Internal Revenue Service

Number: **200208004**
Release Date: 2/22/2002
Index Number: 468A.00-00, 461.00-00, 1012.06-00,1060.00-00, 1031.00-00

Department of the Treasury

Washington, DC 20224

Person to Contact:

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Refer Reply To:
CC:PSI:6-PLR-115801-99
Date:
November 9, 2001

Legend:

Taxpayer/Company 1 =
Company 2 =
Company 3 =
Company 4 =

Parent 1 =
Parent 2 =

Plant 1 =
Plant 2 =
Plant 3 =

Commission A =
Commission B =
Commission C =

State 1 =
State 2 =

Trustee =

Law =

a =

b =

c =

d =

e =

This letter responds to Taxpayer/Company 1's request, dated September 24, 1999, that we rule on certain tax consequences under the Internal Revenue Code of the transfer of the Plants and associated nuclear decommissioning funds. As set forth below, you have requested rulings regarding the tax consequences to Taxpayer/Company 1 and its qualified nuclear decommissioning funds.

The Taxpayer/Company 1 has represented the following facts and information relating to the ruling request:

The Taxpayer/Company 1 is engaged in the generation, transmission, distribution, and sale of electric energy to customers in State 1. Taxpayer/Company 1 is a wholly-owned subsidiary of Parent 1. Companies 2 and 3 are wholly-owned subsidiaries of Parent 2. They are engaged in the generation, transmission, distribution, and sale of electric energy in States 1 and 2, respectively.

Taxpayer/Company 1 owns an a percent interest in Plant 1 and a b percent interest in Plant 3. Taxpayer Company 1 has a leasehold interest of b percent in Plant 2. The remaining interests in Plants 1 and 2 are owned by various subsidiaries of Parent 2 including Company 2. Taxpayer/Company 1 is the operator of Plants 1 and 2. The remaining interests in Plant 3 are owned by various subsidiaries of Parent 2 including Company 3. Company 3 is the operator of Plant 3. The rates for electric energy from Plants 1 and 2 sold by Taxpayer/Company 1 and Company 2 have been approved by Commissions A and B. The rates for electric energy from Plant 3 sold by Company 3 have been approved by Commission C.

Taxpayer/Company 1 has established a qualified nuclear decommissioning fund for its interests in each of the Plants. Company 2 has established a qualified nuclear decommissioning fund for its interest in Plant 1 and will establish such a fund for the interest it will acquire in Plant 2. Company 2 has established a nonqualified nuclear decommissioning fund for its interest in Plant 1 and will establish such a fund for the interest it will acquire in Plant 2. Company 3 has established a qualified nuclear decommissioning fund for its interest in Plant 3.

As a result of the Law, Taxpayer/Company 1 filed a restructuring plant with Commission A. Under this plan, Taxpayer/Company 1 plans to sell its generating assets. Due to the difficulty in selling minority interests in nuclear power plants, Taxpayer/Company 1 entered into an agreement (with Parent 2, Companies 2 and 3, and Company 4, another subsidiary of Parent 2) to transfer all of its interests in the Plants (and certain other generation assets) to Companies 2, 3 and 4 (the "Transferee Group"). In exchange, the Transferee Group will transfer certain generation and other assets to Taxpayer/Company 1. Specifically, Taxpayer/Company 1's interests in Plants 1 and 2 will be transferred to Company 2, and its interest in Plant 3 will be transferred to Company 3. Following the closing of this transaction, Taxpayer/Company 1 will no longer own or operate any nuclear power plants and will sell at auction all of the generating assets received from the Transferee Group (as well as any remaining non-nuclear generating assets still held).[1]

Parent 2 expects to treat the exchange of assets as a like-kind exchange under section 1031. Since Taxpayer/Company 1 will not retain any of the property it receives for productive use in a trade or business it will treat the transaction as a taxable disposition of the assets transferred to the Transferee Group.

As part of the agreement, Taxpayer/Company 1 will transfer the assets of its qualified and nonqualified nuclear decommissioning funds that relate to the Plants and as well as the NRC licenses associated with the Plants. Thus, the assets in the funds relating to Plants 1 and 2 will be transferred to the existing (or to be established) funds of Company 2 relating to the respective Plant. In addition, the assets in the funds relating to Plant 3 will be transferred to the existing (or to be established) funds of Company 3. Companies 2 and 3 will assume all liabilities associated with decommissioning the Plants. Moreover, the agreement will require that all of the assets transferred from the Taxpayer/Company 1's nonqualified nuclear decommissioning funds be use solely for decommissioning the Plants.

The interests acquired by Companies 2 and 3 will be reflected in their respective rate bases as these interests will replace their interests in the other generating assets that are being transferred to the Taxpayer/Company 1. However, because the assets transferred by the Taxpayer/Company 1 in the qualified and nonqualified nuclear decommissioning funds are expected to satisfy the future decommissioning costs of the Plants, Companies 2 and 3 do not anticipate making additional contribution to their qualified nuclear decommissioning funds unless a future estimate of such costs indicates a need for additional funding.

