Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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Person to Contact:

Telephone Number:

Refer Reply To:
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Date:
May 10, 2001

Legend:

Taxpayer =

Parent 1 =
Parent 2 =

Plant 1 =
Plant 2 =
Plant 3 =
Plant 4 =
Plant 5 =
Plant 6 =

Commission A =
Commission B =

State =

Company 1 =
Company 2 =
Company 3 =
Company 4 =

Law =

a =

b =

c =

d =

e =

f =

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This letter responds to your request, dated June 19, 2000, that we rule on certain tax consequences under section 468A of the Internal Revenue Code of the transfer of the Plants to a wholly-owned limited liability company of the Taxpayer in a reorganization. As set forth below, you have requested rulings regarding the tax consequences to the Taxpayer and its qualified nuclear decommissioning funds.

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

The Taxpayer is a public utility engaged in the generation, purchase, transmission, distribution, and sale of electricity in the State. The Taxpayer is a subsidiary of Parent 1. The Taxpayer is under the regulatory jurisdiction of Commission A and Commission B.

The Taxpayer owns a percent of Plants 1, 3, 4, 5, and 6; and b percent of Plant 2. All the Plants are currently in operation except Plant 6 and Unit 1 of Plant 3 which have been retired. The Taxpayer formed a qualified nuclear decommissioning fund for each Plant and has, pursuant to approved schedules of ruling amounts, made contributions to the qualified nuclear decommissioning funds.

On c, the Law became effective in the State. The Law provides a phased-in transition to competition for the generation of electricity. The Law provides a mechanism for electric utilities to recover certain stranded costs and other deregulation transition costs through a non-bypassable transition charge. Customers who choose alternate generation suppliers will be required to pay the transition charge through d.

On e, Commission A approved inclusion of the Taxpayer's recovery of decommissioning costs to a f year period. The Commission A order requires collection of the decommissioning costs by the Taxpayer through a collection agreement by which the decommissioning costs will be conveyed to Company 2 for the entire f year period.

Consistent with the Law, the Taxpayer plans to separate its electric distribution and transmission businesses from its generation business within the same affiliated group. To this end, the Taxpayer will undertake a multi-step process (the "Separation Plan"). First, Parent 1 will merge with and into Parent 2 resulting in the Taxpayer becoming a subsidiary of Parent 2. Second, the Taxpayer will form a wholly-owned subsidiary, Company 1, to which it will contribute its generation assets and liabilities

including the Plants, decommissioning liabilities, and nuclear decommissioning funds. Third, the Taxpayer will distribute the stock of Company 1 to Parent 2 resulting in Parent 2 becoming the common parent of the Taxpayer and Company 1. Fourth, Company 4, a wholly-owned subsidiary of Parent 2, will create a wholly-owned subsidiary, Company 3 and a wholly-owned limited liability company, Company 2. Company 4 will contribute its generation assets and liabilities to Company 2 and then transfer its ownership interest in Company 2 to Company 3. Company 4 will distribute the stock of Company 3 to Parent 2 resulting in Company 3 becoming a subsidiary of Parent 2 and a brother-sister company of Company 1 and the Taxpayer. Company 1 will then merge with and into Company 2. Fifth, the Taxpayer and Company 2 will enter into a power purchase agreement in order to supply electric service during the transition period mandated by the Law. Sixth, Company 2 and the Taxpayer will enter into a collection agreement under which the Taxpayer will separately identify and transfer to Company 2 all decommissioning costs collected from customers relating to the Plants.

Requested Ruling #1: Neither the Taxpayer, Company 1, Company 2, nor their qualified nuclear decommissioning funds will recognize any gain or loss or otherwise take into account any income or deduction by reason of the transfers in the Separation Plan. Company 2's qualified nuclear decommissioning funds will have a basis in the assets held equal to the basis of such assets in the Taxpayer's qualified nuclear decommissioning funds immediately prior to the transfers in the Separation Plan.

Section 468A(a) provides that a taxpayer may elect to deduct payments made to a nuclear decommissioning reserve fund (the qualified nuclear decommissioning 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.

Under section 1.468A-2(b)(2)(i) of the Income Tax Regulations, decommissioning costs are included in a taxpayer's cost of service for a taxable year to the extent such costs are directly or indirectly charged to customers of the taxpayer by reason of electric energy consumed during the taxable year or otherwise required to be included in the taxpayer's income under section 88 and the corresponding regulations.

Section 1.88-1(a) provides that decommissioning costs directly or indirectly charged to customers of the taxpayer include all decommissioning costs that

consumers are liable to pay by reason of electric energy furnished by the taxpayer during the taxable year, whether payable to the taxpayer, a trust, State government, or other entity.

Section 468A(e)(2) provides that the rate of tax on the income of a qualified nuclear decommissioning fund is 20 percent. Section 468A(e)(4) provides, in pertinent part, that the assets in a qualified nuclear decommissioning fund shall be used exclusively for satisfying the liability of any taxpayer contributing to the qualified nuclear decommissioning 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 nuclear decommissioning 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 nuclear decommissioning 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 nuclear decommissioning 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 after the transfer the transferee is an eligible taxpayer. Under section 1.468A-6(g), the Service may treat any disposition of an interest in a nuclear power plant occurring after December 27, 1994, as satisfying the requirements of the regulations if the Service determines that such treatment is necessary or appropriate to carry out the purposes of section 468A.

