deposit), then Class II assets (actively traded personal property, certificates of deposit, foreign currency, US government securities, and publicly traded stock), then Class III assets (assets that the taxpayer marks to market at least annually and certain debt instruments), then Class IV assets (inventory), then Class V assets (assets that are not assets of another class), then Class VI assets (section 197 intangibles, except goodwill and going concern value), and then Class VII assets (goodwill and going concern value). The ordering of the nonresidual classes generally reflects a policy of allocating basis first to those assets that are susceptible to more accurate valuation or the cost of which is recovered most rapidly. See Notice of Proposed Rulemaking REG–107069–97, 1999–2 C.B. 346, 350, 354 [64 FR 43462, 43465, 43469; August 10, 1999].

In connection with the sale of a nuclear power station, the assets sold by the seller and purchased by the purchaser may include the plant, equipment, operating assets, and one or more funds holding assets that have been set aside for the purpose of satisfying the owner's responsibility to decommission the nuclear power station after the conclusion of its useful life (the decommissioning liability), and the purchaser may have agreed to satisfy the decommissioning liability. One or more of the funds may be funds described in section 468A (qualified funds). Contributions to qualified funds are limited by statute and regulations but give rise to a deduction in the year of contribution. The qualified fund, not the contributor, is treated as the owner of the assets of the fund and is taxed on the income earned on the fund's assets. The assets of qualified funds are not treated as sold or purchased in an actual or deemed sale of the assets of a corporation that owns a nuclear power plant. One or more of the funds, however, may be funds that are not described in section 468A (nonqualified funds). Contributions to nonqualified funds do not give rise to a deduction in the year of contribution. In addition, the assets of a nonqualified fund continue to be treated as assets of the contributor.

Because the decommissioning liability will not satisfy the economic performance test until decommissioning occurs, as of the purchase date, it is not included in the purchase price that the purchaser allocates to the acquired assets. As a result, as of the purchase date, the purchase price to be allocated by the purchaser among the acquired assets may be significantly less than the fair market value of those assets. This situation will generally persist until economic performance with respect to the decommissioning liability is satisfied through decommissioning.

Under the residual method, the purchase price is allocated to the nonqualified fund's assets, which are typically Class II assets, before it is allocated to the plant, equipment, and other operating assets, which are typically Class V assets. Because the purchase price does not reflect the decommissioning liability and is first allocated to the assets of the nonqualified fund, the purchase price allocated to the plant, equipment, and other operating assets may be less than their fair market value. To the extent the purchase price allocated to the plant, equipment, and other operating assets is less than their fair market value, the purchaser will not recover a tax benefit (*i.e.*, a depreciation deduction) for the decommissioning liability until economic performance occurs on decommissioning. This result is appropriate given Congress's decision in enacting section 468A not to allow a plant operator a deduction prior to decommissioning for funds set aside in excess of those amounts set aside in qualified funds, and Congress's decision in enacting section 461(h) not to allow a deduction for costs that do not satisfy the economic performance test.

A number of commentators have argued that economic performance occurs with respect to such decommissioning liabilities at the time of the purchase. These commentators have based their positions on section 461(h)(2)(A)(ii) and §1.461–4(d)(5).

The IRS and Treasury Department do not believe that this position is consistent with the rule and policies of section 461(h)(2). Under section 461(h)(2)(A)(ii), if a liability arises out of the providing of property to the taxpayer by another person, economic performance occurs as such person provides such property. Decommissioning liabilities are the same type of lia-

bilities to both the seller and the purchaser and are fixed by the same circumstances, specifically acquiring a power plant and the license to operate it. The economic performance rules look at the nature of the liability and look to what the taxpayer is required to "perform" in order to satisfy the liability. To the purchaser, merely acquiring the power plant does not satisfy the decommissioning liabilities. Instead, the purchaser cannot be considered to satisfy the liabilities until it performs those services required to decommission the plant. See section 461(h)(2)(B) (providing that where the liability of the taxpayer requires the taxpayer to provide property or services, economic performance occurs as the taxpayer provides such property or service). Therefore, section 461(h)(2)(A)(ii) does not apply to treat economic performance as satisfied at the time of purchase.

