Internal Revenue Service

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CC:PSI:B06
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Date:
July 28, 2005

Legend:

Seller =

Buyer =

Taxpayer =

Plant =
Location =
State =
Intermediate =
T&D Subsidiary =
Nuclear Subsidiary =
Energy Subsidiary =
Order =
Prior Owner =
Trustee =
Commission =
New Rule =

a =
b =
c =
d =
e =

Dear

This letter responds to a letter, dated November 12, 2004, requesting a private letter ruling concerning the tax consequences of the transfer from Seller to Buyer of all the outstanding stock of Taxpayer, an entity that owns an interest in a nuclear power plant and the associated assets and liabilities including the liability to fund the cost of decommissioning Taxpayer's interest in Plant. Specifically, you have requested rulings regarding the tax consequences to Taxpayer's nuclear decommissioning funds of the stock transfer, as well as rulings regarding the subsequent remittance by Seller to Taxpayer of amounts collected on behalf of Taxpayer by Seller from Seller's customers to fund the cost of decommissioning Plant.

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

Plant is located in Location, in State, and consists of two generation units and associated assets located together on a single property.

Seller is a corporation engaged in the transmission, distribution, and generation of electric energy in State. Intermediate, a utility holding company, is a single-member limited liability company that is wholly-owned by Seller. T&D Subsidiary, a transmission and distribution company, is a limited liability company wholly-owned by Seller. Both Intermediate and T&D Subsidiary are treated as disregarded entities and as divisions of Seller for federal income tax purposes.

Seller, through Intermediate, also owns a percent of the outstanding stock of Taxpayer, a corporation. The other b percent of Taxpayer's shares are publicly-held. Taxpayer is principally engaged in the generation and sale of electric energy in State. Taxpayer directly owns two limited liability companies, which, in turn, are the sole partners of Nuclear Subsidiary, a limited partnership. The limited liability companies and Nuclear Subsidiary are treated as disregarded entities and as divisions of Taxpayer for federal income tax purposes. Taxpayer also intends to form a wholly-owned indirect subsidiary, Energy Subsidiary, that will own all of Taxpayer's coal, lignite, and gas-fired generation plants. Taxpayer and its subsidiaries are included in the consolidated federal income tax return filed by Seller on a calendar-year basis using the accrual method of accounting.

Taxpayer owns, through its division Nuclear Subsidiary, separately-acquired c and d percent undivided interests in the Plant as a tenant in common. Nuclear decommissioning costs with respect to Taxpayer's c percent interest in Plant (the "existing interest") are collected by T&D Subsidiary through rates charged to Seller's retail customers pursuant to Order and paid over to Taxpayer (the "Decommissioning Collections"). Similarly, nuclear decommissioning costs with respect to Taxpayer's d percent interest in Plant (the "acquired interest") are collected by Prior Owner, the

unrelated public utility company from which the d percent interest was acquired, through a nonbypassable charge levied against Prior Owner's retail customers and paid over to Taxpayer pursuant to a collection agreement. The Commission proceedings establishing rates to be charged to Seller's ratepayers with respect to Taxpayer's c percent interest in Plant will be separate from the Commission proceedings establishing the rates charged to Prior Owner's ratepayers with respect to Taxpayer's d percent interest in Plant. The acquisition by Taxpayer of the d percent interest in Plant is the subject of a separate private letter ruling.

Pursuant to trust agreements with Trustee, Taxpayer has established, for each of its separately-acquired interests in Plant, a separate nuclear decommissioning fund qualifying under section 468A for each unit, and a separate nuclear decommissioning fund that does not meet the requirements of section 468A for each unit. With respect to each unit of the Plant, Taxpayer treats the separate qualified nuclear decommissioning funds maintained for that unit (the existing fund and the acquired fund) as a single fund for purposes of section 468A of the Internal Revenue Code even though the funds are maintained by separate trusts. Taxpayer represents that, pursuant to the New Rule, section 6.19 of the Transaction Agreement, and a Decommissioning Funds Collection Agreement to be entered into by the parties (discussed below), Taxpayer's nuclear decommissioning funds are, and after the stock sale will continue to be, regulated by the Commission in accordance with the Commission substantive rules.

