Office of Chief Counsel
Internal Revenue Service
Memorandum

Number: **201102050**
Release Date: 1/14/2011

CC:ITA:B05: RFBoone
POSTS-114457-10

Third Party Communication: None
Date of Communication: Not Applicable

UILC: 172.03-00

date: October 04, 2010

to:
Associate Area Counsel

from: Associate Chief Counsel
(Income Tax & Accounting)

---

subject: Payments to Comply with the Nuclear Waste Policy Act of 1982

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

LEGEND

Consolidated Group = .

Taxpayer =

Year 1 =

Year 3 =

A# =

ISSUES

May Taxpayer's deductions for payments of periodic fee liabilities under the Nuclear Waste Policy Act of 1982 generate a specified liability loss under section 172(f)?

CONCLUSIONS

Taxpayer's deductions for payments of periodic fee liabilities under the Nuclear Waste Policy Act of 1982 do not generate a specified liability loss under section 172(f).

FACTS

Taxpayer is a member of Consolidated Group that files a consolidated federal income tax return. Throughout its Year 1 through Year 3 taxable years, Taxpayer operated A# nuclear power plants (the plants). During the taxable years at issue Taxpayer made payments to the Department of Energy ("DOE") pursuant to a contract provided for by the Nuclear Waste Policy Act of 1982. The payments are intended to compensate the DOE for costs incurred in disposing of spent nuclear fuel that Taxpayer used to produce electricity. Taxpayer asserts that such payments generate deductions that satisfy liabilities imposed under federal law requiring the decommissioning of a nuclear power plant (or any unit thereof) within the meaning of section 172(f). The examining agent contends that the liabilities do not qualify as nuclear decommissioning liabilities for section 172(f) purposes, and therefore cannot generate a net operating loss (NOL) that qualifies as a specified liability loss.

LAW AND ANALYSIS

Section 172(b)(1)(C) provides that the portion of any NOL that qualifies as a specified liability loss shall be carried back to each of the 10 taxable years preceding the taxable year of the loss. For NOLs arising in taxable years ending on or after October 22, 1998, section 172(f) defines a specified liability loss as the sum of certain deductions to the extent taken into account in computing the net operating loss for the taxable year. In addition to deductions associated with product liability, these deductions include any amount allowable as a deduction under chapter 1 of the Internal Revenue Code (the Code) (other than under section 468(a)(1) or 468A(a)) which is in satisfaction of a liability under a federal or state law requiring--

(I) the reclamation of land,
(II) the decommissioning of a nuclear power plant (or any unit thereof),
(III) the dismantlement of a drilling platform,
(IV) the remediation of environmental contamination, or
(V) a payment under any workers compensation act (within the meaning of section 461(h)(2)(C)(i)).

For this purpose a liability shall be taken into account only if--

(I) the act (or failure to act) giving rise to such liability occurs at least 3 years before the beginning of the taxable year [the 3-year act or failure to act requirement], and
(II) the taxpayer used an accrual method of accounting throughout the period or periods during which such act (or failure to act) occurred. The amount of the specified

liability loss for any taxable year cannot exceed the amount of the NOL for the taxable year.

Section 172(f)(3) provides that, except as provided in regulations prescribed by the Secretary, the portion of a specified liability loss attributable to amounts incurred in the decommissioning of a nuclear powerplant (or any unit thereof) may be carried back to each of the taxable years during the period--

(A) beginning with the taxable year in which such plant (or unit thereof) was placed in service, and
(B) ending with the taxable year preceding the loss year.

Section 468A(a) allows owners/operators of nuclear power plants to currently deduct the future costs of decommissioning a nuclear power plant by making contributions to a fund prior to when economic performance occurs. In addition to any deduction under section 468A(a) for contributions to a fund, section 468A(c)(2) recognizes that an owner/operator may deduct otherwise deductible nuclear decommissioning costs, (such as under section 162), for which economic performance (within the meaning of section 461(h)) occurs during a taxable year.

