Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:Br.6-PLR-159540-01
Date:
September 30, 2002

Legend:

Buyer =

Seller A =

Seller B =

Seller C =

Seller D =

Plant One =
Plant Two =
Seller A's Parent =
Seller B's Parent =
Seller C's Parent =
Seller D's Parent =
Commission A =
Commission B =
Buyer's Parent =
Division =
Holding Company =

A =
B =
C =
D =
E =
F =
G =

H =
I =
J =

Dear :

This letter responds to the request dated October 26, 2001, and subsequent communications, submitted by your authorized representative, for a private letter ruling concerning the tax consequences of the sale to Buyer of the interests previously held by Seller A, Seller B, Seller C, and Seller D (collectively, "the Sellers") in Plant One and Plant Two (collectively, "the Plants") and associated assets and liabilities, including assets and liabilities associated with decommissioning the Plants. Specifically, you have requested rulings regarding the tax consequences under section 468A of the Internal Revenue Code to the Sellers' qualified nuclear decommissioning funds as well as rulings regarding the proper realization and recognition of gain and loss on the sale of the Plants and associated assets and the proper allocation of basis among the assets received by Buyer.

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

Buyer, a limited liability company treated as a disregarded entity for federal income tax purposes, is a wholly-owned subsidiary of Buyer's Parent. Buyer's Parent is wholly owned by Division. Division, a limited liability company treated as a disregarded entity for federal income tax purposes, is a wholly-owned subsidiary of Holding Company, a public utility holding company. Buyer is a member of Holding Company's consolidated group and joins Holding Company in filing a consolidated return on a calendar year basis using the accrual method of accounting. Buyer, Buyer's Parent, Division, and Holding Company are under the audit jurisdiction of the Industry Director, Natural Resources and Construction (LM:NRC).

Seller A, a public utility company, is wholly-owned by Seller A's Parent. Seller A owns a A percent interest in Plant One, and a B percent interest in Plant Two, and has maintained two separate decommissioning funds, each solely for the purpose decommissioning Seller A's respective interests in Plant One and Plant Two. The taxpayers represent that these funds satisfy the requirements necessary to be treated as qualified nuclear decommissioning funds within the meaning of section 468A(a). Seller A also has maintained another nuclear decommissioning fund with respect to both Plants that does not meet the requirements of section 468A, and represents that these funds qualify as grantor trusts under section 671.

Seller B, a public utility company, is wholly-owned by Seller B's Parent. Seller B owns a C percent interest in Plant Two, and has maintained a decommissioning fund solely for the purpose decommissioning its interest in Plant Two. The taxpayers represent that this fund satisfies the requirements necessary to be treated as a qualified nuclear decommissioning fund within the meaning of section 468A(a). Seller B has not maintained any other nuclear decommissioning funds with respect to Plant Two.

Seller C, a public utility company, is wholly-owned by Seller C's Parent. Seller C owns a D percent interest in Plant Two, and has maintained a decommissioning fund solely for the purpose decommissioning its interest in Plant Two. The taxpayers represent that this fund satisfies the requirements necessary to be treated as a qualified nuclear decommissioning fund within the meaning of section 468A(a). Seller C has not maintained any other nuclear decommissioning funds with respect to Plant Two.

Seller D, a public utility company, is wholly-owned by Seller D's Parent. Seller D owns a E percent interest in Plant Two, and maintains a decommissioning fund solely for the purpose decommissioning its interest in Plant Two. The taxpayers represent that this fund satisfies the requirements necessary to be treated as a qualified nuclear decommissioning fund within the meaning of section 468A(a). Seller D has not maintained any other nuclear decommissioning funds with respect to Plant Two.

Each of the Sellers joins its parent company in filing a consolidated return on a calendar year basis using the accrual method of accounting. In addition, each of the Sellers is subject to the regulatory jurisdiction of Commission A and Commission B, and is under the audit jurisdiction of the Industry Director, Natural Resources and Construction (LM:NRC).