Buyer is a newly-formed limited liability company treated as a partnership for federal income tax purposes. Buyer is a calendar year taxpayer and uses the accrual method of accounting.

On e, Seller, Buyer, Taxpayer, Intermediate, and other entities entered into the Transaction Agreement for the sale of the common stock of Taxpayer to Buyer. Under the Transaction Agreement, the proposed transfer will be accomplished in two steps. First, Seller will repurchase all outstanding shares of the common stock of Taxpayer, and Buyer will acquire Energy Subsidiary from Taxpayer. In the second step, Buyer will acquire all of the common stock of Taxpayer in exchange for cash. At the time of this stock acquisition, the principal remaining assets of Taxpayer will be the c and d percent interests in the Plant, including a proportionate amount of the assets constituting or necessary to operate the Plant, and the assets of the qualified and nonqualified nuclear decommissioning funds maintained by Taxpayer with respect to its interest in each unit of the Plant. The parties will not make an election under section 338(h)(10) or any comparable provision of state or local law with respect to the stock sale, and the assets held by the nuclear decommissioning funds prior to the stock sale will continue to be held by those funds after the stock sale.

The Transaction Agreement provides that Seller’s rights to accumulated and future Decommissioning Collections and the responsibility for decommissioning the Plant shall be transferred to Buyer at the closing of the stock sale. Further, the New Rule (discussed below) requires Seller to continue to collect an amount for the cost of

decommissioning Taxpayer's c percent interest in Plant from Seller's regulated ratepayers, and to remit the amount collected to Taxpayer's nuclear decommissioning funds.

After the stock sale, Taxpayer will continue to own both the c percent interest in the Plant acquired from Seller and the d percent interest in the Plant acquired from Prior Owner, and the associated nuclear decommissioning funds. However, Taxpayer will no longer be affiliated with Seller or its subsidiary T&D Subsidiary. Seller, through T&D Subsidiary, will continue to collect the Decommissioning Collections with respect to Taxpayer's c percent interest in the Plant on behalf of, and for the benefit of, Taxpayer pursuant to the New Rule, section 6.19 of the Transaction Agreement, and the Decommissioning Funds Collection Agreement, and will remit the Decommissioning Collections directly or indirectly to Taxpayer's nuclear decommissioning funds. With respect to each unit of the Plant, Taxpayer will continue after the stock sale to treat the qualified nuclear decommissioning fund for its c percent interest in the unit and the qualified nuclear decommissioning fund for its d percent interest in the unit as a single qualified nuclear decommissioning fund for purposes of section 468A.

State enacted the New Rule to ensure that adequate funds will be available to decommission nuclear power plant that have been transferred out of State-jurisdictional rate base. The New Rule provides that, following the transfer of a State-jurisdictional nuclear power plant and the associated nuclear decommissioning funds, any remaining costs associated with nuclear decommissioning obligations will remain subject to cost of service regulation based upon a periodic review of the costs. Under the New Rule, Seller and Taxpayer are required to enter into a Decommissioning Funds Collection Agreement that governs the transfer of responsibility for the administration of the nuclear decommissioning funds, the collection of decommissioning revenues from utility customers, and the remittance of the funds to the nuclear decommissioning funds. The New Rule requires that the parties submit the Decommissioning Funds Collection Agreement and any subsequent amendments to Commission for approval. The New Rule also requires that Taxpayer periodically perform a study of the cost of decommissioning Plant, and to submit the study along with an updated analysis of decommissioning costs to the Commission. Taxpayer is required to demonstrate to Commission that the funds are being invested prudently and in compliance with the New Rule, and that Taxpayer is making efforts to achieve optimum tax efficiency with respect to the nuclear decommissioning funds. The Commission or any affected person may initiate a proceeding to review the balance of the funds, compliance with the New Rule, or the annual funding amount. Taxpayer must file an annual report of the status of the funds with Commission.

