New York State Department of Taxation and Finance
Office of Tax Policy Analysis
Technical Services Division

TSB-A-03(7)C
Corporation Tax
August 1, 2003

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO.C010202A

On February 2, 2001, a Petition for Advisory Opinion was received from Consolidated Edison Company of New York, Inc., 4 Irving Place, Room 1875-S, New York, New York 10003.

The issues raised by Petitioner, Consolidated Edison Company of New York, Inc., are:

1. Whether the determination of the Commissioner of Internal Revenue as to the federal income tax treatment of Petitioner's qualified nuclear decommissioning trust ("QNDT"), as described below, and Petitioner's nonqualified nuclear decommissioning trust ("NQNDT"), as described below, with respect to the sale, as described below, of the nuclear units and related assets, including the QNDT and the NQNDT, will be followed for purposes of determining entire net income under section 208.9 of Article 9-A of the Tax Law and section 3-2.2 of the Business Corporation Franchise Tax Regulations ("Article 9-A Regulations").

2. Whether the transfer of the assets of Petitioner's QNDT and NQNDT to purchaser, as part of the sale of Petitioner's nuclear units that is described below, will result in the recognition of gain or loss by Petitioner under section 186-a of Article 9 of the Tax Law, if Petitioner's aggregate original cost of the assets of Petitioner's QNDT, NQNDT and the nuclear units (unreduced by depreciation) is greater than or equal to the aggregate amount Petitioner realizes on the sale of the nuclear units and related assets, as described below.

Petitioner submits the following facts as the basis for this Advisory Opinion.

Petitioner is a regulated public utility incorporated in New York State on November 10, 1884. It is a subsidiary of Consolidated Edison, Inc. ("CEI"), a public utility holding company under the Public Utility Holding Company Act of 1935 ("PUHCA"), which is exempt from registration with the Securities and Exchange Commission, in accordance with section 3(a)(1) of PUHCA. CEI was incorporated in New York State on September 3, 1997. Petitioner is engaged in the business of furnishing electricity, gas and steam utility services to the general public within New York City and Westchester County. Petitioner is a member of CEI's consolidated group and joins in filing a consolidated return on a calendar year basis using the accrual method of accounting.

In August 1994, the New York State Public Service Commission ("PSC") began hearings with respect to restructuring the New York electric industry to foster competition in the generation of electricity and offer customers a choice of energy providers (The Competitive Opportunities Proceeding, Case No. 94-E-0952). On May 20, 1996, the PSC issued Opinion No. 96-12, Opinion

and Order Regarding Competitive Opportunities for Electric Service, effective May 20, 1996 (the "Generic Order") in that proceeding. The Generic Order endorsed a fundamental restructuring of the electric utility industry in New York State, based on competition in the generation and energy services sectors of the industry. The PSC directed Petitioner to file a restructuring plan, addressing, among other things, retail access, divestiture and a corporate reorganization. Petitioner filed its plan on October 1, 1996.

In the Fall of 1997, Petitioner and the PSC entered into a Settlement Agreement (Opinion No. 97-16.) The Settlement Agreement provides for a transition to a competitive electric market through the development of a retail access plan, a rate plan for the period ending March 31, 2002, and a reasonable opportunity for recovery of "strandable costs." The retail access plan will eventually permit all of Petitioner's electric customers to buy electricity from other suppliers. The delivery of electricity to customers will continue to be through Petitioner's transmission and distribution systems. Further, the Settlement Agreement required the divestiture by Petitioner to unaffiliated third parties of at least 50 percent of its New York City electric generating fossil-fueled capacity. Under the Settlement Agreement, Petitioner's electric generating fossil-fueled capacity not divested to third parties would have been transferred to an unregulated subsidiary of CEI.

As a result of the deregulation of the electric power industry, Petitioner is in the process of withdrawing from the electric power generation business, and on September 6, 2001, sold its interest in two nuclear generating plants, Indian Point Units 1 and 2 (the "Nuclear Units"), and related assets, including the assets in the related QNDT and the assets in the related NQNDT, to Entergy Nuclear New York Investment Company III ("Buyer"). This sale was approved in PSC Case No. 01-E-0040 and was in response to PSC Opinion No. 98-7.