Treas. Reg. § 1.468A-1T(b)(6) states, in part, that "nuclear decommissioning costs" means "all otherwise deductible expenses to be incurred in connection with the entombment, decontamination, dismantlement, removal and disposal of the structures, systems and components of a nuclear power plant that has permanently ceased the production of electric energy. Such term includes all otherwise deductible expenses to be incurred in connection with the preparation for decommissioning, such as engineering and other planning expenses, and all otherwise deductible expenses to be incurred with respect to the plant after the actual decommissioning occurs, such as physical security and radiation monitoring expenses." Treas. Reg. § 1.468A-1T(b)(6) specifically excludes "deductible expenses to be incurred in connection with the disposal of spent nuclear fuel under the Nuclear Waste Policy Act of 1982" from the definition of nuclear decommissioning costs.

Because Treas. Reg. § 1.468A-1T(b)(6) specifically excludes deductions for the payments at issue from the definition of nuclear decommissioning costs for purposes of section 468A, the examining agent asserts that such expenses also do not qualify as nuclear decommissioning expenses for purposes of section 172(f). We do not find it necessary to determine whether the payments at issue qualify as nuclear decommissioning liabilities within the meaning of section 172(f). Even if the liabilities at issue do constitute nuclear decommissioning liabilities within the meaning of that section, an issue we do not address here, the act giving rise to those liabilities does not satisfy the 3-year act or failure to act requirement.

In order for a liability to qualify as a specified liability loss, the act (or failure to act) giving rise to such liability must occur at least 3 years before the beginning of the

taxable year. It is the position of the Service that the final act or failure to act in the chain of causation leading to the creation of a given liability from which it can be determined that the taxpayer has a legal obligation qualifies as "the act or failure to act" for section 172(f) purposes[1]. Thus, it is necessary for us to determine which act or failure to act established Taxpayer's legal liability to pay periodic fees for the disposal of spent nuclear fuel under the Nuclear Waste Policy Act of 1982. As part of our determination, we examine the Nuclear Waste Policy Act itself.

NUCLEAR WASTE POLICY ACT OF 1982

In the late 1970's and early 1980's it became apparent that a solution was needed to deal with the problem of permanently disposing of increasing amounts of various types of nuclear waste. In an attempt to deal with some of these problems, Congress enacted the Nuclear Waste Policy Act of 1982 ("the 1982 Act"). Under section 111(a)(4) of that act, Congress made a general finding that while the federal government has the responsibility to provide for the permanent disposal of high-level radioactive waste ("HLW") and spent nuclear fuel ("SNF") as may be disposed of in order to protect the public health and safety and environment, the costs of such disposal should be the responsibility of the generators and owners of such waste and spent fuel.

In section 302 of the 1982 Act, Congress authorized the Department of Energy ("DOE") to enter into contracts with any person that generates or holds title to HLW or SNF, of domestic origin, under which the DOE would accept title to, responsibility for subsequent transportation of, and responsibility for disposal of such HLW or SNF. For these services section 302 of the 1982 Act specifies that the contracts require contracting generators or title holders of SNF or HLW (subsequently referred to as the contracting party), to pay fees to the DOE sufficient to offset its costs in performing these services. Such fees are deposited into a Nuclear Waste Fund until needed to effectuate the purposes of the 1982 Act.

For electricity generated by a civilian nuclear power reactor and sold on or after the date 90 days after the date of enactment of the 1982 Act, section 302(a)(2) of the 1982 Act initially required the fee to be equal to 1.0 mil per kilowatt-hour (1 tenth of a cent per kilowatt-hour) (the periodic fee).

Section 302(a)(3) of the 1982 Act provides for a one-time fee for SNF, or solidified HLW derived from SNF, used to generate electricity in a civilian nuclear power reactor during

---

[1] Notice 2005-20, 2005-1 C.B. 635 Q&A 4 provides as follows:

Q-4. Which act in the chain of causation leading to the creation of a liability constitutes "the act or failure to act" giving rise to that liability within the meaning of former § 172(f)(1)(B)(i)?