Upon approval by Commission A of the language requiring payment to Company 2 of decommissioning costs collected by the Taxpayer, the Service will generally treat these transfers as dispositions qualifying under the general provisions of section 1.468A-6. This determination is expressly contingent upon the requirement specified

above. This will enable the Service to treat these transfers as decommissioning costs that are directly or indirectly charged to customers of Company 2 by reason of electric energy furnished by Company 2, within the meaning of sections 88 and 468A and the corresponding regulations. Thus, assuming the foregoing condition is satisfied, under section 1.468A-6 the Taxpayer's funds will not be disqualified upon the transfer of the Plants and the funds to Company 2 pursuant to the steps outlined in the Separation Plan.

Section 1.468A-6(c)(1) provides that neither a transferor of an interest in a nuclear power plant nor the transferor's fund will recognize gain or loss or otherwise take any income or deduction into account by reason of a sale or other disposition. Accordingly, neither the Taxpayer nor its qualified nuclear decommissioning funds will recognize gain or loss or otherwise take into account any income or deduction upon the transfer of the qualified nuclear decommissioning funds to Company 2 pursuant to the steps outlined in the Separation Plan.

Section 1.468A-6(c)(3) provides that transfers to which section 1.468A-6 apply do not affect basis. Thus, the qualified nuclear decommissioning funds in the hands of Company 2 will have a basis in their assets equal to the basis in their assets prior to the transfer from the Taxpayer.

Requested Ruling #2: Following the transfer of the Plant and qualified nuclear decommissioning funds to Company 2 pursuant to the steps outlined in the Separation Plan, Company 2 will be treated as the "eligible taxpayer" and the "electing taxpayer" with respect to the Company 2 qualified nuclear decommissioning funds and therefore, Company 2 may make deductible contributions to its qualified nuclear decommissioning funds.

Section 1.468A-1(b)(1) defines an eligible taxpayer as any taxpayer that possesses a qualifying interest in a nuclear power plant. Section 1.468A-1(b)(2) defines a qualifying interest to include a direct ownership interest. Pursuant to section 1.468A-2(a) an eligible taxpayer that elects the application of section 468A is an electing taxpayer. Section 1.468A-6(e)(2) provides rules for the determination of a schedule of ruling amounts for a transferee of a nuclear power plant. Section 468A(b) limits the deductible contribution to the lesser of the ruling amount or the nuclear decommissioning costs allocable to the fund which is included in a taxpayer's cost of service for ratemaking purposes for the taxable year.

Fundamental to making a deductible contribution to a qualified nuclear decommissioning fund pursuant to a schedule of ruling amounts under section 468A are four requirements. First, a taxpayer must be an eligible taxpayer. Second, a taxpayer must be liable for the decommissioning of the nuclear power plant. Third, a taxpayer must have decommissioning costs included in its cost of service for ratemaking purposes for the year for which the deductible contribution is made. Fourth,

a taxpayer must request and receive a schedule of ruling amounts from the Service.

Based on the information submitted by the Taxpayer, Company 2 clearly satisfies the requirements for being an eligible taxpayer under section 1.468A-1(b) and an electing taxpayer under section 1.468A-2. In addition, as part of the Separation Plan, the liability to decommission the Plants has been transferred to Company 2. Upon approval by Commission A of the collection agreement as discussed above, Company 2 will be deemed to have satisfied the requirement of having decommissioning costs included in its cost of service for ratemaking purposes for the year for which the deductible contribution is made. These amounts are limited to the costs approved by Commission A for inclusion in the non-bypassable transition charge and received by Company 2 pursuant to the collection agreement discussed above. Company 2 may rely on the provisions of section 1.468A-6(e)(2) for a determination of the ruling amount in the year of transfer. Pursuant to section 1.468A-6(e)(2)(ii), Company 2 must request a revised schedule of ruling amounts for any tax year subsequent to the tax year in which the Plants are transferred. Finally, section 468A(b) limits the deductible contribution to the lesser of the ruling amount or the nuclear decommissioning costs allocable to the fund which is included in a taxpayer's cost of service for ratemaking purposes for the taxable year.

The rulings expressed, herein, are expressly conditioned the order of Commission A relating to the collection agreement remaining in effect and on the continued direct or indirect ownership and control of Company 2 by Parent 2.

Except as specifically determined above, no opinion is expressed or implied concerning the Federal income tax consequences of the transaction described above. In particular, no opinion is expressed or implied concerning whether the decommissioning costs collected by the Taxpayer is includible in the gross income of, and deductible by, any entity other than Company 2.

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

In accordance with the powers of attorney, we are sending a copy of this ruling to your authorized representative. We are also sending a copy of this letter ruling to the applicable Industry Director.

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