On November 9, 2000, Petitioner and Buyer signed an Asset Purchase Agreement ("APA") in which Petitioner agreed to sell its Nuclear Units and related assets to Buyer, including the assets in the QNDT and possibly the assets in the NQNDT, in exchange for $502 million in cash and the assumption, by Buyer, of the nuclear decommissioning and other plant related liabilities. Buyer has agreed to sell power to Petitioner for the period from closing of the transaction through 2004.

The legal purchaser of the nuclear generating units, certain associated equipment and related decommissioning funds was Entergy Nuclear Indian Point 2 LLC ("ENIP"), a wholly-owned Delaware limited liability company of Buyer, which is incorporated under Delaware law. For federal income tax purposes, ENIP is a disregarded entity and Buyer is the taxpayer. Buyer is a third-tier wholly-owned subsidiary of Entergy Corporation ("Parent"), which is a Public Utility Holding Company registered under PUHCA. Buyer will operate as an "exempt wholesale generator" under the jurisdiction of the Federal Energy Regulatory Commission as to terms and conditions of wholesale power sales and of the Nuclear Regulatory Commission as to the requirements associated with the ownership and operation (including decommissioning) of the nuclear generating units.

Buyer is a member of Parent's consolidated group and joins in filing a consolidated federal income tax return with Parent on a calendar year basis using the accrual method of accounting. Parent conducts its primary businesses, such as power generation, transmission, distribution and sale, through six regulated subsidiaries that operate in Mississippi, Arkansas, Louisiana and Texas. Buyer will be engaged in the business of operating nuclear power plants for the generation and sale of electric power. Buyer will operate as an exempt wholesale generator under PUHCA.

Buyer will use the Nuclear Units in its trade or business of selling electricity; however, the rates for the sale of power generated will not be approved by a public utility commission or be under the jurisdiction of the Rural Electrification Administration.

Prior to the sale, Petitioner directly owned 100 percent of the Nuclear Units, which are located in New York State. Indian Point Unit 1 began commercial service in 1962 and was permanently shut down in October 1974. A portion of Indian Point Unit 1 supports Indian Point Unit 2. Indian Point Unit 2 began commercial service in 1974.

With respect to the Nuclear Units, Petitioner established QNDT, the Con Edison Master Nuclear Decommissioning Trust that contained a separate qualified nuclear decommissioning reserve fund, under section 468A of the Internal Revenue Code ("IRC"), for Indian Point Unit 1 and for Indian Point Unit 2 (each a "Qualified Fund"). The assets of the QNDT were pooled for investment purposes. Such pooling arrangement was a partnership for federal income tax purposes (the "Pooling Partnership"). All members of the Pooling Partnership (that is, each Qualified Fund) elected under section 761(a)(1) of the IRC to exclude the Pooling Partnership from the application of Subchapter K of the IRC. The QNDT was a trust validly existing under the laws of New York and was established on December 30, 1988, and amended June 30, 1993, September 1, 1995, and January 1, 1995. Each Qualified Fund filed Form 1120-ND for federal income tax purposes.

Petitioner also established NQNDT, the Con Edison Non-Qualified Master Nuclear Decommissioning Trust, that contained a separate non-qualified nuclear decommissioning reserve fund for Indian Point Unit 1 and Indian Point Unit 2 (each a "Non-Qualified Fund" and together with the Qualified Funds, the "Funds"). The assets of the NQNDT were pooled for investment purposes. The NQNDT was a trust validly existing under the laws of New York and was established on June 30, 1993, and amended September 1, 1995. The NQNDT was treated as a grantor trust under section 677 of the IRC. On August 30, 2001, each Non-Qualified Fund contributed its respective assets to the Pooling Partnership in exchange for an interest in the partnership. The Pooling Partnership did not make an election under section 754 of the IRC.

Petitioner had to top-off the NQNDT in the amount of $78 million on September 6, 2001, prior to the sale. At closing of the transaction, Petitioner transferred all assets in its QNDT (the interests in Pooling Partnership) to Buyer's newly formed trusts for Indian Point 1 and 2 (the Buyer's Qualified Funds). Petitioner transferred all assets in its NQNDT (the interests in Pooling Partnership) to Buyer's newly formed grantor trusts (the Buyer's Non-Qualified Funds).