On F, Division entered into an asset purchase agreement with Seller A to purchase Seller A's entire A percent interest in Plant One. Division subsequently transferred it rights and obligations under the agreement to Buyer. The agreement contemplates that Buyer will assume all decommissioning liabilities associated with Plant One, in addition to other Plant-related liabilities. Seller A is obligated under the asset purchase agreement to continue to make contributions to the decommissioning funds it maintains with respect to Plant One until the closing of the transaction so that the fair market value of the assets in the decommissioning funds at closing equals the amounts specified in the agreement. The agreement requires that, prior to the closing of the transaction, Buyer will execute a Master Trust Agreement that will establish a qualified nuclear decommissioning fund and a non-qualified nuclear decommissioning fund with respect to Plant One. At the closing of the transaction, Seller A will transfer all assets of Seller A's qualified nuclear decommissioning fund to Buyer's qualified nuclear decommissioning fund, and all assets of Seller A's non-qualified nuclear decommissioning fund to Buyer's non-qualified nuclear decommissioning fund. In addition, under a separate power purchase agreement, Seller A has agreed to purchase power from Buyer from the date of closing through G.

Also on F, Division entered into an asset purchase agreement with Seller A, Seller B, Seller C, and Seller D to purchase the Sellers' combined H percent interest in Plant Two. Division subsequently transferred it rights and obligations under the agreement to Buyer. The agreement contemplates that Buyer will assume all decommissioning liabilities associated with Plant Two, in addition to other Plant-related liabilities. The Sellers are obligated under the asset purchase agreement to continue to make contributions to the decommissioning funds they each maintain with respect to Plant Two until the closing of the transaction so that the fair market value of the assets in the decommissioning funds at closing equals the amounts specified in the agreement. The agreement requires that, prior to the closing of the transaction, Buyer will execute a Master Trust Agreement that will establish a qualified nuclear decommissioning fund and a non-qualified nuclear decommissioning fund with respect to Plant Two. At the closing of the transaction, the Sellers will transfer all assets of each Seller's qualified nuclear decommissioning fund to Buyer's qualified nuclear decommissioning fund, and all assets of Seller A's non-qualified nuclear decommissioning fund to Buyer's non-qualified nuclear decommissioning fund. In addition, under a separate power purchase agreement, the Sellers have agreed to purchase power from Buyer for a period of I years following the date of closing.

The agreement specifies that the corpus and income of Buyer's non-qualified nuclear decommissioning funds will be held for decommissioning the Plants. Any assets remaining in Buyer's non-qualified nuclear decommissioning funds after the Plants are fully decommissioned will be distributed to Buyer or as directed by Buyer. The taxpayer represents that for federal income tax purposes it will treat the proposed sale, including the acquisition by Buyer of the assets of Seller A's non-qualified nuclear decommissioning funds, as an asset purchase subject to section 1060.

The transfer of the Plants and associated assets and liabilities took place on J.

Requested Ruling #1: *Buyer's qualified nuclear decommissioning trust established to hold the assets in Seller A's qualified nuclear decommissioning fund with respect to Plant One will be treated as a qualified nuclear decommissioning fund satisfying the requirements of section 468A.*

Requested Ruling #9: *Buyer's qualified nuclear decommissioning trust established to hold the assets in the Sellers' qualified nuclear decommissioning funds with respect to Plant Two will be treated as a qualified nuclear decommissioning fund satisfying the requirements of section 468A.*

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 nuclear decommissioning fund) where the transferee is an eligible taxpayer after the transfer. In addition, 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 under section 1.468A-6(g) to treat this transaction as a disposition qualifying under the general provisions of section 1.468A-6. Thus, under section 1.468A-6, the qualified nuclear decommissioning fund maintained by Seller A with respect to Plant One, and the qualified nuclear decommissioning funds maintained by the Sellers with respect to Plant Two, will not be disqualified upon the transfer of the assets to Buyer's respective qualified nuclear decommissioning funds, and both of Buyer's qualified nuclear decommissioning funds, after receiving the transferred assets, will be treated as qualified nuclear decommissioning funds for purposes of section 468A.