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[1] In the case of both the Taxpayer/Company 1 and the members of the Transferee Group, the assets transferred with respect to each undivided interest in an electric generating plant, both nuclear and fossil fuel, included a corresponding undivided interest in the tangible and intangible real and personal property associated with the undivided interest in the plant itself. This property included, with respect to each transferred interest in a plant: (a) specified parcels of real property (including buildings, facilities and other improvements), leases of real property and easements relating to the transferred interest; (b) machinery, equipment, vehicles, tools, furniture and furnishings and other personal property related to the transferred interest; (c) major spare parts and spare equipment included in the capital base of the transferred interest; (d) inventories of materials, spare parts, consumable supplies and chemicals associated with the transferred interest; (e) contracts, agreements, licenses and personal property leases associated with each transferred interest; (f) all permits associated with each transferred interest; (g) all books, operating records, operating, safety and maintenance manuals, engineering design plans, documents, blueprints and as-built plans, specification, procedures and similar items relating specifically to the transferred interests; and (h) various other intangible assets related to the transferred interests, including plant names and plans for Year 2000 compliance.

The transaction discussed above was completed on c. Since, the transaction closed prior to Taxpayer/Company 1 receiving a schedule of ruling amounts for the d tax year, certain contingencies were added to the agreement relating to the amounts to be transferred with respect to that tax year. On e, the Service issued the requested schedules of ruling amounts. Since the approved amount with respect to Plant 3 was less than the amounts requested and contributed by the Taxpayer/Company 1, Company 3 requested that its fund trustee transfer the excess amount from its qualified nuclear decommissioning fund to its nonqualified decommissioning fund.

Requested Rulings ##1a, 1b, 2b, 2c, 3a, 3b: With respect to the transfer of the Taxpayer/Company 1's interest in Plants 1 and 2, neither the Taxpayer/Company 1, Company 2, nor their qualified nuclear decommissioning funds will recognize any gain or loss or otherwise take into account any income or deduction by reason of the transfer of the Taxpayer/Company 1's qualified nuclear decommissioning trust funds to Company 2's qualified nuclear decommissioning trust funds. Company 2's qualified nuclear decommissioning funds will have a basis in the assets held equal to the basis of such assets in the Taxpayer/Company 1's qualified nuclear decommissioning funds immediately prior to the transfer. With respect to the transfer of the Taxpayer/Company 1's interest in Plants 3, neither the Taxpayer/Company 1, Company 3, nor their qualified nuclear decommissioning funds will recognize any gain or loss or otherwise take into account any income or deduction by reason of the transfer of the Taxpayer/Company 1's qualified nuclear decommissioning trust funds to Company 3's qualified nuclear decommissioning trust funds. Company 3's qualified nuclear decommissioning funds will have a basis in the assets held equal to the basis of such assets in the Taxpayer/Company 1's qualified nuclear decommissioning funds immediately prior to the transfer.

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

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

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

Section 1.468A-1(b)(1) of the Federal Income Tax Regulations provides that an eligible taxpayer is a taxpayer that possesses a qualifying interest in a nuclear power plant. Section 1.468A-1(b)(2) provides that a qualifying interest is a direct ownership interest or a leasehold interest meeting certain additional requirements. Section 1.468A-1(b)(4) provides, in part, that a nuclear power plant is any nuclear power reactor that is used predominantly in the trade or business of the furnishing or sale of electric energy, if the rates for such furnishing or sale, have been established or approved by a public utility commission.

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

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

Under the specific facts herein, the Service will exercise its discretion to treat this transaction, under section 1.468A-6(g), as a disposition qualifying under the general provisions of section 1.468A-6. Thus, under section 1.468A-6 the qualified nuclear decommissioning funds of the Taxpayer/Company 1 will not be disqualified upon the transfer when the assets are transferred to the respective qualified nuclear decommissioning funds of Companies 2 and 3 and those funds, holding the transferred qualified assets will be treated as qualified nuclear decommissioning funds of Companies 2 and 3.

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, Taxpayer/Company 1 will not recognize gain or loss or otherwise take any income or deduction into account by reason of the transfer of the qualified nuclear decommissioning funds assets to the qualified nuclear decommissioning funds of Companies 2 and 3.

Similarly, 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, Companies 2 and 3 will not recognize gain or loss or otherwise take any income or deduction into account by reason of the transfer of Taxpayer/Company 1's qualified nuclear decommissioning funds assets to the qualified nuclear decommissioning funds of Companies 2 and 3.

