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August 05, 2014

Dear

This letter responds to your request for a ruling request on behalf of Taxpayer dated January 23, 2014. Taxpayer represents that the facts are as specified below.

LEGEND

Taxpayer =

Date 1 =

Year 1 =

Year 2 =

FACTS

Taxpayer is a publicly traded diversified energy company that conducts its business through four wholly-owned subsidiaries that are part of its consolidated group. The group files a consolidated federal income tax return. Through its subsidiaries, Taxpayer indirectly owns interests in several nuclear generating facilities (facilities) and operates or oversees the operation of the facilities.

The facilities are subject to regulation by the U.S. Nuclear Regulatory Commission (NRC). The NRC has the authority to determine whether a nuclear generation facility may operate and requires testing, evaluation, and modification of all aspects of nuclear facilities, including decontamination and decommissioning.

Taxpayer maintains independent testing and monitoring, preventative and corrective maintenance, and equipment and system replacement programs designed to satisfy NRC requirements. These programs generally coincide with plant outages including planned and unplanned shutdowns during which Taxpayer refuels the nuclear reactors, tests, monitor, and mitigates radiation levels, removes and replaces systems and components, and addresses emergency conditions that arise between disconnection and reconnection of the facilities to the electrical grid.

Taxpayer conducts refueling outages of the facilities periodically during which one-fourth to one-third of the fuel rods in a fuel assembly are typically replaced. After removal Taxpayer stores spent nuclear fuel at its own facilities using temporary “wet” and “dry” storage facilities that are expected to satisfy the storage needs for each facility through the end of each facility’s operating license term.

Taxpayer routinely removes and replaces systems and components of the facilities during outages for a variety of reasons, including obsolescence, damage/unreliability, and contamination. During this process retired systems and components are removed and permanently disposed of using different methods depending on the level of contamination.

Taxpayer maintains a staff of radiation technicians to monitor and mitigate radiation levels at the facilities. During planned outages Taxpayer augments its staff with outside third-party technicians. These technicians are responsible for the “drain down” process of reducing radiation levels of the facility, which includes testing, surveying, water filter maintenance, shielding processes, and plant scrubbing.

For the taxable year ending on Date 1, Taxpayer filed an application for change in accounting method on behalf of certain of its subsidiaries with respect to certain expenditures. Prior to obtaining the requested method change, the subsidiaries followed financial statement standards in determining which expenditures constituted deductible repairs and which expenditures had to be capitalized. Beginning with Taxpayer’s Year 1 taxable year, the subsidiaries began deducting all repair expenditures which keep plant systems and components in ordinarily efficient operating condition without materially adding to the value of the equipment or appreciably prolonging its life. A portion of the repair expenditures addressed by the accounting method change are costs related to the systems and components removal and replacement activities discussed above. In connection with the accounting method change, the subsidiaries recognized negative § 481(a) adjustments for Year 1 equal to the amount of deductions omitted under the prior method of accounting.

ISSUES

1. Whether deductions allowable under Chapter 1 of the Code[1] for the following costs incurred by Taxpayer in connection with maintenance outages are

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[1] References to the Code refer to the Internal Revenue Code of 1986.

deductions in satisfaction of a liability under a federal or state law requiring the decommissioning of a nuclear power plant (or any unit thereof) within the meaning of § 172(f) that may give rise to a specified liability loss (hereinafter referred to as nuclear decommissioning costs):

a. Costs to remove, store, and monitor spent fuel assemblies that are permanently retired from service; and

b. Costs to remove, store, transport, dispose, and monitor facility systems and components that are permanently retired from service.

2. Whether the portion of a § 481(a) adjustment for a change in method of accounting, which is from capitalizing to expensing the costs of removing systems and components from service that are to be replaced by other systems and components, qualifies as a nuclear decommissioning cost.