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

Requested Ruling #10: *Neither Buyer nor Buyer's qualified nuclear decommissioning fund with respect to Plant Two will recognize any gain or loss or otherwise take any income or deduction into account by reason of the transfer of the assets of the Sellers' qualified nuclear decommissioning funds for Plant Two to Buyer's qualified nuclear decommissioning fund for Plant Two, and Buyer's qualified nuclear decommissioning fund for Plant Two will have a carryover basis in the assets received from the Sellers' qualified nuclear decommissioning fund for Plant Two.*

For a transaction qualifying under section 1.468A-6, section 1.468A-6(c)(2) provides that neither a transferee nor its fund will recognize gain or loss or otherwise take any income or deduction into account by reason of the transfer of the assets from a transferor's qualified fund to a transferee's qualified fund. Thus, neither Buyer nor its qualified nuclear decommissioning fund will recognize gain or loss or otherwise take any income or deduction into account by reason of the transfer of the assets of Seller A's qualified nuclear decommissioning fund with respect to Plant One, or by reason of the transfer of the assets of the Sellers' qualified nuclear decommissioning funds with respect to Plant Two, to Buyer's qualified nuclear decommissioning fund.

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), Buyer's qualified nuclear decommissioning fund with respect to Plant One will have a basis in the assets received that is the same as the basis of those assets in the qualified nuclear decommissioning fund of Seller A with respect to Plant One immediately before the transfer. Similarly, Buyer's qualified nuclear decommissioning fund with respect to Plant Two will have a basis in the assets

received that is the same as the basis of those assets in the qualified nuclear decommissioning fund of the Sellers with respect to Plant Two immediately before the transfer.

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

Requested Ruling #11: *Neither the Sellers nor the Sellers' qualified nuclear decommissioning funds will recognize any gain or loss or otherwise take any income or deduction into account upon the transfer of the assets of the Sellers' qualified nuclear decommissioning funds for Plant Two to Buyer's qualified nuclear decommissioning fund for Plant Two.*

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 in a transaction to which section 1.468A-6 applies. Thus, neither Seller A nor the qualified nuclear decommissioning fund maintained by Seller A with respect to Plant One will recognize gain or loss or otherwise take any income or deduction into account by reason of the transfer of the qualified nuclear decommissioning fund assets to Buyer's qualified nuclear decommissioning fund for Plant One. Similarly, neither the Sellers nor the qualified nuclear decommissioning funds maintained by the Sellers with respect to Plant Two will recognize gain or loss or otherwise take any income or deduction into account by reason of the transfer of the qualified nuclear decommissioning fund assets to Buyer's qualified nuclear decommissioning fund for Plant Two.

Requested Ruling #4: *Seller A will determine its gain or loss on the sale of Plant One assets by taking the difference between its tax basis in the Plant One assets (other than the qualified nuclear decommissioning fund for Plant One) and the amount realized, which will include the purchase price and the amount of the assumed liabilities and obligations for Plant One (reduced by the amount of the decommissioning liabilities for Plant One to be funded by the qualified nuclear decommissioning fund maintained with respect to that unit) to the extent such liabilities and obligations are taken into account as liabilities for federal income tax purposes.*

Requested Ruling #12: *Each of the Sellers will determine its respective gain or loss on the sale of Plant Two assets by taking the difference between its tax basis in the Plant Two assets (other than the qualified nuclear decommissioning fund for Plant Two) and the amount realized by each Seller, which will include the purchase price and the*

amount of the assumed liabilities and obligations for Plant Two (reduced by the amount of the decommissioning liabilities for Plant Two to be funded by the qualified nuclear decommissioning fund maintained with respect to that unit) to the extent such liabilities and obligations are taken into account as liabilities for federal income tax purposes.

Because the transfer to Buyer of the assets of the existing qualified nuclear decommissioning funds with respect to the Plants will not be taxable transfers, the amount of the liabilities assumed by Buyer that are included in the amounts realized by Seller A and the Sellers, respectively, will not include the portion of the decommissioning liability attributable to the respective qualified nuclear decommissioning funds on the date of the transfer.

Section 1001(a) provides that gain from the sale of property shall be the excess of the amount realized over the adjusted basis provided in section 1011 for determining gain, and that loss from the sale of property shall be the excess of the adjusted basis provided in section 1011 for determining loss over the amount realized. Section 1001(b) provides that a seller's amount realized from the sale of property is the sum of any money received plus the fair market value of the property (other than money) received.

Section 1.1001-2(a)(1) provides that a seller's amount realized from the sale of property includes the amount of liabilities from which the seller is discharged as a result of the sale. This may include debt and non-debt liabilities. See Fisher Co. v. Commissioner, 84 T.C. 1319, 1345-47 (1985) (assumption of lessee's repair liability was part of amount realized on sale of leasehold). The decommissioning liability from which Seller A will be relieved with respect to Plant One, and the decommissioning liability from which the Sellers will be relieved with respect to Plant Two, are fixed and determinable. As owners and operators of nuclear plants, Seller A and the Sellers are required by law to provide for eventual decommissioning of their respective interests in Plant One and Plant Two. See 10 C.F.R. §§ 50.33, 50.75.