Finally, section 1.468A-6(c)(3) provides that transfers of assets of a qualified fund to which section 1.468A-6 applies do not affect basis. Accordingly, under section 1.468A-6(c)(3), the qualified nuclear decommissioning funds of Companies 2 and 3 will have a basis in the assets received that is the same as the basis of those assets in the qualified nuclear decommissioning funds of Taxpayer/Company 1 immediately before the transfer.

Requested Ruling # 2a: The conversion of Taxpayer/Company 1's leasehold interest in Plant 2 to a direct ownership interest of Company 2 in Plant 2 will have no effect on the continuing qualification of the qualified nuclear decommissioning fund maintained by Company 2 with respect to Plant 2.

Section 1.468A-5(a) sets out the qualification requirements for nuclear decommissioning funds. It generally provides that a qualified nuclear decommissioning fund must be established and maintained by an electing (eligible) taxpayer. Section 1.468A-1(b)(1) 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 either a direct ownership interest or a leasehold interest meeting certain additional requirements.

Since section 1.468A-1(b)(2) provides that a qualifying interest may be either a direct ownership interest or a leasehold interest, there is no change in the qualification status of Company 2's qualified nuclear decommissioning fund upon the conversion of Taxpayer/Company 1's leasehold interest in Plant 2 to a direct ownership interest of Company 2 in Plant 2.

Requested Ruling #3d: Neither the Taxpayer/Company 1's qualified nuclear decommissioning fund for Plant 3 nor the qualified nuclear decommissioning fund established by Company 3 with respect to its interest in Plant 3 will be disqualified by reason of the excess contribution, or the transfer of the excess contribution to the nonqualified nuclear decommissioning fund, made by the Taxpayer/Company 1 with respect to the d tax year.

Section 1.468A-3(j)(1) permits a taxpayer that has timely requested a schedule of ruling amounts and has not received the requested schedule by the deemed payment deadline to make a payment to a qualified nuclear decommissioning fund on the basis of the amount requested.

Section 1.468A-3(j)(3) provides that if a taxpayer makes a payment to a qualified fund under section 1.468A-3(j)(1); the ruling amount provided by the IRS is less than that requested by the taxpayer; and, as a result, there is an excess contribution (as defined in 1.468A-5(c)(2)(ii)) for such tax year, then the amount of the excess contribution is not deductible and must be withdrawn by the taxpayer consistent with the rules of section 1.468A-5(c)(2)(i).

Section 1.468A-5(c)(2)(i) provides, in part, that in the case of an excess contribution that is a result of a payment made under section 1.468A-3(j)(1), a qualified nuclear decommissioning fund will not be disqualified if the excess contribution is withdrawn by the taxpayer before the later of 30 days after receipt of the schedule of ruling amounts or the date prescribed by law for filing the return of the fund for the tax year to which the excess contribution results.

Provided Company 3 withdrew the excess contribution in a timely manner under section 1.468A-5(c)(2)(i), neither the Taxpayer/Company 1's qualified nuclear decommissioning fund for Plant 3 nor the qualified nuclear decommissioning fund established by Company 3 with respect to its interest in Plant 3 will be disqualified by reason of the excess contribution made by the Taxpayer/Company 1 with respect to the d tax year or the transfer of the excess contribution to the nonqualified nuclear decommissioning fund.

Requested Rulings ## 1c, 2d, 3c: Taxpayer/Company 1 will be entitled to a deduction under section 1.461-4(d)(5) with respect to any amount of the decommissioning liability for Plants 1 and 2 that is included in the amount realized by Taxpayer/Company 1 as a result of the transfer of the interests in Plants 1 and 2 to Company 2. Taxpayer/Company 1 will be entitled to a deduction under section 1.461-4(d)(5) with respect to any amount of the decommissioning liability for Plant 3 that is included in the amount realized by Taxpayer/Company 1 as a result of the transfer of the interest in Plant 3 to Company 3.

Section 1.446-1(c)(1)(ii)(A) provides that under an accrual method of accounting, a liability is incurred and generally taken into account for federal income tax purposes in the year in which all the events have occurred that establish the fact of the liability, the amount of the liability can be determined with reasonable accuracy, and economic performance has occurred with respect to the liability.

Section 461(h) makes clear that generally the all events test is not treated as having been met any earlier than the taxable year in which economic performance has occurred with respect to a liability. See also section 1.461-(4)(a)(1).

Section 461(h)(2)(B) provides that in the case of a liability that requires the taxpayer to provide services, economic performance occurs as the taxpayer provides the services. Section 1.461-4(d)(4) provides that economic performance occurs with respect to such service liabilities as the taxpayer incurs costs in connection with the satisfaction of the liability. Section 1.461-4(d)(5) 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, the Taxpayer/Company 1 clearly has the obligation to decommission each of its Plants. The fact of the obligation arose many years ago, at the time the Taxpayer/Company 1 obtained its license to operate each of the Plants. See 10 C.F.R. section 50.33 and section 72.30, requiring the operator of a nuclear power plant to decommission it. Moreover, Congress recognized the existence of the decommissioning liability when, in 1984, it enacted section 461(h) and section 468A, noting that "[g]enerally, under Federal and State laws, utilities that operate nuclear power plants are obligated to decommission the plants at the end of their useful lives." H.R. Conf. Rep. No. 98-861, 877 (1984). See also S. Prt. No. 169, Vol. 1, 98th Cong., 2d Sess. 277 (1984).