LAW AND ANALYSIS

Section 172(a) allows a deduction for the taxable year equal to the aggregate of (1) the net operating loss (NOL) carryovers to such year, plus (2) the NOL carrybacks to such year. With certain modifications, § 172(c) defines a NOL as the excess of the deductions allowed by Chapter 1 of the Code over the gross income. Section 172(b)(1)(A) generally provides that a NOL for any taxable year is carried back to each of the 2 taxable years preceding the taxable year of the loss and carried forward to each of the 20 taxable years following the year of the loss. However, § 172(b)(1)(C) provides a 10-year carryback period for the portion of any NOL that qualifies as a specified liability loss. Moreover, § 172(f)(3) provides a special carryback period for a specified liability loss attributable to amounts incurred in the decommissioning of a nuclear power plant (or any unit thereof).

Section 172(f)(1)(B)(i) defines a specified liability loss, in part, as any amount allowable as a deduction under Chapter 1 of the Code (other than § 468(a)(1) or § 468A(a)) which is in satisfaction of a liability under a federal or state law requiring the decommissioning of a nuclear power plant (or any unit thereof) that is taken into account in computing the NOL for the taxable year. Section 172(f)(1)(B)(ii) provides that a deduction for a liability may only generate a specified liability loss 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, 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 phrase "amounts incurred in the decommissioning of a nuclear power plant" should be interpreted to have the same meaning as the term "nuclear decommissioning costs" under § 468A because the relevant language contained in both § 172(f)(3) and § 468A was added to the Code by the same section of the Tax Reform Act of 1984 (the 1984 Act), and both sections were intended to provide relief to the nuclear power plant industry. *See generally* H. Rep. No. 861, 98th Cong., 2d Sess. 877 (1984). Accordingly, Taxpayer's expenses in decommissioning the facilities that are deductible under Chapter 1 of the Code are "amounts incurred in the decommissioning of a nuclear power plant" under § 172(f)(3) to the extent they are amounts described in § 1.468A-1(b)(6) of the Income Tax Regulations.

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 Nuclear Decommissioning Reserve Fund (Fund) prior to when economic performance occurs.

Section 468A(c)(1) generally requires the owner/operator to include in gross income amounts that are distributed from a Fund. In addition to any deduction under § 468A(a) for contributions to a Fund, § 468A(c)(2) recognizes that an owner/operator may deduct otherwise deductible nuclear decommissioning costs (such as under § 162), for which economic performance (within the meaning of § 461(h)) occurs during a taxable year.

Section 1.468A-1(b)(6) states 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, whether that nuclear power plant will continue to produce electric energy or has permanently ceased to produce 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. Such term also includes costs incurred in connection with the construction, operation, and ultimate decommissioning of a facility used solely to store, pending acceptance by the government for permanent storage or disposal, spent nuclear fuel generated by the nuclear power plant or plants located on the same site as the storage facility. Such term does not include otherwise deductible expenses to be incurred in connection with the disposal of spent nuclear fuel under the Nuclear Waste Policy Act of 1982 (Pub.L. 97–425). An expense is otherwise deductible for purposes of this paragraph (b)(6) if it would be deductible under chapter 1 of the Internal Revenue Code without regard to section 280B." The term "nuclear decommissioning costs" does not include replacement costs (including installation and repair costs and the costs of replacement systems and components) incurred by a taxpayer to extend the useful life of the facilities. In addition, costs incurred by a taxpayer with respect to ongoing monitoring, testing, and mitigation of radiation levels at nuclear facilities do not qualify as decommissioning costs as defined under § 1.468A-1(b)(6) for purposes of § 468A.

Issue 1a: Refueling

Taxpayer represents that deductible costs incurred with respect to spent nuclear fuel include: (1) spent fuel removal costs, (2) handling and monitoring costs, (3) on-site storage costs, (4) operating and maintenance costs for on-site storage, (5) security costs for on-site storage, and (6) the cost of dry storage canisters filled with spent fuel. Costs to remove, store, and monitor spent fuel assemblies include the cost of augmenting Taxpayer's normal staff of technicians during the refueling process.