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

Accordingly, on the sale of Seller A's interest in Plant One and of the Sellers' interests in Plant Two and the respective interests in the assets of the decommissioning trust funds (other than those assets in the qualified funds), their respective gain or loss on each transferred asset will be the difference between the basis of the asset and the amount realized with respect to that asset, taking into account the allocation of

consideration pursuant to section 1060 and the corresponding regulations. The amount realized from the sale of the Plants and the assets in the decommissioning trust funds will include the cash received from Buyer and the liabilities assumed by Buyer, to the extent these liabilities are taken into account for federal income tax purposes. This would include the amount of the decommissioning liability assumed by Buyer with respect to the Plants, not including the portion of the liability to decommission the Plants attributable to the respective qualified nuclear decommissioning funds on the date of the transfer.

Requested Ruling #5: *Seller A shall be entitled to a current deduction in determining its taxable income for its taxable year that includes the closing date of the sale of the Plants in an amount equal to the total of any amounts treated as realized by Seller A as a result of Buyer's assumption of the decommissioning liabilities for Plant One.*

Requested Ruling #13: *Each of the Sellers shall be entitled to a current deduction in determining its taxable income for its taxable year that includes the closing date of the sale of the Plants in an amount equal to the total of any amounts treated as realized by each Seller as a result of Buyer's assumption of the decommissioning liabilities for Plant Two.*

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, Seller A clearly has the obligation to decommission Plant One, and each of the Sellers clearly have an obligation to decommission Plant Two. The fact of the obligation arose many years ago, at the time they obtained their respective licenses to operate the Plants. See 10 C.F.R. § 50.33 and § 72.30, requiring the operator of a nuclear power plant to decommission it. Moreover, Congress recognized the existence of the decommissioning liability when, in 1984, it enacted 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 because the amount of Seller A's decommissioning liability with respect to Plant One, and the amount of each Sellers' decommissioning liability with respect to Plant Two, has been calculated by independent evaluators in the nuclear decommissioning industry. These calculations have been reviewed and accepted by both the Nuclear Regulatory Commission and Commission A. 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, economic performance with respect to the decommissioning liability occurs with respect to Plant One as of the date of the sale to the extent the liability is included in Seller A's amount realized. At that time, Seller A will be entitled to a deduction for the amount of its decommissioning liability associated with Plant One expressly assumed by the Buyer and included in Seller A's amount realized.

Similarly, economic performance with respect to the decommissioning liability occurs with respect to Plant Two as of the date of the sale to the extent the liability is included in the each of the Sellers' amount realized. At that time, the each of the Sellers will be entitled to a deduction for the amount of its decommissioning liability associated with Plant Two expressly assumed by the Buyer and included in each Sellers' amount realized.

Requested Ruling #6: *In the taxable year of the closing, Buyer will not recognize any gain or loss or otherwise take any income or deduction into account by reason of the transfer of the assets of Seller A's non-qualified nuclear decommissioning fund for Plant One to Buyer's non-qualified nuclear decommissioning fund for Plant One at the Closing.*

Requested Ruling #14: *In the taxable year of the closing, Buyer will not recognize any gain or loss or otherwise take any income or deduction into account by reason of the transfer of the assets of Seller A's non-qualified nuclear decommissioning fund for Plant Two to Buyer's non-qualified nuclear decommissioning fund for Plant Two at the Closing.*

In general, 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, Buyer cannot acquire an interest in the Plants without assuming the decommissioning liabilities, which are inextricably associated with the ownership and operation of the Plants. There is no indication that the transaction is other than a bona fide purchase of the business and its associated assets and liabilities. The exception to the general rule set forth in Rev. Rul. 71-450, 1971-2 C.B. 78, does not apply. In Rev. Rul. 71-450, unlike the present situation, the purchaser agreed to assume the prepaid subscription liability in return for a separate cash payment, and the liability was not reflected in the sales price of the business.

