FINAL PRIVATE LETTER RULING

REQUEST LETTER

08-008

July 7, 2008

Utah State Tax Commission
210 North 1950 West
Salt Lake City UT 84134

Re: COMPANY.
Private Letter Ruling Request

Dear Commissioners:

For and on behalf of COMPANY, a STATE corporation (the "Company"), this letter requests a ruling from the Utah State Tax Commission (the "Commission") on the application of the Utah Corporate Franchise and Income Tax Act, Utah Code Ann. §59-7-101, *et seq.,* with respect to the proposed transaction described herein.

A. REQUEST

Pursuant to Utah Admin. Code Ann. § 59-1-210 (Commission general powers and duties) and Utah Admin. Code R861-1A-34 (Private Letter Rulings, the Company seeks a "Private Letter Ruling" that having its doré (defined below) refined by an independent refiner located in Utah for a processing (service) fee will not subject the Company to Utah corporate franchise and income taxes. That is, the Company seeks a determination from the Commission that (1) the Company will not be deemed to be "doing business in Utah" through or as a result of the proposed refining arrangement; (2) the proposed refining arrangement will not constitute a taxable Utah "sale" by the Company that is apportionable to Utah; and (3) neither the issuance nor transfer of electronic credits for gold and silver bullion will constitute a taxable "sale" by the Company that is apportionable to Utah.

B. FACTS

The Company is in the business of mining gold from mines it owns and operates in 2 ND STATE. The Company has no presence in Utah and is not qualified to do business and is not doing business in Utah. As a result of the extracting and smelting processes that occur at the mines in 2ND STATE, the Company produces a product known as "doré" (a mixture of gold, silver and other metals cast in bars). Further refining of doré is required in order for the gold and silver content to be separated into established industry specification levels for sale or exchange on international commodity markets. This further refining produces bars of "gold bullion" and "silver bullion". Presently the Company's doré refining occurs outside of the

United States (primarily Switzerland) and that arrangement is likely to continue without a favorable Commission ruling.

The Company proposes to ship quantities of doré to AGENT, as its agent, for the necessary further refining into bullion. AGENT, an unrelated precious metals refiner, has a facility located in Salt Lake City and proposes to refine the Company's doré into bullion for a processing (service) fee. Shortly after AGENT receipt of the doré, the Company's account will be credited with the specified measure of gold and silver based upon weight, assay and agreed commercial metal return terms of the doré bars. At all times throughout the agent refining operations, title to the gold and silver remains with the Company.

The Company proposes to enter into a master gold and silver purchase contract with INTERNATIONAL COMPANY, a OUT OF COUNTRY COMPANY, whereby INTERNATIONAL COMPANY will purchase bullion from the Company based upon the London Gold Market PM Fix price for gold bullion and the London Silver Market Spot Fixing price for silver bullion as determined by the London Bullion Market Association on the settlement date. The contract between the Company and INTERNATIONAL COMPANY will be negotiated and entered into outside of Utah and will be in place before doré is delivered by the Company to AGENT in Salt Lake for the refining described above.

Within set time periods and through electronic commodity account transfers, the specified measure of bullion will be electronically transferred (credited) to a designated JP Morgan commodity account of INTERNATIONAL COMPANY in London, UK. Until the credit to the designated JP Morgan London commodity account of INTERNATIONAL COMPANY is electronically made, all market and price risks remain with the Company. Once INTERNATIONAL COMPANY designated JP Morgan London commodity account is electronically credited, title and risk of loss for the gold and silver pass from the Company to INTERNATIONAL COMPANY. At this point in time the agreed purchase price will be paid by INTERNATIONAL COMPANY to the Company.

The credits electronically deposited into INTERNATIONAL COMPANY designated JP Morgan London commodity account represent a specific measure of gold or silver, but such are not identifiable to specific bars, grains (or other forms) of gold or silver. Although the doré undergoes a change in form and purity, the Company has gold and silver at the start of the AGENT refining process and the right to an equivalent measure of gold and silver upon completion of the refining process, albeit in the form of intangible gold and silver credits. This is very analogous to a person delivering money to a bank. The bank receives the currency (or coin) and issues a credit (pass-book) so the person can demand back equivalent amounts of currency (or coin). While the credit entitles the holder to get an equivalent sum of currency (or coin) from the bank, it will not necessarily be the same currency (or coin) that was delivered to the bank in the first instance.