Section 1.468A-1(b)(6) states that the term "decommissioning costs" includes costs incurred in connection with the construction, operation, and ultimate decommissioning of a facility used solely to store, pending acceptance by the government for permanent storage or disposal, spent nuclear fuel generated by the nuclear power plant or plants located on the same site as the storage facility. Accordingly, the deductible costs incurred by Taxpayer with respect to spent nuclear fuel will qualify as "decommissioning costs" as defined under § 1.468A-1(b)(6) for purposes of § 468A.

Issue 1b: Systems and Components Removal

Taxpayer represents that deductible costs with respect to removed systems and components include: (1) system and component removal costs, (2) on-site storage costs, (3) monitoring and handling costs, (4) operating and maintenance costs for on-site storage, (5) security costs for on-site storage, and (6) transportation and disposal costs for off-site storage.

Section 1.468A-1(b)(6) states 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, whether that nuclear power plant will continue to produce electric energy or has permanently ceased to produce electric energy." Accordingly, with respect to costs described in items (1) through (6), the deductible costs incurred by Taxpayer with respect to spent nuclear fuel qualify as "decommissioning costs" as defined under § 1.468A-1(b)(6) for purposes of § 468A.

To qualify as nuclear decommissioning costs under § 172(f), the liability for such costs must also satisfy the requirements of § 172(f)(1)(B)(ii). That is, the act or failure to act giving rise to such liabilities must have occurred at least 3 years prior to the beginning of the taxable year when such liabilities are deductible. Also, Taxpayer must have used an accrual method of accounting throughout the period or periods during which such act (or failure to act) occurred. Taxpayer uses an accrual method of accounting for federal income tax purposes. With respect to the costs referred to in 1a and 1b, the act giving rise to the liabilities for such costs occurred when licenses to operate the plants were granted and the plants were placed in service.

Taxpayer has represented that costs at issue in this ruling are for nuclear power plants placed in Service during or before Year 2. Consequently, liabilities for such costs also satisfy the 3-year act or failure to act requirement of § 172(f)(1)(B)(ii). To the extent the costs referred to in 1a and 1b are deductible under Chapter 1 of the Code, such costs qualify as nuclear decommissioning costs within the meaning of § 172(f). The portion of any NOL generated by such costs will qualify as a specified liability loss within the meaning of § 172(f)(1).

Issue 2: Section 481(a) Adjustment

A portion of the negative § 481(a) adjustments discussed above is attributable to system and component removal costs that were capitalized under the subsidiaries' old method of accounting but would have been expensed under the subsidiaries' new method of accounting. If that portion of the § 481(a) adjustments is characterized as system and component removal costs, the adjustments will qualify as nuclear decommissioning costs for § 172(f) purposes.

Section 481(a) requires those adjustments necessary to prevent amounts from being duplicated or omitted to be taken into account when a taxpayer's taxable income is computed under a method of accounting different from the method used to compute taxable income for the preceding taxable year. When there is a change in method of accounting to which § 481(a) is applied, income for the taxable year preceding the year of change must be determined under the method of accounting that was then employed, and income for the year of change and the following taxable years must be determined under the new method of accounting as if the new method had always been used. See section 2.04 of Rev. Proc. 2002-18, 2002-1 C.B. 678 and section 2.05 of Rev. Proc. 2011-14, 2011-1 C.B. 330.

Section 1.481-1(d) provides that "any adjustments required under section 481(a) that are taken into account during a taxable year must be properly taken into account for purposes of computing gross income, adjusted gross income, or taxable income in determining the amount of any item of gain, loss, deduction, or credit that depends on gross income, adjusted gross income, or taxable income."