Accordingly, Buyer will not realize income from its acquisition of the Plants or of the interests in the assets in the non-qualified fund, except to the extent that, under the rules of section 1060, the amount of cash and other Class I assets received by Buyer (not including the assets in the qualified fund) exceeds the amount of consideration provided by Buyer and taken into account in the year of the acquisition.

Further, to the extent that Buyer is entitled to take into account other consideration paid, Buyer will make appropriate adjustments to reflect any income previously recognized by virtue of having acquired Class I assets in excess of the consideration taken into account in the year of the acquisition. See sections 1.1060-1T(c)(2); 1.338-6T(b)(1) and -7T(b).

Requested Ruling #7: *For purposes of determining Buyer's tax basis in any specific asset included in the Plant One assets (excluding the qualified nuclear decommissioning fund for Plant One) immediately after the closing, Buyer's total basis will be allocated among the Plant One assets (excluding the qualified nuclear decommissioning fund for Plant One) pursuant to the residual method required by section 1060 and described in sections 1.338-6 and 1.338-7.*

Requested Ruling #15: *For purposes of determining Buyer's tax basis in any specific asset included in the Plant Two assets (excluding the qualified nuclear decommissioning fund for Plant Two) immediately after the closing, Buyer's total basis will be allocated among the Plant Two assets (excluding the qualified nuclear decommissioning fund for Plant Two) pursuant to the residual method required by section 1060 and described in sections 1.338-6 and 1.338-7.*

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 1.1060-1(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 1.338-6 and 1.338-7 in order to determine, respectively, the amount realized from, and the basis in, each of the transferred assets.

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

Section 1.1060-1(c)(1) defines a seller's consideration as the amount in the aggregate, realized from selling the assets in the applicable asset acquisition under section 1001(b). Section 1060 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 1.1060-1(c)(1) defines a purchaser's consideration as the amount in the aggregate, of its cost of purchasing the assets in the applicable asset acquisition that is properly taken into account in basis. Section 1060 provides no independent basis for determining a taxpayer's cost of acquired assets; cost is determined solely under generally applicable 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 association, and other depository institutions), Class II (generally consisting of actively traded personal property such as 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). See sections 1060-1(c)(2), 1.338-6(b)(1), and 1.338-6(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. See sections 1060-1(a), 1.1060-1(c)(2), and 1.338-7.

Each of the Plants, together with its related equipment, operating assets and non-qualified fund assets, constitute a trade or business in its Seller's hands and the gain or loss recognized by each Seller with respect to those assets will be determined wholly by reference to each Seller's amount realized. Thus, Seller A's transfer of Plant One, its equipment, operating assets and non-qualified fund assets to Buyer in exchange for cash, a note 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 and the regulations thereunder. Likewise, the Sellers' transfer of their H percent undivided interests in Plant Two, together with its equipment, operating assets and non-qualified fund assets to Buyer in exchange for cash, a note 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, the Federal tax treatment of each Plant's acquisition is determined under section 1060 and the regulations thereunder.

The following example illustrates the operation of section 1060 for a seller: On Date 1, 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 section1231

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).

Therefore, we conclude that, on the sale of its interest in Plant One, Seller A's gain or loss on each of the purchased assets (excluding the assets of Seller A's qualified funds) will be the difference between Seller A's basis in the asset and the amount realized with respect to that asset, taking into account the allocation of consideration pursuant to section 1060 and the regulations thereunder.

Similarly, on the sale of each Seller's interest in Plant Two, each Seller's gain or loss on each of the purchased assets (excluding the assets of the each Seller's qualified funds) will be the difference between its proportionate basis in the asset and the proportionate amount realized by such Seller 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 Plants, equipment, operating assets and the assets of the non-qualified funds, Buyer will not recognize income except to the extent the Class I assets (as defined in section 1.338-6(b)(1)) it receives exceed its total cost determined under section 1012 (which will be the sum of its cash consideration, if any, and the fair market value of any other consideration Buyer provides to Seller(s), that is taken into account, under applicable tax principles, on the date of the applicable asset acquisition). If Buyer is thus required to take an amount into account as income and is subsequently permitted under general principles of tax law to take additional consideration into account (e.g., when Buyer satisfies the economic performance requirement with respect to the decommissioning liability assumed), Buyer will be entitled to deduct (and will not be required to capitalize) such amount. Arrowsmith v. Commissioner, 344 U.S. 6 (1952).