The New Rule requires that if a taxpayer has an existing nuclear decommissioning trust for the same generating unit in which an interest is being transferred that is funded by a set of ratepayers entirely distinct from the transferor's ratepayers, a separate trust or subaccount shall be maintained that will segregate the

decommissioning funds received from the transferor, and the earnings thereon, from the nuclear decommissioning trust funds received from other sources.

Taxpayer represents that it will be a named recipient of, and will be bound by the terms of, all orders issued by Commission establishing the cost of decommissioning Taxpayer's interest in Plant and establishing the amount to be collected from ratepayers with respect to that cost.

Seller currently collects the Decommissioning Collections as part of its general rate structure. Under the New Rule, within 30 days following the stock sale and the disaffiliation of Taxpayer and Seller, Seller must apply to Commission to have its current level of decommissioning funding removed from its general rates and stated as a separate nonbypassable charge. After the issuance of a Commission order that adjusts the cost of service for decommissioning Plant, Seller must file a rate application to adjust the nonbypassable charge. Taxpayer may also request a change in the decommissioning funding level during a general rate case of Seller.

The Decommissioning Funds Collection Agreement will provide as follows:

(a) Seller will continue collecting decommissioning costs from customers in the same manner that it currently collects for decommissioning the Plant;

(b) Seller will remit all such Decommissioning Collections directly or indirectly to Taxpayer's nuclear decommissioning funds by wire transfer each week;

(c) Seller and Taxpayer will comply with all applicable laws so as not to adversely affect the collectibility of the decommissioning costs or their ability to perform under the Decommissioning Funds Collection Agreement;

(d) At the request of Taxpayer, Seller will file applications with the Commission in proceedings regarding any increases or decreases in the amount of Decommissioning Collections; and

(e) In connection with any final reconciliation proceeding after completion of decommissioning of the Plant, Seller will collect any further Decommissioning Collections authorized by the Commission and remit such amounts directly or indirectly to Taxpayer's Decommissioning Funds.

Requested Ruling #1: *Following the closing, each of Taxpayer's qualified nuclear decommissioning funds will continue to be treated as a qualified nuclear decommissioning fund that satisfies the requirements of section 468A and the regulations promulgated thereunder. Additionally, Taxpayer 's qualified nuclear decommissioning funds will not recognize gain or loss as a result of the stock sale.*

Section 468A(a) of the Code provides that a taxpayer may elect to deduct payments made to a qualified nuclear decommissioning reserve 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(e)(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-5(a) of the Federal Income Tax Regulations sets out the qualification requirements for nuclear decommissioning funds. It provides, in part, that a qualified fund must be established and maintained pursuant to an arrangement that qualifies as a trust under state law. An electing taxpayer can establish and maintain only one qualified fund for each nuclear power plant. Section 1.468A-5(c)(1)(i) provides that if, at any time during the taxable year, a nuclear decommissioning fund does not satisfy the requirements of section 1.468A-5(a) the Service may disqualify all or a portion of the fund as of the date that the fund does not satisfy the requirements. Section 1.468A-5(c)(3) provides that if a qualified fund is disqualified the fair market value (with certain adjustments) of the assets in the fund is deemed to be distributed to the electing taxpayer and included in that taxpayer's gross income for the taxable year.

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

Taxpayer does not meet the literal requirements of section 1.468A-5(a)(iii) because it maintains more than one qualified nuclear decommissioning fund for each unit of the Plant (one fund for the existing interest in each unit, and one fund for the interest in each unit acquired from Seller), established pursuant to separate trust documents under the jurisdiction of one public utility commission rather than multiple public utility commissions. However, the facts submitted by the parties state that Commission requires that the assets of the qualified nuclear decommissioning funds maintained for Taxpayer's c percent interest in the Plant not be commingled with the assets of the qualified nuclear decommissioning funds maintained for Taxpayer's d percent interest in the Plant. In addition, Commission issues two separate rate orders to Buyer, one for the qualified nuclear decommissioning funds maintained for Taxpayer's c percent interest in the Plant and the other for the qualified nuclear decommissioning funds maintained for Taxpayer's d percent interest in the Plant.