The Funds, which owned interests in the Pooling Partnership, were held solely for the purpose of decommissioning the Nuclear Units. As of September 6, 2001, the QNDT held assets with a fair market value of $215,593,798. As of September 6, 2001, the NQNDT held assets with a fair market value of $214,406,202. The QNDT and the NQNDT were not regulatory assets of Petitioner for purposes of section 208.9(c-2)(5) of the Tax Law.

On April 8, 2002, the Internal Revenue Service issued a private letter ruling to Petitioner and Buyer concerning the federal income tax consequences of the sale of the nuclear power plant and associated assets and liabilities, including nuclear decommissioning liability, between Petitioner and Buyer. The letter ruling provides, among other things, that:

> 1. The Internal Revenue Service will exercise its discretion to treat the transaction, under Treasury Regulation section 1.468A-6(g), as a disposition qualifying under the general provisions of section 1.468A-6. Thus, under section 1.468A-6 the Qualified Funds of Petitioner will not be disqualified upon the transfer when the assets are transferred to the respective Qualified Funds of ENIP and those funds, holding the transferred qualified assets, will be treated as Qualified Funds of ENIP.
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> 2. Neither Petitioner nor the Qualified Funds maintained by Petitioner will recognize gain or loss or otherwise take any income or deduction into account by reason of the transfer of the Qualified Funds assets to the Qualified Funds of ENIP.
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> 3. ENIP will not recognize gain or loss or otherwise take any income or deduction into account by reason of the transfer of the assets of Petitioner's Qualified Funds to the Qualified Funds of ENIP.
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> 4. Indian Point Units 1 and 2, the equipment, operating assets and Non-Qualified Funds assets comprise a trade or business in Petitioner's hands and the gain or loss recognized by Petitioner with respect to those assets will be determined wholly by reference to Petitioner's amount realized. Thus, Petitioner's transfer of Indian Point Units 1 and 2, the equipment, operating assets and Non-Qualified Funds assets to ENIP in exchange for cash and the assumption of the decommissioning liability (except to the extent funded by the Qualified Funds) is an applicable asset acquisition as defined in section 1060(c). As such, its federal tax treatment is determined under section 1060 and the regulations thereunder. Accordingly, on the sale of Petitioner's interests in Indian Point Units 1 and 2 and the assets in its nuclear decommissioning funds (other than the assets held by Petitioner's Qualified Funds), Petitioner's 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.

5. Petitioner's amount realized on the sale of its interests in Indian Point Units 1 and 2 and the associated assets (not including the assets held by Petitioner's Qualified Funds) will include the cash consideration received by Petitioner and the liabilities from which Petitioner is relieved, to the extent those liabilities are taken into account for federal income tax purposes. The liabilities taken into account would include Petitioner's decommissioning liability, not including any portion of the liability attributable to Petitioner's Qualified Funds.

6. Under Treasury Regulation section 1.468A-6(c)(3), the Qualified Funds of ENIP will have a basis in the assets received that is the same as the basis of those assets in the Qualified Funds of Petitioner immediately before the transfer.

7. Pursuant to Treasury Regulation section 1.461-4(d)(5), the economic performance with respect to the decommissioning liability of Petitioner occurs as of the date of the sale to the extent the liability is included in Petitioner's amount realized. At that time, Petitioner will be entitled to a deduction for the amount of its decommissioning liability associated with Indian Point Units 1 and 2 expressly assumed by ENIP and included in Petitioner's amount realized.

8. The transfer of the assets of the Non-Qualified Funds to the Pooling Partnership prior to the closing had no substantial business purpose, and was merely a device to attempt to change the allocation of the consideration paid for Indian Point Units 1 and 2 among the transferred assets under section 1060. Accordingly, the transfer of the assets of the Non-Qualified Funds to the Pooling Partnership prior to the closing will be disregarded for federal income tax purposes. Petitioner will be treated as selling, and ENIP will be treated as buying, the underlying assets of the Non-Qualified Funds, and the Pooling Partnership will not be treated as holding such assets at the time of the closing.

9. At the time of closing, ENIP will have a cost basis in the purchased assets equal to the cash paid to Petitioner, as well as any liabilities that are otherwise incurred for federal income tax purposes. The purchased assets and the liabilities incurred do not include the assets in the Qualified Funds or the liability attributable to the Qualified Funds, because the tax effect of the Qualified Funds is determined under section 468A. ENIP will not be entitled to treat as a component of its cost basis at the time of the closing any amount attributable to the future decommissioning liability. ENIP's cost basis in the purchased assets, including all assets held in the Non-Qualified Funds, must be allocated among all such assets in accordance with the residual method provided in section 1060 and Treasury Regulation section 1.1060-1T(d)and (e).