With respect to the application of §1.461–4(d)(5), that regulation 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 (the seller) but for the economic performance requirement would have been entitled to incur as of the date of the 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 (the seller). The IRS and Treasury Department believe the "taxpayer" described in §1.461–4(d)(5) is the seller, and the acceleration of economic performance is for the "taxpayer." Section 1.461–4(d)(5) does not address the treatment of the purchaser. This interpretation is consistent with the discussion of the preamble to that regulation. (T.D. 8408, 1992–1 C.B. 157, 160 [57 FR 12412–3, 12415–6; April 10, 1992].

Nonetheless, the IRS and Treasury Department recognize the special circumstances related to the purchase and sale of nuclear power plants and transfer of nonqualified funds. The Nuclear Regulatory Commission requires, as one of several decommissioning alternatives available to nuclear power plant operators, that funds be established and maintained to fund decommissioning and related administrative expenditures and that the use of such set aside funds be primarily restricted to such uses. Thus, although the assets in nonqualified funds are relatively liquid, they are ones to which the purchaser's access is significantly limited.

To mitigate the tax effect of these decommissioning liabilities' not satisfying the statutory requirements for economic performance as to the purchaser, these temporary regulations add §1.338–6T. That regulation provides that, for purposes of allocating purchase or sales price among the acquisition date assets of a target, a taxpayer may elect to treat a nonqualified fund as if such fund were an entity classified as a corporation the stock of which were among the acquisition date assets of the target and a Class V asset. In these cases, for allocation purposes, the hypothetical corporation will be treated as bearing the responsibility for decommissioning to the extent assets of the fund are expected to be used for that purpose. A section 338(h)(10) election will be treated as made for the hypothetical corporation (regardless of whether the requirements for a section 338(h)(10) election are otherwise satisfied).

The election provided for in these temporary regulations converts the assets of the nonqualified fund from primarily Class I and Class II assets to the assets of a corporation the stock of which is a Class V asset and allows the present cost of the decommissioning liability funded by the nonqualified fund, which otherwise cannot be taken into account for income tax purposes, to be netted against the fund assets for the sole purpose of valuing the stock of the hypothetical subsidiary corporation. Therefore, if this election were made, it would be expected that the assets of the nonqualified fund would be allocated a much smaller amount of the initial purchase price than if no such election had been made, and the disposition of fund assets would result in gain. A larger amount of the initial purchase price, however, would be available for allocation to the plant and other operating assets.

This election is available for applicable asset acquisitions and qualified stock purchases on or after September 15, 2004. The purchaser may make this election regardless of whether the seller or sellers also make the election. However, in the case of a deemed asset acquisition under section 338, if the target corporation is an S corporation, all of the S corporation shareholders, including those that do not sell their stock, must consent to the election for the election to be effective as to any S corporation shareholder. In the case of a deemed asset acquisition under section 338, the election is made by taking a position on an original or amended tax return for the taxable year of the qualified stock purchase that is consistent with having made the election. Such tax return, however, must be filed no later than the later of 30 days after the date on which the section 338 election is due or the day the original tax return for the taxable year of the qualified stock purchase is due (with extensions). The election is irrevocable. If the transaction is an applicable asset acquisition within the meaning of section 1060, the election is made by taking a position on the timely filed original return for the year of the applicable asset acquisition.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. These temporary regulations provide elective relief to certain purchasers of stock and assets by providing an alternative method for allocating basis among acquired assets. It is necessary to provide this relief immediately to remove an impediment to such transactions. Accordingly, good cause is found for dispensing with prior notice and comment pursuant to 5 U.S.C. 553(b) and for dispensing with a delayed effective date pursuant to 5 U.S.C. 553(d). For applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6), see the notice of proposed rulemaking on this subject in this issue of the Bulletin. The IRS and the Treasury Department request comments from small entities that believe they might be adversely affected by these regulations. Pursuant to section 7805(f) of the Code, these temporary regulations will be submitted to the Chief Counsel for the Advocacy of the Small Business Administration for comment on their impact.

Drafting Information

The principal author of these regulations is Richard Starke, Office of the Associate Chief Counsel (Corporate).

* * * * *

Adoption of Amendments to the Regulations

Paragraph 1. The authority citation for part 1 is amended by adding entries in numerical order to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.338–6T also issued under 26 U.S.C. 337(d), 338, and 1502. * * *

Par. 2. Section 1.338–0 is amended by adding an entry in the list of captions for paragraph (c)(5) of §1.338–6 and §1.338–6T to read as follows:

§1.338–0 Outline of topics.

* * * * *

§1.338–6 Allocation of ADSP and AGUB among target assets.

* * * * *

(c) * * *

(5) Allocation to certain nuclear decommissioning funds. [Reserved]

* * * * *

§1.338–6T Allocation of ADSP and AGUB among target assets (temporary).

(a) through (c)(4) [Reserved].

(c)(5) Allocation to certain nuclear decommissioning funds.

(d) [Reserved].

Par. 3. Section 1.338–6 is amended by adding paragraph (c)(5) to read as follows:

§1.338–6 Allocation of ADSP and AGUB among target assets.

* * * * *

(c) * * *

(5) *Allocation to certain nuclear decommissioning funds*. [Reserved]. For further guidance, see §1.338–6T.

* * * * *

Par. 4. Section 1.338–6T is added to read as follows:

§1.338–6T Allocation of ADSP and AGUB among target assets (temporary).

(a) through (c)(4) [Reserved]. For further guidance, see §1.338–6(a) through (c)(4).

(5) *Allocation to certain nuclear decommissioning funds*—(i) *General rule*. For purposes of allocating ADSP or AGUB among the acquisition date assets of a target (and for no other purpose), a taxpayer may elect to treat a nonqualified nuclear decommissioning fund (as defined in paragraph (c)(5)(ii) of this section) of the target as if—

(A) Such fund were an entity classified as a corporation;

(B) The stock of the corporation were among the acquisition date assets of the target and a Class V asset;

(C) The corporation owned the assets of the fund;

(D) The corporation bore the responsibility for decommissioning one or more nuclear power plants to the extent assets of the fund are expected to be used for that purpose; and

(E) A section 338(h)(10) election were made for the corporation (regardless of whether the requirements for a section 338(h)(10) election are otherwise satisfied).

(ii) *Definition of nonqualified nuclear decommissioning fund*. A nonqualified nuclear decommissioning fund means a trust, escrow account, Government fund or other type of agreement—

(A) That is established in writing by the owner or licensee of a nuclear generating unit for the exclusive purpose of funding the decommissioning of one or more nuclear power plants;

(B) That is described to the Nuclear Regulatory Commission in a report described in 10 CFR 50.75(b) as providing assurance that funds will be available for decommissioning;

(C) That is not a Nuclear Decommissioning Reserve Fund, as described in section 468A;

(D) That is maintained at all times in the United States; and

(E) The assets of which are to be used only as permitted by 10 CFR 50.82(a)(8).

(iii) *Availability of election*. P may make the election described in this paragraph (c)(5) regardless of whether the selling consolidated group (or the selling affiliate or the S corporation shareholders) also makes the election. In addition, the selling consolidated group (or the selling affiliate or the S corporation shareholders) may make the election regardless of whether P also makes the election. If T is an S corporation, all of the S corporation shareholders, including those that do not sell their stock, must consent to the election for the election to be effective as to any S corporation shareholder.