In order to permit Buyer to comply with New Rule and Commission's order, we are exercising our discretion under section 1.468A-6 to treat the two separate rate orders issued by Commission approving decommissioning costs for Taxpayer's separate c percent and d percent interests in Plant as having been issued by two

separate commissions for purposes of section 1.468A-5(a)(iii). Accordingly, we conclude that Taxpayer may maintain separate qualified nuclear decommissioning funds for these interests in Plant, and the maintenance of the separate funds will not disqualify Taxpayer's qualified nuclear decommissioning funds. This exercise of discretion, however, applies to the provisions of section 1.468A-6 except those outlined in section 1.468A-6(e) with respect to the calculation of a schedule of ruling amounts subsequent to a sale.

Thus, following the transfer of ownership of Taxpayer to Buyer, each of Taxpayer's qualified nuclear decommissioning funds for each unit of Plant will continue to be treated as a qualified nuclear decommissioning fund that satisfies the requirements of section 468A and the regulations thereunder. This exercise of discretion is valid only so long as the New Rule is in effect, and only so long as Commission requires separate qualified nuclear decommissioning funds to be maintained.

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, Taxpayer's qualified nuclear decommissioning funds will not recognize gain or loss or otherwise take any income or deduction into account by reason of the transfer of the common stock of Taxpayer between Seller and Buyer.

Requested Ruling #2: *Following the closing and for all periods after the closing when Taxpayer and Seller are subject to Section 6.19 of the Transaction Agreement and are parties to, and subject to the terms of, the Decommissioning Funds Collection Agreement, Seller will not realize income upon its receipt of the Decommissioning Collections.*

Section 61 defines gross income as all income from whatever source derived, including compensation for services such as fees, commissions, and similar items. However, the mere receipt and possession of money does not by itself constitute gross income. One such instance where the receipt of money does not result in gross income is the receipt of money by a person acting as an agent under the control of, and receiving the payment for the benefit of, another. For example, a rental agent does not have income upon receipt of a rental payment from a tenant because the agent is a mere conduit for the payment from the tenant to the owner. This concept has been applied in a variety of situations involving agents and other conduits. *See*, *for example*, *Maryland Casualty Co. v. United States*, 381 U.S. 342, 345 (1920) and *Fogarty v. United States*, 780 F.2d 1005 (Fed. Cir. 1986).

The position that the principal, and not the agent, is taxed on amounts received by the agent on the principal's behalf is embodied in numerous revenue rulings. For example, Rev. Rul. 74-581, 1974-2 C.B. 25, involved fees received by a law school's faculty members for their court-appointed representation of indigent defendants while

participating in the university's clinical program. Each faculty member must agree, as a condition of participation in the program, that since the time spent in supervising work of students on these cases and in the representation of the client is part of the faculty member's teaching duties for which the faculty member is compensated by a total annual salary, all amounts received for such representation are to be endorsed over to the law school. The attorney-faculty members involved are working solely as agents of the law school, while supervising the law students within the scope of the clinical programs, and realize no personal gain from payments for their services in representing the indigent defendants. The revenue ruling thus holds that the payments received by the faculty members for their representation of clients while participating in the clinical program are not required to be included in their gross income. *See also* Rev. Rul. 69-274, 1974-1 C.B. 36; Rev. Rul. 65-282, 1965-1 C.B. 21; and Rev. Rul. 58-220, 1958-1 C.B. 26.

In the present case, under the Decommissioning Funds Collection Agreement mandated by the Commission, the Seller will be required to continue to charge rates from Seller's regulated ratepayers for the purpose of collecting decommissioning monies to be remitted to Buyer's nuclear decommissioning trust fund. The purpose of the Decommissioning Funds Collection Agreement is to ensure that Buyer will have adequate funds to decommission the generating facility. The Decommissioning Funds Collection Agreement will require Seller to remit all collections to Buyer. Moreover, Seller receives no benefit from the Decommissioning Collections. Rather, Buyer is the intended recipient of, and the only party benefiting from, the collections.