A-4. The act or failure to act resulting in the establishment of a legal liability constitutes the act or failure to act within the meaning of former § 172(f)(1)(B)(i). For example, in the case of a trespass, the act of trespassing constitutes the relevant act for purposes of former § 172(f)(1)(B)(i), not the judgment of a court.

periods prior to the application to the reactor of the periodic fee. The statute directs the DOE to charge this fee per kilogram of heavy metal in SNF or HLW. The statute directs that the one-time fee be in an amount equivalent to an average charge of 1.0 mil per kilowatt-hour for electricity generated by the SNF or solidified HLW derived therefrom.

Section 302(a)(4) of the 1982 Act directs the DOE to annually review the fees set forth above to evaluate whether collection of such fees will provide sufficient revenues in order for the federal government to recover its costs associated with disposing of the nuclear waste subject to the contracts. If the DOE determines that fees will be insufficient to recover such costs the statute directs the DOE to propose a fee adjustment to insure full cost recovery. This proposed adjustment goes into effect after a prescribed period absent congressional disapproval. No adjustment to the periodic fee has been made since it was originally enacted.

Section 302(a)(5)(A) of the 1982 Act requires that contracts entered into between the contracting party and the DOE provide that following commencement of operation of a repository, the DOE shall take title to the HLW or SNF involved as expeditiously as practicable upon the request of the contracting party. Section 302(a)(5)(B) of the 1982 Act requires that such contracts provide that in return for the payment of the fees previously discussed, the DOE, beginning not later than January 31, 1998, will dispose of the HLW or SNF as specified under relevant provisions of federal law.

In accordance with its regulatory authority under the 1982 Act, the DOE promulgated the "Standard Contract for Disposal of Spent Nuclear Fuel And/Or High Level Radioactive Waste" ("the Standard Contract"). 10 CFR 961.11. Consistent with the statute, the Standard Contract sets the periodic fee at 1.0 mil per kilowatt-hour for electricity generated and sold. The Standard Contract requires this fee to be paid quarterly. The fee must be received by the DOE not later than the close of the last business day of the month following the end of each assigned 3-month period. This is the 3-month period assigned to a contracting party for purposes of reporting kilowatt hours generated by the contracting party's nuclear power reactor for the purpose of establishing fees due and payable to the DOE. For example, for a 3-month power generation period starting April 1 and ending on June 30, the periodic fee must be paid by July 31 of the same year.

In accordance with the 1982 Act, the Standard Contract provides for a possible adjustment to the periodic fee. However, the Standard Contract specifies that any adjustment to the periodic fee shall be prospective. The Standard Contract also provides that upon payment of all applicable fees, interest and penalties on unpaid or underpaid amounts, the contracting party shall have no further financial obligation to the DOE for the disposal of the accepted SNF and/or HLW.

Calculation of the one-time fee under the Standard Contract is broken into two components: (1) a fee for SNF, or solidified HLW derived from SNF where the fuel was used to generate electricity in a civilian nuclear power plant prior to April 7, 1983, and

(2) a fee for fuel in core as of April 7, 1983, based on the portion of such fuel burned through April 6, 1983. Component (1) is imposed on a dollars per kilogram basis, with charges per kilogram varying based on nuclear spent fuel burnup range. Calculation of component (2) of the one-time fee is more complicated.

A contracting party may choose among three options in paying the one-time fee. Under the first option, the contracting party may prorate the fee evenly over forty quarters such charge to be based on the fee plus interest on the outstanding fee balance. The contracting party may fully or partially prepay its obligation under this option and if so, appropriate adjustments are made to the remaining obligation taking such prepayments into account. Under the second option, the contracting party may pay the fee in a single payment prior to June 30, 1985, or prior to two years after contract execution, whichever comes later. If the contracting party complies with this option, no interest is due from April 7, 1983, through the date of full payment.

Under the third option, the contracting party may satisfy its obligation by making a single payment anytime prior to the first delivery of material to be disposed of under the contract, as reflected in the DOE approved delivery schedule. Under this option the payment must consist of the fee plus interest on the outstanding fee balance computed from April 7, 1983, to the date of payment.

