

CLIENT ALERT

Under Federal Circuit Decision, Asset Purchaser May Recognize Gain

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Last week, in *AmerGen Energy Company, LLC v. United States*, the Federal Circuit agreed with the Court of Claims that an acquirer of assets may not include assumed contingent liabilities in its tax basis until the "all events" test is met and the liabilities are "incurred." While *AmerGen* involved nuclear decommissioning liabilities, it is relevant in many other situations in which an acquirer assumes contingent liabilities in connection with the purchase of assets. The court's holding also presents a trap for the unwary. Depending on the facts, a purchaser may have to recognize gain as a result of the transaction, a result that would be an unwelcome surprise.

The case involved AmerGen Energy's purchase of three nuclear power plants for about \$93 million in cash and the assumption of \$2.15 billion in decommissioning liabilities. In exchange, AmerGen received the power plants as well as funds of marketable securities worth about \$974 million. At issue was AmerGen's "cost basis" in the power plants. AmerGen contended that its basis should include the assumed decommissioning liabilities. The government argued that AmerGen should not get basis credit for the assumed liabilities until those liabilities were "incurred," something that might not happen for over 100 years. The facts and background of the case are discussed further in our [Alert on the Court of Federal Claims' decision](#) in this case.

In short, both parties in the case agreed that a taxpayer's basis in purchased assets is "cost" under Code section 1012. They also agreed that where a purchaser assumes an obligation that is debt for federal income tax purposes, the purchaser receives immediate basis credit for the issue price of that debt. The question was essentially whether a contingent liability that could be estimated with reasonable accuracy could be considered to be "debt" for this purpose. The Federal Circuit agreed with the government that it could not. Thus, under this holding, where a purchaser assumes a contingent liability, the purchaser does not get basis credit until the obligation would otherwise be deductible under the purchaser's method of accounting. For an accrual method taxpayer like AmerGen, the economic performance rules would have to be met.

Acquirers of assets should consider this holding when allocating the purchase price among the assets. Often purchasers and sellers will agree to a "section 1060 allocation" of the purchase price plus assumed liabilities among the assets. Where an accrual method purchaser assumes a liability, but has not satisfied the economic performance requirement for that liability, the purchase price allocated under section 1060 should not include the liability. The parties should agree, however, on how the liability will be allocated once economic performance occurs. Such agreements are common for other delayed consideration, such as escrow and earnout payments.

The delay in basis credit for assumed contingent liabilities can also cause an anomalous result in certain circumstances. Generally, a purchaser does not have taxable income as a result of an acquisition. However, a purchaser could potentially have taxable income if the amount of cash it receives in a transaction exceeds its basis in the property. Treas. Reg. § 1.338-6(b). The Federal Circuit determined that AmerGen could get immediate basis credit only for the \$93 million in cash it paid and not for the \$2.15 billion in liabilities it assumed. Thus, for example, if AmerGen had received \$974 million in cash instead of marketable securities, AmerGen would have had immediate taxable income of \$881 million (the excess of \$974 million over the \$93 million

paid by AmerGen). AmerGen avoided this up-front taxable income by receiving funds of marketable securities instead of cash. However, because it only had \$93 million in basis to allocate to the funds, it ended up recognizing gain as it sold assets in the funds. Thus, receiving marketable securities instead of cash only helped AmerGen to some extent.

Businesses acquiring assets and assuming contingent should carefully consider the implications of *AmerGen* in planning the transaction.

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