The electronic credits for gold and silver bullion may be sold or exchanged on the international commodity markets and/or used in a fashion that is similar to currency. Additionally, the electronic credits do not represent a claim check or warehouse receipt for any actual gold or silver bullion, nor are they secured obligations.

Under the above-described transactions, except for the short time required to complete the refining process, AGENT will not store or warehouse gold and silver for the Company. At no time will AGENT take title to the doré or gold and silver bullion. No Company doré or bullion is reflected in the inventory of AGENT. No Company gold or silver will be purchased by or sold to AGENT. There will be no Utah buyers of the Company's doré. The sole purpose for any Utah contact in the transaction is for AGENT to refine doré into bullion for a processing (service) fee. In connection with the refining process, AGENT will seldom have possession of the gold and silver for more than two weeks.

Although the Company is seeking assurance that the foregoing refining services arrangement with AGENT will not create a Utah corporate franchise and income tax liability for the Company, the commission has already considered this issue in an advisory opinion dated November 16, 2000, a redacted copy of which is attached as Exhibit A. In that request, assurance was sought that processing doré and granting of credits associated with bullion would not create Utah corporate franchise and income tax liability. The commission found that no Utah corporate franchise and income tax liability would arise for AGENT customer under the circumstances described in the request. With only minor deviations, the arrangement contemplated herein is substantially identical to the arrangement present in the prior private letter ruling. However, because a private letter ruling concerns "the application of statues and rules to specific facts and circumstances," Utah Admin. Rule 861-1A-35A., the company seeks its own ruling that the transactions described herein will not create Utah corporate franchise and income tax liability for the Company.

C. LAW

Utah corporate franchise and income taxes are governed by Utah Code Ann. §59-7-101, *et. Seq.* (the "Statute"). Specifically, Utah Code ann. § 59-7-104(1) provides in pertinent part:

> (1) Each domestic and foreign corporation . . . shall pay an annual tax based on its Utah taxable income for the taxable year for the privilege of exercising its corporate franchise or for the privilege of doing business in the state.

Therefore, a foreign corporation shall be subject to Utah corporate franchise and income tax if it is found to be "doing business in the state." *Id.; see also,* Utah Admin. R 865-6F-6(B). The Statute goes on to provide that "doing business in the state" means "any transaction" performed by a "foreign corporation doing intrastate business in the state." Utah Code Ann. § 59-7-101(12). The administrative rules accompanying the Statute provide some specific examples of situations where a foreign corporation not qualified to do business in the state would nevertheless be conducting business in the state. *See generally*, Utah Admin. R. 865-6F-6. Although none of the situations presented in the administrative rules directly address the present matter, it appears that certain actions are more likely to be viewed as constituting doing business in the state than others. Examples of such actions include, among other things, conducting sales to purchasers located in the state, or maintaining an office, inventory or employees in the state. *Id.*

In the event a foreign corporation is found to be doing business in the state, its multi-state income is then apportioned among Utah and the other states in which it conducts business under the Uniform Division of Income for Tax Purposes Act ("UDITPA"). Under UDITPA, the amount of "business income [1]" of a foreign corporation that will be apportioned as taxable income in Utah is calculated by multiplying the corporation's waters-edge (or worldwide) business income by a fraction that is comprised of the average of three indicators or factors of economic activity of the foreign corporation in the state. Utah Code Ann. § 59-7-311. These factors of economic activity include actions within the state relating to the corporation's (1) property, (2) payroll, and (3) sales. *Id.*

The property factor is based upon property located in the state available or capable of being used during the tax period in the regular course of business of the taxpayer. Utah Admin. R. 865-6F-8(7)(b). Property in transit between locations of the taxpayer to which it belongs shall be considered to be at the destination for purposes of calculating the property factor. Utah Admin. R. 865-6F-8(7)(d).

The payroll factor is calculated by taking the total amount paid by the taxpayer in the state as compensation during the tax period and dividing this figure by the total amount of compensation paid by the employer on a waters-edge (or worldwide basis during the tax period. Utah Code Ann. § 59-7-316.

The sales factor is determined by taking the total sales of the taxpayer in the state during the tax period and dividing this figure by the total sales of the taxpayer on a water-edge (or worldwide) basis during the tax period. Utah Code Ann. § 59-7-317. More specifically, the sale of tangible property will be deemed to have occurred in Utah if:

(1) The property is delivered or shipped to a purchaser, other than the United States Government, within this state regardless of the f.o.b. point or other conditions of the sale, or

(2) The property is shipped from an office, store, warehouse, factory, or other place of storage in this state, and

(a) the purchaser is the United States Government; or

(b) the taxpayer is not taxable in the state of the purchaser.