The submission did not identify the character of the fees at issue. However, any NOLs that might be present in this case will occur during a period from the beginning of Year 1 and ending at the close of Year 3. With the possible exception of one-time fees paid under the third option, an exception which is unlikely to apply to the taxable years at issue, it is logical for us to assume that the only fees at issue in this case are the periodic fees. Therefore, in the remainder of this memorandum we will assume that this case only involves the proper tax treatment of periodic fees. If the facts prove otherwise, we will be glad to issue a supplemental opinion regarding the proper tax treatment of any NOLs that may be generated by deductions for such fees.

Because the fees in question are paid to the DOE for the transportation and disposition of the contracting party's SNF and HLW, the fees may be characterized as payments for services. Except as otherwise provided in Treasury regulations, section 461(h)(2)(A)(i) provides that if the liability of the taxpayer arises out of the providing of services to the taxpayer by another person, economic performance occurs as such person provides such services. Payment for services prior to when the services are performed does not constitute economic performance. *See* Treas. Reg. § 1.461-4(d)(7) Example 1(ii).

To date no permanent repository for SNF and HLW has been established. As a result, the DOE has not yet begun accepting SNF and HLW from contracting parties for final disposition. In light of the January 31, 1998, date specified in the statute, some contracting parties have sought damages from the DOE for additional expenses incurred for interim storage of SNF and HLW because of the DOE's failure to take possession of SNF and HLW.

In the absence of a special rule, there would be significant delays between the payment of most of the fees required to be paid pursuant to the Standard Contract and the performance of the services required of the DOE under the terms of that contract. Consequently, in the absence of a special rule, a contracting party would be required to bear most of the economic costs of the final disposition of SNF and HLW far in advance of when the contracting party would be allowed to deduct those costs for federal income tax purposes. Congress recognized this potential hardship and took steps to prevent it when it enacted the economic performance requirement.

The conference report to the 1984 Act provides:

> *Payments for nuclear waste disposal.*—The conferees anticipate that the Treasury Department will issue regulations providing that economic performance with respect to amounts paid under the Nuclear Waste Disposal Act of 1982 occurs as payments are made to the Federal Government.

H.R. Rep. No. 861, 98th Cong., 2d Sess. 875 (1984). Consistent with the conference report, Treas. Reg. § 1.461-4(h) provides:

> *Liabilities arising under the Nuclear Waste Policy Act of 1982*. Notwithstanding the principles of paragraph (d) of this section, economic performance with respect to the liability of an owner or generator of nuclear waste to make payments to the Department of Energy ("DOE") pursuant to a contract required by the Nuclear Waste Policy Act of 1982 (Pub. L. 97-425, 42 U.S.C. 10101-10226 (1982)) occurs as each payment under the contract is made to DOE and not when DOE satisfies its obligations under the contract. This rule applies to the continuing fee [the periodic fee] required by 42 U.S.C. 10222(a)(2) (1982), as well as the one-time fee required by 42 U.S.C. 10222 (a)(3) (1982). For rules relating to when economic performance occurs with respect to interest, see paragraph (e) of this section.

Consequently, satisfaction of the economic performance requirement requires no delay between the economic outlay required to satisfy the liabilities at issue and the deduction of those liabilities. To apply section 172(f), however, still requires determining which act gives rise to those liabilities.

It is our position that the liability to dispose of SNF and HLW, as funded through the periodic fee, arises only as nuclear fuel is used to generate power sold to customers.

Section 111(a) of the 1982 Act provides certain findings of Congress. These include section 111(a)(4) of that act which provides:

> [W]hile the Federal Government has the responsibility to provide for the permanent disposal of high-level radioactive waste and such spent nuclear fuel

> as may be disposed of in order to protect the public health and safety and the environment, the costs of such disposal should be the responsibility of the generators and owners of such waste and spent fuel.