The second prong of the all events test requires the amount of the liability to be reasonably determinable. See section 1.461-1(a)(2)(ii). This prong is also satisfied. In the instant case, the amount of the Taxpayer/Company 1'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 (NRC), which is charged with ensuring that sufficient funds are available to decommission the Plants. In addition, there is also support in the Code for finding that the amount of the decommissioning liability is reasonably determinable at the time of sale. Section 468A(d) generally permits a current deduction for a "ruling amount," based on estimated future decommissioning expenses. To the extent the decommissioning costs are sufficiently determinable to entitle the utility to a deduction under section 468A, it is reasonable to conclude that the costs must also be sufficiently determinable to satisfy the second prong of the all events test.

Given that the two prongs of the all events test are satisfied and, from the Taxpayer/Company 1's perspective, the exchange constitutes a sale of a trade or business, economic performance with respect to the decommissioning liability occurs as of the date of the exchange to the extent the liability is included in the Taxpayer/Company 1's amount realized. At that time, the Taxpayer/Company 1 will be entitled to a deduction for the amount of its decommissioning liability not associated with its qualified nuclear decommissioning funds with respect to the Plants expressly assumed by Company 2 or Company 3 and included in the Taxpayer/Company 1's 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 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 liabilities from which Taxpayer/Company 1 will be relieved are fixed and determinable. As an owner and operator of nuclear plants, Taxpayer/Company 1 is required by law to provide for eventual decommissioning. See 10 CFR sections 50.33, 50.75.

Accordingly, in each transaction, the amount of Taxpayer/Company 1's decommissioning liability (not including the portion of the liability attributable to the qualified funds on the date of the transfer) will be included in Taxpayer/Company 1's amount realized.

Requested Rulings ## 1d, 2e, 3e: Company 2 will not recognize gain or loss or otherwise take any income or deduction into account by reason of the transfer of all of the assets of the Taxpayer/Company 1's nonqualified nuclear decommissioning funds with respect to Plants 1 and 2 to the nonqualified nuclear decommissioning funds maintained by Company 2 respectively for Plants 1 and 2 except to the extent otherwise required by section 1031 and the regulation thereunder and/or to the extent the Class 1 assets (as defined in section 1.338-6T(b)(1)) received by Company 2 exceed the fair market value of the assets transferred by Company 2 to the Taxpayer/Company 1. Company 3 will not recognize gain or loss or otherwise take any income or deduction into account by reason of the transfer of all of the assets of the Taxpayer/Company 1's nonqualified nuclear decommissioning fund with respect to Plant 3 to the nonqualified nuclear decommissioning fund maintained by Company 3 for Plant 3 except to the extent otherwise required by section 1031 and the regulation thereunder and/or to the extent the Class 1 assets (as defined in section 1.338-6T(b)(1)) received by Company 3 exceed the fair market value of the assets transferred by Company 2 to the Taxpayer/Company 1.

Section 1031(a)(1) provides that no gain or loss shall be recognized on the exchange of property held for productive use in a trade or business or for investment if such property is exchanged solely for property of like kind which is to be held either for productive use in a trade or business or for investment.

Section 1031(b) provides that if an exchange would be within the provisions of section 1031(a) if it were not for the fact that the property received in exchange consists not only of property permitted by such provisions to be received without the recognition of gain, but also of other property or money, then gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

Section 1.1031(j)-1(b) provides the rules for computing gain with respect to exchanges of multiple properties qualifying for nonrecognition of gain or loss under section 1031. Section 1.1031(j)-1(b)(2) provides that to the extent possible the properties transferred and the properties received by the taxpayer in the exchange are separated into exchange groups and a residual group. Each exchange group consists of the properties transferred and received in the exchange, all of which are of a like kind or like class. A residual group is created if the aggregate fair market value of the properties transferred in all of the exchange groups differs from the aggregate fair market value of the properties received in all of the exchange groups. section 1.1031(j)-1(b)(2)(iii).

Section 1.1031(j)-1(b)(3) provides that the amount of gain or loss realized with respect of each exchange group and the residual group is the difference between the aggregate fair market value of the properties transferred in that exchange group or residual group and the properties' aggregate adjusted basis. The gain realized with respect to each exchange group is recognized to the extent of the lesser of the gain realized and the amount of the exchange group deficiency, if any. An exchange group deficiency is the excess aggregate fair market value of the properties transferred in an exchange group over the aggregate fair market value of the properties received (less the amount of any excess assumed liabilities). The amount of gain or loss realized and recognized with respect to property not within any exchange group or the residual group is determined under section 1001 and other applicable provisions of the Code.