Utah Code Ann. § 59-7-318.

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[1] A corporation's "business income" is defined as income "arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition management, and disposition of the property constitutes integral parts of the taxpayer's regular trade or business operations." Utah Code Ann. § 59-7-302(8).

With respect to 2(b) above, the Statute further provides that "for purposes of allocation and apportionment of income [under the Statute], a taxpayer is taxable in another state if . . . that state has jurisdiction to subject the taxpayer to a net income tax *regardless of whether, in fact, the state does or does not."* Utah Code Ann. § 59-7-305 (emphasis added).

In *Hercules Inc. v Utah State Tax Commission,* 877 P.2d 133 (Utah 1994) the Utah Supreme Court adopted and explained this Statutory "destination rule" for purposes of determining the proper sourcing of a sale as "the destination of the goods sold determines the location of the sale, rather than the point at which title passes or other conditions of the sale that the parties can manipulate." *Id.* at 136. The Court's analysis stressed that the destination rule applies "only to interstate sales." Accordingly, the rule did not apply in *Hercules* because the sales of the rocket motors at issue were not in interstate commerce. *Id.* Rather, the Court found the rocket motors were delivered to Lockheed Martin, the intended purchaser, within Utah "[b]ecause Lockheed was a Utah purchaser, not an out-of-state purchaser, the motor sales were Utah sales were Utah sales," property included in the Utah numerator under the UDITPA sales factor for apportionment of Hercules' Utah income. *Id.* However, as explained above, the "purchaser" in this case is INTERNATIONAL COMPANY, which is undisputedly an "out-of-state purchaser." Hence, as explained below, the "destination rule" applies.

D. DISCUSSION AND APPLICATION

In order for the Company to be taxable in Utah it must be considered to be "doing business in the state." *See* Utah Code Ann. § 59-7-104(1). The Company believes that the sole act of sending doré to Utah for contract refining by an independent refiner does not constitute its doing business in the state. Moreover, the doré / bullion are literally in transit while in Utah and are not stored or held as inventory in Utah. The Company's limited contact with Utah is distinguishable from activities that would typically be considered doing business in the state, such as maintaining a store of good, employing workers, engaging in sales to Utah persons or entities, or maintaining an office. *See* Utah Admin. R. 865-6F-6(B). Therefore, the Company believes that its contacts with Utah through having contract services performed by AGENT, an independent third party, are *de minimis* and insufficient to subject the Company to taxation under the "the doing business in Utah" standard pursuant to the Statute.

In the unlikely event the Commission were to find the Company is doing business in Utah, the Company further believes that it will generate no apportionable income under the Statute.

With respect to the property factor, doré / bullion will only temporarily be located in Utah for contract processing while it is in transit from mines in 2nd STATE to its ultimate destination in London or elsewhere outside of Utah. In accordance with Utah Admin. R. 865-6F-8(7)(d), property in transit shall be considered to be at the destination of the gold and silver, which in this proposed transaction will be outside of Utah. The Company has no inventories or warehoused

gold or silver in Utah being held for sale in the ordinary course of business. Therefore, the property factor is zero.

With respect to the payroll factor, the Company will maintain no Utah employees and will pay no compensation in the state. Therefore, the payroll factor is zero.

With respect to the sales factor, no elements of a sale of a tangible property will occur in Utah, because under the requirements of Section 59-7-318, the purchaser is neither in Utah nor is it the United States government. Utah Code Ann. § 59-7-318(1)(a). Moreover, and in accordance with Section 59-7-318(1)(b), no gold or silver is being shipped from "an office, store, warehouse, factory, or other place of storage in this state," because AGENT does not act as a "place of storage" of the gold and silver, and the Company has no storage facilities in the state. *See* Utah Code Ann. § 59-7-318(1).

Even assuming the gold and silver are considered to be held at a temporary "place of storage" in the state, the "throwback rule" of Section 59-7-318 provides that a sale of tangible goods will only be considered to have occurred in Utah if "the taxpayer is not taxable in the state of the purchaser." *See* Utah Code Ann. § 59-7-318(1)(b)(ii)(B). As described in the Law section above, Section 59-7-305 sets forth the test that whether a "taxpayer is taxable in another state" does not hinge upon whether the taxpayer is actually taxed in such other state, but rather on whether the "state has jurisdiction to subject the taxpayer to a net income tax." Utah Code Ann. § 59-7-305(2). The jurisdiction wherein the sale occurs, in this instance London, UK, has the authority to subject the sale to a income type tax. Accordingly, the destination rule should control the sourcing of the sale and no Utah sales factor would exist.