Accordingly, we conclude that, except as provided below, Seller will not realize income upon Seller's receipt of Decommissioning Collections after the closing of the sale. If, in accordance with the Decommissioning Funds Collection Agreement or for some other reason, Seller retains a portion of the Decommissioning Collections and does not remit all of such collections to Buyer, Seller must include the amount retained in its gross income.

Requested Ruling #3: *Following the closing and for all periods after the closing when Taxpayer and Seller are subject to Section 6.19 of the Transaction Agreement and are parties to, and subject to the terms of, the Decommissioning Funds Collection Agreement, Taxpayer will realize income upon Seller's receipt of the Decommissioning Collections in accordance with section 88 and the regulations thereunder.*

In Requested Ruling #2 we determined that Seller acts as Taxpayer's agent when collecting amounts for the decommissioning of Plant from its retail customers that are required to be remitted to Taxpayer. Under the principles of agency, Taxpayer is deemed to be in receipt of these amounts at the time they are collected by Seller.

Section 88 provides that, in the case of any taxpayer who is required to include the amount of any nuclear decommissioning costs in the taxpayer's cost of service for

ratemaking purposes, there shall be includible in the gross income of such taxpayer the amount so included for any taxable year.

Taxpayer has represented that it will be a named recipient of, and will be bound by the terms of, all orders issued by Commission establishing the cost of decommissioning Taxpayer's interest in the Plant and establishing the amount to be collected from ratepayers with respect to that cost. Consequently, and based upon the continued validity of that representation, we conclude that following the closing and for all periods after the closing when Taxpayer and Seller are parties to, and subject to the terms of, the Decommissioning Funds Collection Agreement, Taxpayer will realize income upon Seller's receipt of the Decommissioning Collections in accordance with section 88 and the regulations thereunder.

Requested Ruling #4: *Following the closing and for all periods after the closing when Taxpayer and Seller are subject to Section 6.19 of the Transaction Agreement and are parties to, and subject to the terms of, the Decommissioning Funds Collection Agreement, Taxpayer will satisfy the "cost of service" requirement with respect to its qualified nuclear decommissioning funds within the meaning of section 468A and the regulations promulgated thereunder and, therefore, Taxpayer will be permitted to make deductible contributions to its qualified nuclear decommissioning funds for the Decommissioning Collections collected by Seller through a nonbypassable charge and remitted directly or indirectly to Taxpayer 's qualified nuclear decommissioning funds in accordance with the Commission rules, Section 6.19 of the Transaction Agreement, and the Decommissioning Funds Collection Agreement.*

The taxpayers have represented that Taxpayer will be a named recipient of, and will be bound by the terms of, all orders issued by Commission establishing the cost of decommissioning Taxpayer's interest in the Plant and establishing the amount to be collected from ratepayers with respect to that cost. Consequently, and based upon the continued validity of that representation, we conclude that following the closing and for all periods after the closing when Taxpayer and Seller are parties to, and subject to the terms of, the Decommissioning Funds Collection Agreement, Taxpayer will be deemed to have satisfied the "cost of service" requirement with respect to its qualified nuclear decommissioning funds within the meaning of section 468A and the regulations thereunder and, therefore, Taxpayer will be permitted to make deductible contributions to its qualified nuclear decommissioning funds for the Decommissioning Collections collected by the Seller through a nonbypassable charge and remitted directly or indirectly to Taxpayer's nuclear decommissioning funds in accordance with the rules of Commission and the Decommissioning Funds Collection Agreement.

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 representative. A copy of this letter must be attached to any income tax return to which it is relevant.

Sincerely,

Peter C. Friedman
Senior Technician Reviewer, Branch 6
(Passthroughs & Special Industries)

cc: