



STATE OF WASHINGTON
DEPARTMENT OF REVENUE

January 5, 2004

D. Michael Young, Partner
KPMG
801 Second Ave Suite 900
Seattle WA 98104

Subject: Tax Consequences from Transfer of Assets

Registration No.: 602 035 878, Frederickson Power LP
179 010 055, Puget Sound Energy, Inc.

Dear Mr. Young:

This is in response to your letter dated December 17, 2003, regarding the tax consequences of transferring assets between three entities as described in your letter. Below, I will outline the facts and the steps to the transfer as described in your letter. After each step, I will provide a ruling as to the tax obligations incurred by conducting that step. We will consider the applicability of real estate excise tax (REET), sales/use tax and business and occupation (H&O) tax to each step. We will conclude by discussing the above tax consequences of the steps/ transactions taken as a whole.

Facts:

You provide the following information:

- Frederickson Power, L.P. (FPLP) is registered to conduct business in Washington.
- Puget Sound Energy, Inc. (PSE) is registered to conduct business in Washington.
- EPDC Inc. (EPDC) owns 99.9% of FPLP and Frederickson Power Management, Inc (FPMI) owns the remaining .1%
- FPLP owns land, improvements and personal property, comprising a natural-gas-fired combined-cycle generating facility. (the Frederickson I Facility)
- Of the Frederickson I Facility's 249.3-megawatt output capacity, 125 MW is fully committed in contract with three public utility districts.
- The uncommitted output capacity of 124.3 MW is 49.85% of the facility's total capacity.
- FPLP has proposed to transfer 49.85% of the Frederickson I Facility to PSE.
- Washington REET was previously imposed on the real property currently owned by FPLP in August 2002, when EPDC acquired a controlling interest in FPLP from a third party.

Taxpayer Services
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- There has not been any subsequent transfer of interest in FPLP.
- Washington sales or use tax has been paid with respect to the tangible personal property that is included in the Frederickson I Facility.

The parties anticipate the following transactions:

Step 1.

At the closing of the transactions, FPLP will contribute all of the assets that are associated with the ownership and operation of the Frederickson I Facility (the "Frederickson I Assets") – including all real and tangible property – and liabilities in nature of potential future, contingent exposures (but not debt) to a new limited liability company (LLC) of which FPLP will be the sole owner. The LLC will have been formed prior to the date that the contribution of the Frederickson I Assets will take place. The LLC will, however, issue additional LLC interests to FPLP as a result of its' receipt of the Frederickson I Assets, with FPLP continuing to own 100% of the issued and outstanding interests in the LLC.

REET

The Department agrees with your conclusion that REET will not be assessed based upon this transaction. The above transfer is a mere change in identity or form of ownership of the real estate. As provided in WAC 458-61-375, these types of transactions are exempt from REET.

Sales and Use Tax

The Department agrees with your conclusion that sales or use tax would not be imposed because of the above transaction. (Step 1.) As provided in WAC 458-20-106, this transaction consists of capital assets that are transferred through an adjustment of the beneficial interest of the business.

B&O Tax

The Department agrees with your conclusion that B&O tax would not be due on Step 1. As stated above, the transaction is a transfer of capital assets through an adjustment of the beneficial interest in the business. This does not constitute a "sale" within the meaning of RCW 82.04.040.

Step 2.

Immediately following Step 1, FPLP will sell a 49.85% interest in the LLC to PSE, with the result that FPLP will remain the owner of 50.15% of LLC and PSE will become the owner of the other 49.85% interest in LLC.

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REET

The Department agrees with your conclusion, that REET will not be imposed due to Step 2. The transfer is less than 50%; therefore, it is not a transfer of controlling interest. As provided in WAC 458-61-025, only transfers in the controlling interest in an entity are subject to REET. However, if within one year of this transaction, an additional transfer of 0.5% or more of the interest in the LLC is transferred, REET will apply to the total transferred within that one year period.

Sales and Use Tax

The Department agrees with your conclusion, that sales/use tax will not apply to transaction in Step 2. The sale of beneficial interest in the company is a sale of intangible property, not tangible personal property, and, therefore, not subject to sales or use tax. As provided in RCW 82.04.050, retail sales include all tangible personal property and certain "retail services" but do not include the sale of intangible property.

B&O Tax

Assuming that the transfer of the ownership interest in the LLC is not a regular business activity of FPLP, the Department agrees with your conclusion, that the transaction described in Step 2, will not result in the imposition of the B&O tax. We agree that this is a casual sale as described in WAC 458-20-106 and not subject to the B&O tax.

Step 3.

Immediately following Step 2, LLC will liquidate by distributing all of its' assets and liabilities to FPLP and PSE according to their respective ownership interests. Thus, after the liquidation FPLP and PSE will own 50.15% and 49.85%, respectively, undivided interest in the Frederickson 1 assets as tenants in common.

REET

The Department agrees with your conclusion, that the transaction as described in Step 3 will not result in the imposition of REET. As provided in WAC 458-61-375 (2H) the distribution of real property to the partners is exempt as long as the property distributed and vests in each of the partners in proportion to the partners' interest in the LLC.

Sales and Use Tax

The Department agrees with your conclusion, that the transaction as described in Step 3 will not result in the imposition of sales/use tax. There is no "sale" of the assets. The transaction is considered a transfer of capital assets accomplished through an

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adjustment of the beneficial interest in the business. This type of transaction is not taxable under RCW 82.04.050.

R&O Tax

The Department agrees with your conclusion, that the transaction as described in Step 3 is not subject to the B&O tax. This transaction does not constitute a sale within the meaning of 82.04.040, and is, therefore, not subject to R&O tax.

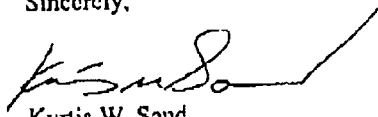
Transaction as a whole:

The Department agrees that the above outlined transaction taken as a whole will not result in the imposition of R&O, sales, use, or B&O taxes. As outlined in *3 WTD 259*, when the individual steps result in no taxation, the transaction as a whole must result in no taxation.

This ruling is binding upon Frederickson Power L.P., Puget Sound Energy, Inc., and the Department of Revenue under the facts presented. It will remain binding until: the facts change, the law changes (either by statute or court decision); the applicable rule(s) are amended; the Department of Revenue publicly announces a change in the policy upon which this ruling is based; or Frederickson Power L.P. or Puget Sound Energy, Inc., is notified in writing that this ruling is not valid.

Please let me know if you have any further questions.

Sincerely,



Kurtis W. Sand
Tax Information Specialist
Taxpayer Information and Education Section