Section 111(b) of the 1982 Act sets forth the purposes of the act. Section 111(b)(4) includes the following purpose:

> [T]o establish a Nuclear Waste Fund composed of payments made by the generators and owners of such waste and spent fuel, that will ensure that the costs of carrying out activities relating to the disposal of such waste and spent fuel will be borne by the persons responsible for generating such waste and spent fuel.

The above quoted provisions, although expressing a congressional expectation that all of the costs of disposing of SNF and HLW will be borne by the generators and owners of such waste, does not expressly impose such liability on those parties. Actual liability is imposed on generators and owners of the waste pursuant to the Standard Contract as authorized by section 302 of the 1982 Act. These payments are used to fund the Nuclear Waste Fund. Under the terms of the Standard Contract the periodic fee is imposed at a rate of 1.0 mil per kilowatt hour for electricity generated and sold. The DOE, in the absence of congressional disapproval, has the authority to increase the periodic fee if the DOE determines that the amounts collected will be inadequate to cover the costs of disposing of all of the SNF and HLW. However, the Standard Contract provides that any adjustment to the periodic fee shall be prospective. Moreover, the Standard Contract provides that once a contracting party has paid all amounts due under the contract, the contracting party has no more liability to the DOE for disposing of the SNF and/or HLW. At least one court has likened fees paid under the 1982 Act to a tax:

> This is not, in other words, the typical government contracts situation. The fee paid by utilities into the Fund resembles an assessment or tax more than it does a freely negotiated price. The size of the fee, moreover, is fixed by statute at the equivalent of 1 mil per kilowatt-hour of electricity generated.

Commonwealth Edison Co. v. United States, 877 F.2d 1042, 1045 (D.C. Cir. 1989). The Standard Contract does not specifically require that a contracting party pay all of the costs of disposing of its SNF and HLW. Consequently, a contracting party's liability for the disposal of SNF and HLW, at least to the extent that liability is funded through the periodic fee, arises only as the contracting party generates and sells power produced by nuclear fuel.

With respect to the periodic fee, liability arises only when nuclear fuel is used to generate power sold to customers. This fee must be paid within a month after the quarter for which it is imposed. Congress recognized that deferring the deduction of such fees from the time paid until the time of actual disposal of the SNF and HLW would

result in a hardship to contracting parties. To alleviate this hardship, in the legislative history to the 1984 Act, Congress indicated that regulations interpreting the economic performance requirement should treat the economic performance requirement as satisfied when such amounts were paid, and regulations taking such a position were issued. Thus, for timely paid periodic fees the act giving rise to the liability for such fees and the deduction of the fees upon payment will not satisfy the 3-year act or failure to act requirement of section 172(f)(1)(B). Therefore, deductions for such fees cannot generate a specified liability loss.

Federal or State Law

As previously noted, section 172(f)(1)(B)(i) only applies to amounts allowable as deductions which are allowable in satisfaction of a liability under a federal or state law requiring one of the five specified activities. Because liability for the periodic fees is imposed pursuant to the Standard Contract, there is an issue regarding whether such liabilities should be treated as imposed under federal law, or whether, under the reasoning of *Sealy Corp. v. Commissioner*, 107 T. C. 177 (1996), *aff'd*, 171 F.3d 655 (9th Cir. 1999) and *Major Paint Co. v. United States*, 334 F.3d 1042 (Fed. Cir. 2003), *aff'g*, *Standard Brands Liquidating Creditor Trust v. United States* 53 Fed. Cl. 25 (2002) such liabilities should be treated as not imposed by federal law for purposes of section 172(f). Because we believe that it is quite clear that the liabilities for the periodic fees do not satisfy the 3-year act or failure to act requirement, we do not feel it is necessary to address that issue in this memorandum. Accordingly, we express no opinion regarding whether, for section 172(f) purposes, federal law imposes the periodic fee liability.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call (202) 622-4960 if you have any further questions.

George Blaine
Associate Chief Counsel
(Income Tax & Accounting)

By: _____
William A. Jackson
Chief, Branch 5
(Income Tax & Accounting)