An adjustment under § 481(a) can include amounts attributable to tax years that are closed by the statute of limitations. *Suzy's Zoo v. Commissioner*, 114 T.C. 1, 13 (2000), *aff'd*, 273 F.3d 875, 884 (9th Cir. 2001); *Superior Coach of Florida, Inc. v. Commissioner*, 80 T.C. 895, 912 (1983), *Weiss v. Commissioner*, 395 F.2d 500 (10th Cir. 1968), *Spang Industries, Inc. v. United States*, 6 Cl. Ct. 38, 46 (1984), *rev'd on other grounds* 791 F.2d 906 (Fed. Cir. 1986).

Sections 481(c) and 1.481-4 provide that the adjustment required by § 481(a) may be taken into accounting in determining taxable income in the manner, and subject to the conditions, agreed to by the Service and a taxpayer. Section 1.446-1(e)(3)(i) authorizes the Service to prescribe administrative procedures setting forth the limitations, terms, and conditions deemed necessary to permit a taxpayer to obtain consent to change a method of accounting in accordance with § 446(e). Generally, the adjustment period for voluntary method of accounting changes is one taxable year (year of change) for a net negative § 481(a) adjustment and four taxable years (year of change and next three taxable years) for a net positive § 481(a) adjustment. *See* section 5.04 of Rev. Proc. 2011-14, and section 5.03 of Rev. Proc. 97-27.

The purpose of the § 481(a) adjustment is to prevent amounts from being duplicated or omitted in computing taxable income as a result of a change in method of accounting. In this particular instance, the change in method of accounting results in the omission of an amount of deductions, and thus a negative adjustment (reduction of taxable income) is mandated by § 481 to rectify such omission. Section 481 does not expressly address whether a § 481(a) adjustment retains or reflects the characteristics of the gross income or deductions that underlie the adjustment. However, if the § 481(a) adjustment does not retain or reflect the characteristics of its underlying item, other distortions caused by the change in method of accounting could occur in some circumstances. In this particular case, for example, some portion of the negative § 481(a) adjustment relates to removal costs that qualify as nuclear decommissioning costs under § 172(f). If that portion of the § 481(a) adjustment is not treated as qualifying for treatment as nuclear decommissioning costs, the amount of nuclear decommissioning costs incurred by Taxpayer over its lifetime will be permanently understated.

In the context of certain foreign corporations, the Service has stated that the § 481(a) adjustment does retain the character of the underlying item, for purposes of subpart F. Rev. Proc. 2011-14 provides that a negative § 481(a) adjustment necessary to prevent the omission of amounts of an expense item is allocated to the class of gross income that has the same source, separate limitation classification, character, and treatment for purposes of subpart F as the foreign corporation's income that would have been offset by the expense in the prior year or years. Furthermore, a negative § 481(a) adjustment necessary to prevent the duplication of amounts of an income item offsets gross income that has the same source, separate limitation classification, character, and treatment for purposes of subpart F as the foreign corporation's income had in the prior year or years. *See* section 5.07 of Rev. Proc. 2011-14.

Additionally, in *MMC Corp. v. Commissioner*, T.C. Memo 2007-354, the Tax Court held that a positive § 481 adjustment is treated as built-in gain under § 1374. In *MMC Corp.*, the taxpayer elected to convert from a C corporation to an S corporation after year two of the four year § 481 spread period. The Tax Court observed that “when we examine whether the section 481 adjustment is built-in gain [for purposes of § 1374], we consider the related item, not the section 481 adjustment itself." The court further noted that the taxpayer "mistakenly focused on the section 481 adjustment itself, rather than the related item that the section 481 adjustment is correcting."

Finally, allowing the portion of the § 481(a) adjustment allocable to repair expenditures qualifying as nuclear decommissioning costs to retain the character of nuclear decommissioning costs makes intuitive sense. The ultimate reason that this portion of the § 481(a) adjustment exists is that Taxpayer incurred certain expenses that qualified as deductions and as nuclear decommissioning costs. The only reason that these expenses were not taken into account as deductions and treated as nuclear decommissioning costs is due to the change in method of accounting. Although the express language of § 481 only addresses distortions in the amount of lifetime taxable income (here, an omission of deductions), it seems appropriate in this circumstance to interpret this section to prevent closely related distortions caused by accounting method changes (the understatement of deductions qualifying as nuclear decommissioning costs).