10. On the acquisition date, ENIP's basis in the assets acquired must be determined by allocating its cost (i.e., the consideration provided by ENIP on the acquisition date, which includes the cash and the issue price of its notes, but not the assumption of the decommissioning liability) among the acquired assets in accordance with the provisions of section 1060 and the regulations thereunder. 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 Funds pay or incur decommissioning expenses), such amounts will be taken into account as increases to ENIP'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.

11. ENIP will not realize income from its acquisition of Indian Point Units 1 and 2, the equipment, operating assets, and Petitioner's interests in the assets in the Non-Qualified Funds except to the extent that, under the rules of section 1060, the amount of cash and other Class 1 assets (as defined in Treasury Regulation 1.338-6(b)(1)) received by ENIP (not including the assets held by Petitioner's Qualified Funds) 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 ENIP provides to Petitioner, that is, under applicable tax principles, taken into account on the date of the applicable asset acquisition). If ENIP is thus required to take an amount into account as income, then, when under general principles of tax law ENIP is permitted to take additional consideration into account (e.g.,when ENIP satisfies the economic performance requirement with respect to the decommissioning liability assumed), ENIP will be entitled to deduct (and will not be required to capitalize) such amount.

Applicable Law and Regulations

Section 208.9 of Article 9-A of the Tax Law provides that "the term 'entire net income' means total net income from all sources, which shall be presumably the same as the entire taxable income (but not alternative minimum taxable income), (i) which the taxpayer is required to report to the United States treasury department ... except as hereinafter provided, and subject to any modification required by paragraphs (d) and (e) of subdivision three of section two hundred ten of this article...."

Section 3-2.2(b) of the Business Corporation Franchise Tax Regulations (Article 9-A Regulations) provides that "Federal taxable income is the starting point in computing entire net income. Generally, *Federal taxable income* means taxable income as defined in section 63 of the Internal Revenue Code. After determining Federal taxable income, it must be adjusted as required by section 3-2.3, 3-2.4, 3-2.5 and 3-2.6 of this Subpart...."

Section 186-a of Article 9 of the Tax Law provides, in part:

1. Notwithstanding any other provision of this chapter, or of any other law,

* * *

(b) a tax equal to (1) ... two and forty-five one hundredths percent from January first, two thousand one through December thirty-first, two thousand one ... of that portion of its gross income derived from the transportation, transmission or distribution of gas or electricity ... and (2) ... two percent from January first, two thousand one through December thirty-first, two thousand one ... of all of its other gross income, is hereby imposed upon every utility not taxed under paragraph (a) of this subdivision [with respect to providers of telecommunication services] doing business in this state which is subject to the supervision of the state department of public service which has a gross income for the year ending December thirty-first in excess of five hundred dollars ...

* * *

2. As used in this section,

* * *

(c) the words “gross income” mean and include receipts received in or by reason of any sale, conditional or otherwise, (except sales hereinafter referred to with respect to which it is provided that profits from the sale shall be included in gross income) made or service rendered for ultimate consumption or use by the purchaser in this state...

* * *

(5) “Gross income” also includes profits from the sale of securities; also profits from the sale of real property growing out of the ownership or use of or interest in such property; also profit from the sale of personal property (other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the period for which a return is made); also receipts from interest, dividends, and royalties, derived from sources within this state other than such as are received from a corporation a majority of whose voting stock is owned by the taxpaying utility, without any deduction therefrom for any expenses whatsoever incurred in connection with the receipt thereof, also profits from any transaction (except sales for resale and rentals) within this state whatsoever....

Opinion

The sale of Petitioner's Nuclear Units and related assets was in response to requirements of the PSC arising out of the Competitive Opportunities Proceeding instituted in 1994 by the PSC in Case No. 94-E-0952 which endorsed a fundamental restructuring of the electric utility industry. In its Opinion and Order Regarding Competitive Opportunities for Electric Service, Opinion No. 96-12 (Issued and Effective May 20, 1996), the PSC stated that it "... strongly encourage[d] divestiture, particularly of generation assets...." (Slip Op. at 60). See Central Hudson Gas & Electric Corporation, Adv Op Comm T&F, December 18, 2002, TSB-A-02(22)C, for reference to PSC Opinion No. 96-12.