Thus, under section 1031, gain will be recognized to the extent of the lesser of the gain realized and deficiency. Although the nonqualified decommissioning funds are not like kind property and will not be included in any exchange group, an exchange group deficiency may, in fact, result from their transfer (the aggregate fair market value of the like-kind property received may be less than the aggregate fair market value of the like-kind property transferred) and gain may be recognized. On the other hand, to the extent the residual group consists of all or a portion of the nonqualified decommissioning funds received, section 1.1031(j)-1(b)(3) provides that no gain will be realized.

Thus, Company 2 and Company 3 will not realize income from their receipt of the assets in the nonqualified qualified nuclear decommissioning funds except to the extent that, under the rules of section 1060, the amount of cash and other Class I assets[2] received by Company 2 or Company 3 (not including the assets in the qualified nuclear decommissioning fund) exceeds the amount of consideration provided by Company 2 or Company 3 and taken into account in the year of the exchange. See section 1.338-6T(b)(1).

Requested Rulings ## 1f, 2g, 3g: If the exchange of assets between Taxpayer/Company 1 and Company 2 qualifies as a like kind exchange under section 1031, the Plant 1 and 2 decommissioning liability that is not attributable to the qualified nuclear decommissioning funds for Plants 1 and 2, respectively, and that is assumed by

[2] It is represented that at the time of the transfer the nonqualified decommissioning funds will consist solely of stocks and securities (no cash or other Class 1 assets).

Company 2 will be taken into account in determining gain recognized under sections 1031 and 1.1031(j)-1(b), but will not be taken into account in determining basis under sections 1031 and 1.1031(j)-1(c), until such time as economic performance occurs with respect to such liability. If the exchange of assets between Taxpayer/Company 1 and Company 3 qualifies as a like kind exchange under Section 1031, the Plant 3 decommissioning liability that is not attributable to the qualified nuclear decommissioning fund for Plant 3 and that is assumed by Company 3 will be taken into account in determining gain recognized under sections 1031 and 1.1031(j)-1(b), but will not be taken into account in determining basis under sections 1031 and 1.1031(j)-1(c), until such time as economic performance occurs with respect to such liability.

Section 1031(a)(1) provides that no gain or loss shall be recognized on the exchange of property held for productive use in a trade or business or for investment if such property is exchanged solely for property of like kind which is to be held either for productive use in a trade or business or for investment.

Section 1031(b) provides that if an exchange would be within the provisions of section 1031(a) if it were not for the fact that the property received in exchange consists not only of property permitted by such provisions to be received without the recognition of gain, but also of other property or money, then gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

Section 1031(d) provides that if property was acquired in an exchange described in this section then the basis shall be the same as that of the property exchanged, decreased in the amount of any money received by the taxpayer and increased in the amount of gain or decreased in the amount of loss to the taxpayer that was recognized on such exchange. If the property so acquired consisted in part of the type of property permitted by this section to be received without the recognition of gain or loss, and in part of other property, the basis provided in this subsection shall be allocated between the properties (other than money) received, and for the purpose of the allocation there shall be assigned to such other property an amount equivalent to its fair market value at the date of the exchange.

Section 1.1031(j)-1 provides specific rules for computing basis and gain with respect to exchanges of multiple properties qualifying for nonrecognition of gain or loss under section 1031. See Sections 1.1031(j)-1(c) & 1.1031(j)-1(b).

Section 1.1031(j)-1(c) provides that in an exchange of multiple properties qualifying for nonrecognition of gain or loss under section 1031 the aggregate adjusted basis of property received by the taxpayer within that exchange group is adjusted for, among other things, the amount, if any, of the excess liabilities assumed by the taxpayer that are allocated to that exchange group. The basis of properties received by the taxpayer that are not within any exchange group or the residual group is determined under section 1012.

Section 1.1031(j)-1(b)(2) provides that to the extent possible the properties transferred and the properties received by the taxpayer in the exchange are separated into exchange groups and a residual group. Each exchange group consists of the properties transferred and received in the exchange, all of which are of a like kind or like class. A residual group is created if the aggregate fair market value of the properties transferred in all of the exchange groups differs from the aggregate fair market value of the properties received in all of the exchange groups. Section 1.1031(j)-1(b)(2)(iii). The amount of gain or loss realized and recognized with respect to properties transferred by the taxpayer that are not within any exchange group or the residual group is determined under section 1001 and other applicable provisions of the Code, with proper adjustments made for all liabilities not allocated to the exchange groups or the residual group. section 1.1031(j)-1(b)(3)(ii). If there are excess liabilities assumed (the amount of the liabilities assumed by the taxpayer exceed the amount of liabilities of which the taxpayer is relieved) by the taxpayer as part of the exchange, the excess amount is allocated among the exchange groups (but not to the residual group) in proportion to, but not in excess of, the aggregate fair market value of the properties received by the taxpayer in the exchange groups. Section 1.1031(j)-1(b)(2)(B).

The issue presented is whether the assumed decommissioning liabilities not associated with the qualified nuclear decommissioning funds should be taken into account for purpose of determining the Company 2 and 3's basis in the property received and/or their gain on the exchange.

a. Basis

As a general rule, 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. The legislative history underlying the enactment of section 461(h) makes it clear that Congress intended to exclude an item from being taken into account for tax purposes until economic performance occurs. This treatment applies to capital and well as non-capital transactions. H.R. Rep. No. 432, Pt. 2, 98th Cong., 2d Sess., 1252,1255 (1984); S. Prt. No. 169, Vol. 1, 98th Cong., 2d Sess. 266-267 (1984). Despite criticism from some commentators that the Service lacks authority to apply the economic performance rules broadly enough to include the calculation of basis and cost of goods sold, the Service explicitly stated in the preamble to the final regulations implementing section 461(h) that the Service and Treasury believe the intended scope of the statutory provision is indeed broad enough to apply in this manner. Preamble to T.D. 8408, 57 Fed. Reg. 12411 (Apr. 10, 1992) [1992-1 C.B. 155, 156].

Consistent with this position, the Service amended the regulations under section 446 to clarify that a liability is incurred, and generally is taken into account for federal income tax purposes, in the taxable year in which the all events test is satisfied and economic performance has occurred with respect to the item. Section 1.446-1(c)(1)(ii)(A). Section 1.446-1(c)(1)(ii) provides that "[t]he term 'liability' includes any item allowable as a deduction, cost, or expense for Federal income tax purposes." The regulations further clarify that applicable provisions of the Code, the regulations, and other guidance published by the Secretary prescribe the manner in which a liability that has been incurred is taken into account, and specifically cite to the capitalization provisions of section 263 as an example of a Code provision subordinate to the economic performance requirement. Specifically, the regulations state, "[f]or example, an amount that a taxpayer expends or will expend for capital improvements to property must be incurred before the taxpayer may take the amount into account in computing its basis in the property." Section 1.446-1(c)(1)(ii)(B).

Thus, critical to determining whether Companies 2 and 3 are entitled to treat the future decommissioning liability as a component of its basis in the received assets at the time of the transfer is determining whether the liability will be incurred as of that date. 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 Companies 2 and 3 will not have performed any services relating to the decommissioning liability at the time of the transfer of the Plants, economic performance will not have occurred, and the liability will not have been incurred at that time for purpose of determining Company 2 or 3's basis under section 1031.

Accordingly, at the time of transfer, Companies 2 and 3 will have a basis in the received assets computed in accordance with section 1.1031(j)-1(c) without taking into account the amount of the assumed liabilities relating to their assumption of the decommissioning liability associated with the qualified nuclear decommissioning fund.

Companies 2 and 3's basis in the assets received that are not part of the like kind exchange must be allocated among all such assets in accordance with section 1012 and the residual method provided in section 1060 and section 1.1060-1T(c). Companies 2 and 3 will not be entitled to treat as a component of its basis at the time of the transfer any amount attributable to the future decommissioning liability.

b. Gain

The fact that prior to economic performance a liability is not "incurred" and, thus, not taken into account for purpose of determining a taxpayer's basis does not mean that the liability is ignored for all purposes. Specifically, the enactment of the economic performance rules contained in section 461(h) did not change the rules for determining when a liability is included in the calculation of amount realized under Sections 451 and 1001.

This principle is reflected in section 1.461-4(d)(5), in the context of relief from a liability as an amount realized. Section 1.461-4(d)(5) provides an exception to the economic performance rules in the case of the sale of a trade or business and makes clear that section 461(h) does not determine the amount or timing of the taxpayer's amount realized. When it applies, section 1.461-4(d)(5) provides that "economic performance ... occurs as the amount of the liability is properly included in the amount realized on the transaction" by the Taxpayer/Company 1. This language provides an exception that deems economic performance to be satisfied when the amount of the liability is properly included in the taxpayer's amount realized and clarifies that the rules for determining whether and when the liability is "properly included" in the amount realized are independent of section 461(h). See the cross-reference to section 1.1001-2 at the end of section 1.461-4(d)(5)(i).

The "all events test" in section 451 and section 1.451-1(a), require gain/income to be included in gross income under an accrual method of accounting when (1) all the events have occurred which fix the right to receive the income; and (2) the amount of income can be determined with reasonable accuracy. As indicated above, both prongs of the "all events test" have been met here.

Under the section 1.1031(j) regulations, liabilities assumed are initially pooled, reduced by liabilities relieved, if any, and then allocated among the exchange groups to reduce the fair market value of properties received, in order to determine whether gain is recognized because of a "deficiency" in that group. See section 1.1031(j)-1(b); section.1103(j)-1(d), Example 4.

The specific issue addressed in, for example, section 1.461-4(d)(5) - whether relief from a liability is included in amount realized - and the specific question addressed here - whether an assumed liability is taken into account in determining realized and recognized gain under the section 1.1031(j) regulations - are not identical. However, they both concern the effect of liability assumption on the calculation of amount realized. Thus, while section 1.1031(j)-1(b) provides special rules for calculating gain with respect to exchanges of multiple properties qualifying for nonrecognition under section 1031, the issue of whether a liability is taken into account in such a calculation is governed by the general principles of section 1001 and section 451, which do not require, at least in this context, that economic performance be satisfied.

Accordingly, the decommissioning liability should be taken into account for purposes of determining the Transferees' gain on the exchange of property, but not for purposes of determining their basis in the received property.

c. Section 1060 considerations

Section 1060 provides that, in the case of an "applicable asset acquisition," the consideration received for such assets 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 sections 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 1060(c) also provides that a transfer shall not be treated as failing to be an applicable asset acquisition merely because section 1031 applies to a portion of the 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 sections 1001 and 461(h). Section 1.1060-1T(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 rules of tax accounting.

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).

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.

The Plants, equipment, operating assets and nonqualified fund assets comprise a trade or business in Taxpayer/Company 1's hands and the gain or loss recognized by with respect to those assets will be determined wholly by reference to Taxpayer/Company 1's amount realized. Thus, the transfer of the Plants, equipment, operating assets and nonqualified fund assets to Companies 2 and 3 in exchange for the non-nuclear generating assets 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.

The following example illustrates the operation of section 1060 for a seller: 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, half of which are section 1231 assets with a fair market value of $60 and a basis of $70, and the other half of which are not section 1231 assets with a fair market value of $40 and a basis of $50; and Class VI assets, which are section 1231 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 $775 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 a $10 loss on the section 1231 assets and a $10 loss on the non section 1231 assets); $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). Sections 1.1060-1T(a)(1), 1.1060-1T(c)(2), and 1.338-6T.

Therefore, on the sale of its interests in the Plants, Taxpayer/Company 1's gain or loss on each of the purchased assets (excluding the assets of the qualified nuclear decommissioning funds) will be the difference between Taxpayer/Company 1's basis in the assets and the amount realized with respect to that asset, taking into account the allocation of consideration pursuant to section 1060 and the regulations thereunder.

With respect to the acquisition of the non-nuclear generating assets, Taxpayer/Company 1 will not recognize income except to the extent the Class I assets (as defined in section 1.338-6T(b)(1)) it receives exceed its total cost determined under section 1012 (which will be the sum of its cash consideration and the fair market value of any other consideration it provides to Companies 2 and 3, that is, under applicable tax principles, taken into account on the date of the applicable asset acquisition).

Therefore, in the taxable year of closing, Taxpayer/Company 1 will not recognize any gain or otherwise currently take any income into account by reason of the receipt of the non-nuclear generating assets, provided the Class I assets it receives do not exceed its total cost.

The non-nuclear generating assets comprise a trade or business in the hands of Companies 2 and 3 and the basis Taxpayer/Company 1 takes in those assets will be determined wholly by reference to Taxpayer/Company 1's consideration paid. Thus, Companies 2 and 3s' transfer of the non-nuclear generating assets to Taxpayer/Company 1 in exchange for the Plants, equipment, operating assets, assets of the nonqualified decommissioning funds, and the assumption of liabilities 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.

The following example illustrates the operation of section 1060 for a purchaser: On Date1, an applicable asset acquisition is made. The assets acquired consist of Class I assets in the amount of $50, Class II assets with a fair market value of $350, 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. The consideration paid consists of $150 cash and an assumed liability for which economic performance has not occurred. On Date1, the purchaser has provided $150 of consideration that may be allocated as basis; it will be first reduced by $50 (the amount of Class I assets); the remaining $100 will be allocated to Class II assets (pro rata according to fair market value); nothing is allocated to 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 assets (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 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).

Therefore, Taxpayer/Company 1's total basis will be allocated among the non-nuclear generating assets pursuant to the residual method as required by section 1060 and the regulations promulgated thereunder.

Requested Rulings ## 1g, 2h, 3h: When and to the extent additional amounts are paid or incurred by Company 2 for the assets acquired in the applicable assets acquisition (*e.g.*, when and to the extent the nonqualified decommissioning fund pays or incurs decommissioning expenses), such amounts will be taken into account as increases to Company 2'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, including for purposes of the adjustments to basis contemplated by section 1.1031(j)-1(c), if the exchange of assets between Taxpayer/Company 1 and Company 2 qualifies as a like kind exchange under Section 1031. When and to the extent additional amounts are paid or incurred by Company 3 for the assets acquired in the applicable assets acquisition (*e.g.*, when and to the extent the nonqualified decommissioning fund pays or incurs decommissioning expenses), such amounts will be taken into account as increases to Company 3'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, including for purposes of the adjustments to basis contemplated by Treas. Reg. section 1.1031(j)-1(c), if the exchange of assets between Taxpayer/Company 1 and Company 3 qualifies as a like kind exchange under Section 1031.