E. CONCLUSION

Consistent with the prior private letter ruling obtained by AGENT customer, the Company requests the Commission rule that the transactions described herein will create no Utah corporate franchise and income tax liability for the Company for the reasons that (1) refinement of doré by an independent refiner in Utah does not constitute the Company doing in business in Utah, (2) no doré or bullion is delivered to a purchaser in Utah, and (3) for purposes of apportionment, even if a "sale" is claimed to occur in Utah, it would properly be attributable to the destination state (foreign county) rather than Utah, because the electronic credit transfer occurs in the foreign county and the throwback rule does not apply.

A conference is requested if any decision is contemplated by the Commission that would be adverse to the requested ruling, prior to the decision being issued.

To the best knowledge of the Company, the issues presented in this request are not pending before the Commission in an audit assessment, refund request or other agency action.

We thank you in advance for the clarity you can provide with respect to the application of the Utah corporate franchise and income tax to the above-described transaction, and appreciate your attention to this private letter ruling request.

Sincerely,

REQUESTOR BUSINESS
REQUESTOR

Under penalties of Perjury, I declare I have reviewed this letter, including all accompanying documents and to my knowedge and belief the facts and statement presented herein are true, correct and complete.

COMPANY
By: NAME, Tax Director

[REQUEST LETTER EXHIBIT A IS PRIVATE LETTER RULING 00-011.]

RESPONSE LETTER

January 29, 2009

REQUESTOR
ADDRESS

Sent via e-mail
Original to follow in the U.S. mail

Re: PLR 08-008—Tax Consequences for COMPANY.

Dear REQUESTOR:

You have requested the Tax Commission to issue a private letter ruling on whether COMPANY can contract for further refining services from AGENT Utah facility without being deemed to be doing business in Utah for Utah corporate franchise tax purposes. Specifically, the Company seeks this private letter ruling to obtain assurances that it would not be subject to changes in its Utah corporation franchise tax based on a proposed arrangement. Although the Company is currently not doing business in Utah, it is part of a unitary group that files a waters-edge return in Utah. The unitary group includes an affiliated service company that maintains a Utah presence with a small office and employees. Based on your request letter, as well as subsequent conversations, we understand that the proposed transaction would involve the circumstances as stated below.

PROPOSED ARRANGEMENT

The Company is a 1ST STATE corporation that engages in mining activities in 2 ND STATE. These activities produce quantities of doré, a mixture of gold, silver, and other metals cast in bars. These bars must be further refined into gold and silver bullion, which meet established industry specification levels for sale on the international commodity markets. Presently, the Company's further refining occurs outside the United States, primarily in Switzerland.

The Company proposes to contract with AGENT to provide further refining of doré at AGENT Utah facility instead of outside the United States. Under the agreement, the Company would transfer physical possession of its doré to AGENT. Shortly after receipt, AGENT would issue credits to the Company for the specified measure of gold and silver based upon weight, assay and agreed commercial metal return terms of the doré. These credits represent the right to a specific amount of bullion in terms of quantity and quality. At all times throughout the AGENT refining operations, the Company would retain title to the gold and silver.

The Company would own the doré at the start of the refining process and hold title and the right to a specified measure of gold and silver bullion upon issuance of the credits by

AGENT. This right would be in the form of electronic credits for gold and silver bullion. These credits are readily transferable on the international commodities market. Inasmuch as gold and silver bullion is a fungible commodity, the credits do not represent a claim for any particular gold or silver, and may be redeemed at any gold or silver repository throughout the world.

For the refining process, AGENT would have possession of a shipment of gold and silver for approximately two weeks or less. During that time, AGENT would not take title for the gold and silver nor would its records reflect ownership of the Company's gold and silver in its inventory. AGENT would not purchase the gold and silver at anytime. AGENT would receive a processing fee for the refining services.