In August, 1997, in its Competitive Opportunities Proceeding, the PSC had issued for public comment a Staff Report on Nuclear Generation ("Staff Nuclear Report"), in which, as a preferred statewide nuclear solution, the PSC's Staff recommended that nuclear power plants be sold to third parties, preferably through an auction process. On the same day that it issued its Opinion and Order in Case Nos. 94-E-0098 and 94-E-0099, and following receipt of comments from the public on the Staff Nuclear Report, the PSC adopted "as a rebuttable presumption the premise that nuclear power should be priced on a market basis to the same degree as power from other sources." The PSC also transferred its consideration of the sales of nuclear units from its Competitive Opportunities Proceeding to a generic proceeding (PSC Case No. 98-E-0405, Proceeding Concerning Nuclear Generation in a Competitive Electric Market). PSC Opinion No. 98-7, Case 94-E-0921 and 98-E-0405, Opinion and Order Instituting Further Inquiry (Issued and Effective March 20, 1998), at 44. See Central Hudson Gas & Electric Corporation, supra, for this background information.

Petitioner sold its Nuclear Units and related assets, including the assets in Petitioner's QNDT and NQNDT in a transaction on September 6, 2001. Such sale was in response to PSC Opinion No. 98-7 and was approved in PSC Case No. 01-E-0040.

With respect to Issue 1, the starting point for computing entire net income under Article 9-A is federal taxable income which is modified as required by section 208.9 of the Tax Law. For federal income tax purposes, neither Petitioner nor the Qualified Funds maintained by Petitioner will recognize gain or loss or otherwise take any income or deduction into account by reason of the transfer of the Qualified Funds assets to the Qualified Funds of ENIP. With respect to the Non-Qualified assets, the transfer of such assets to the Pooling Partnership prior to the closing is disregarded for federal income tax purposes. Petitioner is treated as selling the underlying assets of the Non-Qualified Funds, and Petitioner's 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 of the IRC and the corresponding regulations.

Section 208.9 of the Tax Law does not contain any modifications that would modify Petitioner's federal taxable income with respect to the treatment of the Qualified Funds and

Non-Qualified Funds. Accordingly, for purposes of Article 9-A of the Tax Law, the federal treatment of these Funds will be followed.

With respect to Issue 2, section 186-a of the Tax Law is not federally conformed. Petitioner's transfer of the assets of its QNDT and NQNDT to ENIP in the September 6, 2001 transaction is treated as the sale or other disposition of such assets. The sale of Petitioner's Nuclear Units and related assets, including the assets of Petitioner's QNDT and NQNDT, is treated as one transaction or sale, and Petitioner will realize gross income under section 186-a of the Tax Law for the year of disposition under the category of profits from any transaction within New York State whatsoever. (See Central Hudson Gas & Electric Corporation, Adv Op Comm T&F, July 29, 1998, TSB-A-98(12)C, Q&A11).

Petitioner's profit, if any, that is recognized as gross income under section 186-a of the Tax Law, would equal the amount that the consideration received by Petitioner as a result of the transaction exceeds the original cost of the Nuclear Units and related assets, including the assets of Petitioner's QNDT and NQNDT, without deduction for depreciation. The profit is determined based on the sale of the aggregate of Petitioner's Nuclear Units and related assets, including the assets in Petitioner's QNDT and NQNDT, not the sale of each asset separately. If the sale of the Nuclear Units and related assets, including the assets of Petitioner's QNDT and NQNDT results in a loss, rather than a profit, such loss may not be deducted from Petitioner's other gross income. See Central Hudson Gas & Electric Corporation, Adv Op Comm T&F, December 18, 2002, TSB-A-02(22)C. This Advisory Opinion does not address how to determine the original cost of the Nuclear Units and related assets, or what particular assets should be included in determining such original cost.

DATED: August 1, 2003

/s/
Jonathan Pessen
Tax Regulations Specialist IV
Technical Services Division

NOTE: The opinions expressed in Advisory Opinions are limited to the facts set forth therein.