Consequently, the portion of the negative § 481(a) adjustments attributable to system and component removal costs that were capitalized under the subsidiaries' old method of accounting but would have been expensed under the subsidiaries' new method of accounting qualifies as nuclear decommissioning costs for § 172(f) purposes.

Carryback Period

The remaining issue concerns the carryback period for a specified liability loss attributable to nuclear decommissioning expenses. As a general rule, § 172(b)(1)(C) allows the unabsorbed portion of a specified liability loss to be carried back to each of the 10 taxable years preceding the taxable year of the loss, with the 10th preceding taxable year being the first year to which the loss is carried. However, § 172(f)(3) provides that, except as provided in regulations, the portion of a specified liability loss which is attributable to amounts incurred in the decommissioning of a nuclear power plant (or any unit thereof) may, for purposes of subsection (b)(1)(C), 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.

This special rule for NOLs generated by nuclear decommissioning costs and the economic performance requirements of § 461(h) for accrual method taxpayers were both originally enacted in the same section of the 1984 Act. In adding § 172(k) to the Code, the 1984 Act provided for an extended carryback period for such losses. However, former § 172(k)(4) did not allow carrybacks to taxable years beginning before January 1, 1984, unless the loss could be carried back to those years without the benefit of special rules for deferred statutory or tort liability losses.

In § 11811 of the Omnibus Budget Reconciliation Act of 1990 (the 1990 Act), Congress reorganized the provisions in § 172. Congress placed the 10-year carryback for product liability losses and what had previously been called deferred statutory or tort liability losses under the same subsection of § 172, namely § 172(f), labeling such losses specified liability losses. After striking certain sections of § 172, in § 11811(b)(2)(A) of the 1990 Act, Congress enacted a new § 172(f). Included in § 11811(b)(2)(B) of the 1990 Act is the following savings provision which continued the carryback limitation originally contained in the 1984 Act:

> The portion of any loss which is attributable to a deferred statutory or tort liability loss (as defined in section 172(k) of the Internal Revenue Code of 1986 as in effect on the day before the date of the enactment of this Act) may not be carried back to any taxable year beginning before January 1, 1984, by reason of the amendment made by subparagraph (A).

In § 3004 of the Tax and Trade Relief Extension Act of 1998 (the 1998 Act), Congress restricted the types of liabilities the deduction of which could generate a specified liability loss to five enumerated liabilities (in addition to product liability losses), including federal or state law liabilities to decommission a nuclear power plant (or any unit thereof). Prior to the 1998 Act, a specified liability loss could be based on any deduction arising out of a federal or state law provided the additional requirements of the statute were satisfied.

In contrast to the prior acts, in the 1998 Act Congress did not enact a savings provision prohibiting the carryback of specified liability losses to any taxable year beginning before January 1, 1984. This raises the question of whether the portion of any specified liability loss attributable to expenses to decommission nuclear power plants placed in service prior to January 1, 1984, may be carried back to the taxable year the plant was placed in service.

In the 1998 Act, Congress only amended the definition of a specified liability loss. Congress did not amend the Code sections that addressed the taxable years to which such losses could be carried back. Congress did not amend § 172(f)(3) which contains the special carryback rule for specified liability losses attributable to deductions for nuclear decommissioning costs. Consequently, the savings provision contained in the 1990 Act continues to apply to § 172(f)(3) after the purely definitional changes that Congress made in the 1998 Act.

Therefore, under the facts of this case, a specified liability loss attributable to nuclear decommissioning costs for a nuclear power plant placed in service in a taxable year beginning before January 1, 1984, may not be carried back to taxable years beginning before January 1, 1984.

CAVEATS

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

Sincerely,

Seoyeon Sharon Park
Assistant to the Branch Chief, Branch 5
(Income Tax & Accounting)