(iv) *Time and manner of making election*. The election described in this paragraph (c)(5) is made by taking a position on an original or amended tax return for the taxable year of the qualified stock purchase that is consistent with having made the election. Such tax return must be filed no later than the later of 30 days after the date on which the section 338 election is due or the day the original tax return for the taxable year of the qualified stock purchase is due (with extensions).

(v) *Irrevocability of election*. An election made pursuant to this paragraph (c)(5) is irrevocable.

(vi) *Effective date*. This paragraph (c)(5) applies to qualified stock purchases occurring on or after September 15, 2004.

(d) [Reserved]. For further guidance, see §1.338–6(d).

Par. 5. Section 1.1060–1 is amended by revising the Outline of Topics in paragraph (a)(3) to add an entry to reflect the addition of paragraph (e)(1)(ii)(C); by adding a sentence to the end of paragraph (c)(3); and by adding paragraph (e)(1)(ii)(C) to read as follows:

§1.1060–1 Special allocation rules for certain asset acquisitions.

(a) * * *

(3) * * *

* * * * *

(e) Reporting requirements.

(1) Applicable asset acquisitions.

(ii) Time and manner of reporting.

(C) Election described in §1.338–6T(c)(5).

* * * * *

(c) * * *

(3) * * * For further guidance, see §1.1060–1T.

(e) * * *

(1) * * *

(ii) * * *

(C) *Allocation to certain nuclear decommissioning funds*. [Reserved]. For further guidance, see §1.338–6T.

* * * * *

Par. 6. Section 1.1060–1T is added to read as follows:

§1.1060–1T Special allocation rules for certain asset acquisitions (temporary).

(a) through (c)(2) [Reserved]. For further guidance, see §1.1060–1(a) through (c)(2).

(c)(3) *Certain costs*. The seller and purchaser each adjusts the amount allocated to an individual asset to take into account the specific identifiable costs incurred in transferring that asset in connection with the applicable asset acquisition (*e.g.*, real estate transfer costs or security interest perfection costs). Costs so allocated increase, or decrease, as appropriate, the total consideration that is allocated under the residual method. No adjustment is made to the amount allocated to an individual asset for general costs associated with the applicable asset acquisition as a whole or with groups of assets included therein (*e.g.*, non-specific appraisal fees or accounting fees). These latter amounts are taken into account only indirectly through their effect on the total consideration to be allocated. If an election described in §1.338–6T(c)(5) is made with respect to an applicable asset acquisition, any allocation of costs pursuant to this paragraph (c)(3) shall be made as if such election had not been made. The preceding sentence applies to applicable asset acquisitions occurring on or after September 15, 2004.

(c)(4) through (e)(1)(ii)(B) [Reserved]. For further guidance, see §1.1060–1(c)(4) through (e)(1)(ii)(B).

(e)(1)(ii)(C) *Election described in §1.338–6T(c)(5)—(1) Availability*. The election described in §1.338–6T(c)(5) is available in respect of an applicable asset acquisition provided that the requirements of that section are satisfied. Such election may be made by the seller, regardless of whether the purchaser also makes the election, and may be made by the purchaser, regardless of whether the seller also makes the election.

(*2*) *Time and manner of making election*. The election described in §1.338–6T(c)(5) is made by taking a position on a timely filed original tax return for the taxable year of the applicable asset acquisition that is consistent with having made the election.

(*3*) *Irrevocability of election*. The election described in §1.338–6T(c)(5) is irrevocable.

(*4*) *Effective date*. This paragraph (e)(1)(ii)(C) applies to applicable asset acquisitions occurring on or after September 15, 2004.

(e)(2) [Reserved]. For further guidance, see §1.1060–1(e)(2).

Mark E. Matthews,
Deputy Commissioner for Services and Enforcement.

Approved September 8, 2004.

Gregory F. Jenner,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on September 15, 2004, 8:45 a.m., and published in the issue of the Federal Register for September 16, 2004, 69 F.R. 55740)