Before shipping the doré to AGENT, the Company would enter into a purchase contract with INTERNATIONAL COMPANY, a Barbados company. INTERNATIONAL COMPANY and the Company are related through a non-U.S. parent. Under the contract, INTERNATIONAL COMPANY would purchase from the Company gold and silver bullion based on gold and silver market prices established from day to day on the London commodity markets for gold and silver as fixed on the settlement date. All market and price risks remain with the Company until the settlement date. It appears from your letter that at the time the contract is formed, the exact prices and quantities are unknown. It is not until the settlement date that these factors are known and the exact terms of payment are established. This purchase contract would be negotiated and entered into outside of Utah.

Pursuant to the contract, the Company would transfer its credits for specific measures of bullion to INTERNATIONAL COMPANY through electronic commodity transfers to INTERNATIONAL designated JP Morgan commodity account in London, England in exchange for the agreed upon purchase price. These credits to the London account are the same credits issued by AGENT to the Company's account at the beginning of the refining process. According to your letter when INTERNATIONAL COMPANY account is credited, title and risk of loss for the gold and silver would pass from the Company to INTERNATIONAL COMPANY. None of the gold or silver would be sold or transferred to a Utah buyer. By this point, the specific bullion has lost its identity, and has become part a general inventory maintained by AGENT for other entities as well as the Company. Furthermore, as we stated previously, the credit right for bullion is not specific to AGENT, but rather, may be redeemed anywhere in the world. Any purchaser of the credits has the right to deposit them with any repository where the purchaser has or opens an account.

In a subsequent phone conversation, you represented that once the bullion is credited to INTERNATIONAL COMPANY account, the credits are sold on a bullion commodities market. The credits or options can be sold several times in one day. Ultimately, bullion is transferred in one form or another to an end user. Again, none of the bullion can be identified as the original product shipped from 2ND STATE to Utah, nor do any of the credits issued by AGENT and sold by the Company require that the bullion be withdrawn from inventories maintained by AGENT.

A critical issue is that at no point, from the time they are issued by AGENT throughout multiple transactions in the commodities market, can the credits be sourced to discreet, identifiable bullion. Based on a conversation with your client and a representative from AGENT,

we understand that even when an end user takes physical possession of the actual bullion, it is done so by request for withdrawal and presentation of a credit for the amount of bullion to be withdrawn. An account in which credits have been deposited must be set up prior to any transfer of bullion.

ISSUES

The three issues of this private letter ruling, as you set forth in your letter, are:

1. Whether the Company would be deemed to be doing business in Utah as a result of the proposed refining arrangement.

2. Whether the proposed refining arrangement would constitute a sale apportionable to Utah for the calculation of corporate franchise tax.

3. Whether the issuance of electronic, bullion credits from AGENT or the transfer of those credits to INTERNATIONAL COMPANY, a non-Utah buyer, would constitute a sale apportionable to Utah.

ANALYSIS

I. THE COMPANY WOULD BE DEEMED TO BE DOING BUSINESS IN UTAH AS A RESULT OF ITS PROPOSED REFINING ARRANGEMENT.

The Company would be subject to Utah corporate franchise tax because the refining arrangement would be considered a transaction, and because the Company would own doré, which is personal property, within Utah. Utah Code Ann. § 59-7-101(15) defines "foreign corporation" as "a corporation that is not incorporated or organized under the laws of this state." Utah Code Ann. § 59-7-101(12) provides:

> (a) "Doing business" includes any transaction in the course of its business by a domestic corporation, or by a foreign corporation qualified to do or doing intrastate business in this state.
> (b) Except as provided in Subsection 59-7-102(2), "doing business" includes:
> (i) the right to do business through incorporation or qualification;
> (ii) the owning, renting, or leasing of real or personal property within this state; and
> (iii) the participation in joint ventures, working and operating agreements, the performance of which takes place in this state.

A. The proposed refining arrangement would constitute a transaction.

Utah Code Ann. § 59-7-101(12)(b)(iii) provides that a corporation is doing business in Utah if it engages in a transaction within this state. Under the proposed arrangement, the

Company would pay AGENT a processing fee to refine the doré into bullion. We deem this to be a transaction.

B. The Company would own doré in Utah.

Under § 59-7-101(12)(b)(ii), a corporation is doing business if it owns personal property within Utah.[1] In the current situation, the Company owns personal property within Utah in the form of the doré, under the proposed arrangement. The Company would continue to own the doré while AGENT further refines it; AGENT would not purchase the doré. Accordingly, the ownership of the doré causes the Company to be doing business in Utah. Furthermore, as discussed more fully below, such ownership of doré would not be de minimis. Rather, the average value of the doré inventory must be included in the property factor. Moreover, the "in transit" language under Utah Admin. Code R865-6F-8 ("Rule 8") subparagraph (8)(d) does not exclude the doré inventory within Utah from the property factor.