As indicated above, the amount of Company 2 and 3's basis in the received assets will not include the amount of its assumption of the decommissioning liability associated with the nonqualified nuclear decommissioning fund at the time of the exchange. When and to the extent economic performance is satisfied with respect to such liability, such amounts will be taken into account as increases in the Companies' consideration and allocated in the same manner and subject to the same conditions as though they were incurred on the exchange date. To the extent the liability, when incurred, is not taken into account under section 1.1031(j)-1(c) such amounts shall be allocated to the non-like kind property as though they were incurred on the exchange date. Sections 1.1060-1T(a)(1), 1.1060-1T(c)(2), 1.338-6T, and 1.338-7T.

No determination is made as to whether the described exchange satisfies the requirements for nonrecognition of gain or loss under section 1031.

Requested Rulings ## 1e, 2f, 3f: Company 2 is treated as the owner of the entire nonqualified nuclear decommissioning funds, for Plants 1 and 2 respectively, under section 677 and 1.677(a)-1(d). Company 2 shall include in computing its taxable income and credits all items of income, deduction, and credits against tax of its nonqualified nuclear decommissioning funds to the extent that such items would be taken into account in computing taxable income or credits against the tax of Company

2. Company 3 is treated as the owner of the entire nonqualified nuclear decommissioning fund for Plant 3 under section 677 and 1.677(a)-1(d). Company 3 shall include in computing its taxable income and credits all items of income, deduction, and credits against tax of its 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 Company 3.

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

Section 1.671-2(e)(1) provides that for purposes of part I of subchapter J, chapter 1 of the Internal Revenue 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 section 1.671-2(e)(2)) of property to a trust. For purposes of section 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 section 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.

Company 2 received the assets of Taxpayer/Company 1’s nonqualified decommissioning funds for Plants 1 and 2 as part of the like kind exchange. Company 2 then contributed those assets as grantor to Company 2’s nonqualified decommissioning funds for Plants 1 and 2. Under the terms of Company 2’s Nuclear Decommissioning Trust Agreement between Company 2 and Trustee, all income, as well as principal of Company 2’s nonqualified decommissioning funds for Plants 1 and 2, is held to satisfy Company 2’s legal obligation to decommission Plants 1 and 2, and upon completion of the decommissioning any remaining assets will be distributed to

Company 2. Accordingly, Company 2 is treated as the owner of the entire Company 2's nonqualified decommissioning funds for Plants 1 and 2 under section 677 and section 1.677(a)-1(d). Company 2 shall include in computing its taxable income and credits all items of income, deduction, and credits against tax of Company 2's nonqualified decommissioning funds for Plants 1 and 2 to the extent that such items would be taken into account in computing taxable income or credits against the tax of Company 2.

Company 3 received the assets of Taxpayer/Company 1's nonqualified decommissioning funds for Plant 3. In addition, Company 3 is treated as receiving the excess contribution (as defined in section 1.468A-5) from Taxpayer/Company 1 as part of the like kind exchange. Company 3 then contributed the fund and the excess contribution as grantor to Company 3's nonqualified decommissioning fund for Plant 3. Under the terms of the Company 3's Nuclear Decommissioning Trust Agreement between Company 3 and Trustee, all income, as well as principal of Company 3's nonqualified decommissioning fund for Plant 3, is held to satisfy Company 3's legal obligation to decommission Plant 3 and upon completion of the decommissioning any remaining assets will be distributed to Company 3. Accordingly, Company 3 is treated as the owner of the entire Company 3's nonqualified decommissioning fund for Plant 3 under section 677 and section 1.677(a)-1(d). Company 3 shall include in computing its taxable income and credits all items of income, deduction, and credits against tax of the Company 3's nonqualified decommissioning fund for Plant 3 to the extent that such items would be taken into account in computing taxable income or credits against the tax of Company 3.

Except as specifically determined above, no opinion is expressed or implied concerning the Federal income tax consequences of the transaction described above. This letter ruling is directed only to Taxpayer/Company 1 that requested it. Section 6110(k)(3) provides that this ruling may not be used or cited as precedent.

In accordance with the powers of attorney the original of this letter is being sent to Taxpayer/Company 1's authorized representative. In addition, we are sending a copy of this ruling to Taxpayer/Company 1 and an additional copy of this ruling to the Taxpayer/Company 1's second authorized representative. We are also sending a copy of this letter ruling to the applicable Industry Director.

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