Therefore, we conclude that, in the taxable year of closing, Buyer will not recognize any gain or otherwise currently take any income into account by reason of the transfer of Seller A's Plant One assets to Buyer, provided the Class I assets Buyer receives do not exceed its total cost for Plant One.

Similarly, in the taxable year of closing, Buyer will not recognize any gain or otherwise currently take any income into account by reason of the transfer of any Seller's Plant Two assets to Buyer, provided the Class I assets Buyer receives do not exceed its total cost for Plant Two.

Because the transfer of each Plant is an applicable asset acquisition on the acquisition date, Buyer's basis in the assets acquired must be determined by allocating its costs (i.e., the consideration provided by Buyer on the acquisition date, which includes cash, but not the assumption of the decommissioning liability) among the acquired assets in accordance with the provisions of section 1060 and the regulations thereunder.

The following example illustrates the operation of section 1060 for a purchaser: On Date 1, an applicable 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 asserts 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 Date 1, 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).

Accordingly, with respect to each Plant, Buyer will first reduce the consideration paid by the amount of the Class I assets it receives in the transaction (including any Class I assets held in the non-qualified fund); to the extent the Class I assets received exceed the consideration Buyer provides, Buyer will recognize income. To the extent Buyer's consideration paid 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. Any excess remaining after allocation to Class II assets will be allocated to Class III, IV, V, VI, and VII assets in accordance with sections 1.1060-1(c)(2) and 1.338-6. 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 fund pays or incurs decommissioning expenses), such amounts will be taken into account as increases to Buyer's consideration paid and allocated in the same manner and subject to the same conditions as though they were paid or incurred on the acquisition date. See sections 1.1060-1(a)(1), 1.1060-1(c)(2), 1.338-6, and 1.338-7.

Therefore, we conclude that Buyer's total consideration will be allocated among the purchased assets of Plant One (excluding the qualified funds) for purposes of determining Buyer's tax basis in any specific asset included in the purchased assets (determined immediately after the closing and excluding the qualified funds) pursuant to the residual method as required by section 1060 and the regulations thereunder.

Further, Buyer's total consideration will be allocated among the purchased assets of Plant Two (excluding the qualified funds) for purposes of determining Buyer's tax basis in any specific asset included in the purchased assets (determined immediately after the closing and excluding the qualified funds) pursuant to the residual method as required by section 1060 and the regulations thereunder.

Requested Ruling #8: *The post-closing non-qualified nuclear decommissioning fund established for Plant One under Buyer's post-closing decommissioning trust to hold the assets from Seller A's non-qualified nuclear decommissioning fund for Plant One shall be considered a grantor trust under section 671, and Buyer will be treated as the grantor of the trust.*

Requested Ruling #16: *The post-closing non-qualified nuclear decommissioning fund established for Plant Two under Buyer's post-closing decommissioning trust to hold the assets from Seller A's non-qualified nuclear decommissioning fund for Plant Two shall be considered a grantor trust under section 671, and Buyer will be treated as the grantor of the trust.*

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

Section 1.671-2(e)(1) provides that for purposes of part I of subchapter J, chapter 1 of the Code, a grantor includes any person to the extent such person either creates a trust, or directly or indirectly makes a gratuitous transfer (within the meaning of 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.

Because Buyer is treated as purchasing the assets of Seller A's non-qualified nuclear decommissioning funds for federal income tax purposes, Buyer is treated as contributing those assets as grantor to Buyer's non-qualified nuclear decommissioning funds. Under the terms of the Nuclear Decommissioning Master Trust Agreement, all income, as well as principal of Buyer's non-qualified nuclear decommissioning funds, is held to satisfy Buyer's legal obligation to decommission the Plants and, upon completion of the decommissioning, any remaining assets will be distributed to Buyer or as directed by Buyer. Accordingly, Buyer is treated as the owner of each of Buyer's non-qualified nuclear decommissioning funds under section 677 and section 1.677(a)-1(d). Buyer shall include in computing its taxable income and credits all items of income, deduction, and credits against tax of Buyer's non-qualified nuclear decommissioning funds to the extent that such items would be taken into account in computing taxable income or credits against the tax of Buyer.

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

Pursuant to the power of attorney on file with this office copies of this letter are being sent to taxpayer's authorized representatives. We are also sending a copy of this letter ruling to the Industry Director, Natural Resources and Construction (LM:NRC).

Sincerely,

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