C. The Company's ownership of doré in Utah would not be de minimis.

Consistent with § 59-7-101(12)(b)(i), subparagraph K. of Utah Admin. Code R865 -6F-6 ("Rule 6") states:

> The following in-state activities, assuming they are not of a de minimis level, will constitute doing business in Utah under P.L. 86-272 and will subject the corporation to the Utah corporation franchise tax:
>
> . . .
>
> 16. owning, leasing, using, or maintaining any of the following facilities or property in-state:
>
> . . .
>
> (f) stock of goods other than samples for sales personnel or that are used entirely ancillary to solicitation . . . .

Subparagraph A.2. of Rule 6 defines de minimis as follows:

> "De minimis activities" means those activities that, when taken together, establish only a trivial connection with the taxing state. An activity conducted within Utah on a regular or systematic basis or pursuant to a company policy, whether or not in writing, shall not normally be considered trivial.

Under subparagraph A.2., activities that are regular, systematic, or pursuant to a company policy are normally <u>not</u> de minimis. In the current situation, the Company would be sending the doré to AGENT for further processing on a regular or systematic basis and pursuant to a company policy. The refining of the doré will be regular and systematic. Therefore, even though the Company might have a relatively small amount of inventory in Utah at a given point in time, that

[1] Utah Code Ann. § 59-7-102(2), concerning certain printing activities, does not apply to this current private letter ruling.

inventory would still not be de minimis. Additionally, a decision finding the inventory to be de minimis in this situation would be inconsistent with the Utah State Tax Commission's treatment of other Utah companies in similar situations.

D. The Company's relationship with AGENT, an independent contractor, does not change the result.

Subparagraph M. of Rule 6 states:

> P.L. 86-272 provides protection to certain in-state activities if conducted by an independent contractor that would not be afforded if performed by the company or its employees or other representatives. . . . [However,][m]aintenance of stock of goods in the state by the independent contractor under consignment or any other type of arrangement with the company, except for purposes of display and solicitation, shall remove the protection.

Under subparagraph M., the maintenance of a stock of goods is treated the same regardless of whether the stock is maintained by the corporation's employees or by an independent contractor. In the current situation, the Company would continue to be doing business in Utah even though AGENT, an independent contractor, would be maintaining the Company's inventory of doré.

E. The property factor of the unitary group will include the value of the doré in Utah.

Utah Code Ann. § 59-7-312(1) defines the property factor as follows:

> . . . the property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in this state during the tax period and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used during the tax period.

Under § 59-7-312(1), the property factor includes personal property owned by a corporation within the state. Under the Utah Administrative Code, personal property includes inventories. Subparagraph (8)(a)(i) of Rule 8 states:

> The property factor of the apportionment formula shall include all real and tangible personal property owned or rented by the taxpayer and used during the tax period in the regular course of its trade or business. Real and tangible personal property includes land, buildings, machinery, stocks of goods, equipment, and other real and tangible personal property but does not include coin or currency.

Under subparagraph (8)(a)(i), tangible personal property includes "stocks of goods" and "all tangible personal property owned or rented." Inventories fall within these two broad categories of tangible personal property. Subparagraph (8)(b) of Rule 8 provides:

> Property Used for the Production of Business Income. Property shall be included in the property factor if it is actually used or is available for or capable of being used during the tax period in the regular course of the trade or business of the taxpayer. Property held as reserves or standby facilities or property held as a reserve source of materials shall be included in the factor. For example, a plant temporarily idle or raw material reserves not currently being processed are includable in the factor. Property or equipment under construction during the tax period, except inventoriable goods in process, shall be excluded from the factor until the property is actually used in the regular course of the trade or business of the taxpayer. If the property is partially used in the regular course of the trade or business of the taxpayer while under construction, the value of the property to the extent used shall be included in the property factor.

Under subparagraph (8)(b), the property factor includes "raw material reserves" and "inventoriable goods in process," whether such property "is actually used or . . . capable of being used." We interpret personal property to include inventories of raw material such as the doré the Company sends to AGENT.

In the current situation, the Company would be sending its doré into Utah for further refining into bullion. The doré is tangible personal property, an inventory, owned by the Company within Utah. The value of the doré must be included in the property factor of the unitary group because the Company owns this property in Utah. The inventory would be valued according to Utah statutes and rules, as explained below.

1. *The value of doré within Utah will be determined by averaging either the inventory values at the beginning and ending of the tax period or the monthly values during the tax period.*

Utah statutes and administrative rules provide guidance on valuing inventories. Utah Code Ann. § 59-7-314(1) states:

> The average value of property shall be determined by averaging the values at the beginning and ending of the tax period or averaging of monthly values during the tax period if monthly averaging more clearly reflects the average value of the taxpayer's property.

Under § 59-7-314(1), inventories are valued based on averaging. Subparagraph (8)(e)(ii) of Rule 8 states: "Inventory of stock of goods shall be included in the [property] factor in accordance with the valuation method used for state tax purposes." Subparagraph (8)(g) of Rule 8 provides additional guidance on when monthly averaging is appropriate.

In the current situation, the Company would value its doré by averaging its doré in Utah during the tax year, as required by § 59-7-314(1). As discussed earlier, although the Company's doré inventory may be relatively small, its inventory is still not de minimis. The inventory's value must still be included in the property factor even if the Company's apportionment creates a relatively low Utah tax when compared with the other states.

2. *Subparagraph (8)(d) of Rule 8, concerning property in transit, does not preclude the Company's inventory within Utah from the property factor.*

Subparagraph (8)(d) of Rule 8 states:

> Numerator. The numerator of the property factor shall include the average value of the real and tangible personal property owned or rented by the taxpayer and used in this state during the tax period in the regular course of the trade or business of the taxpayer. Property in transit between locations of the taxpayer to which it belongs shall be considered to be at the destination for purposes of the property factor. Property in transit between a buyer and seller that is included by a taxpayer in the denominator of its property factor in accordance with its regular accounting practices shall be included in the numerator according to the state of destination.

The "property in transit" language of this section cannot be interpreted to nullify the requirement to "include the average value of . . . property . . . used in this state . . . in the regular course of the trade or business of the taxpayer." Inventory that is being further processed may be destined for a different final destination. Having a final destination out-of-state, however, does not cause that inventory to be counted as out-of-state. In the current situation, the inventory is in Utah for a critical business purpose; it is not just passing through. Accordingly, the Company's inventory in transit into Utah for processing in Utah would be included in the Utah property factor even if such inventory were still in transit outside of Utah.

F. The Company's proposed arrangement differs from that of the previous Private Letter Ruling, PLR 00-011. The Company will own the doré stored in Utah whereas the mining company in PLR 00-011 did not.

In PLR 00-011, an out-of-state gold mining company ("mining company") mined and refined its gold doré bars in 2ND STATE. It proposed to hire a company with a Utah facility ("Utah company") to sample and verify in Utah the gold and silver content of the bars. As we understood and as stated in our letter for PLR 00-011, to perform the services, the Utah company issued credits to the mining company before it took physical possession of the gold doré. Outside of Utah, the mining company would auction those credits to non-Utah buyers. That auction would be "completed prior to the gold doré being moved from 2ND STATE to [Utah]." Additionally, the mining company would recognize revenue for purposes of its federal tax returns before moving the doré bars to Utah. Therefore, the mining company would not own the gold doré when it would be in Utah for refining. The unique facts of PLR 00-011 supported the Commission's implicit conclusion that the mining company's Utah tax position would not change based on the proposed transaction; e.g., the mining company did not own property in Utah.

In contrast, under the proposed arrangement, before the Company transfers its inventory into Utah, it will enter into a purchase contract with INTERNATIONAL COMPANY, a non-Utah, related-party buyer. However, the ultimate selling price of the credits will be unknown.

Therefore, the Company apparently would not recognize revenue for purposes of its federal tax returns at this time. It will continue to own its inventory at all times throughout the AGENT refining operations. Upon completion of the refining process, the Company will own the electronic credits for gold and silver bullion and the associated rights for the specified bullion as represented by the credits issued by AGENT. The Company will then transfer the electronic credits to INTERNATIONAL COMPANY for the now-known, purchase price. Therefore, the Company will likely recognize revenue for purposes of its federal tax returns at this time, which is after gold doré processing is completed in Utah. Under the terms of the proposed arrangement, it is clear that the Company will not complete the processing and selling of its inventory before doré enters Utah.

In summary, because the two proposed arrangements differ as to the timing of the transfer of the doré inventory, the Company will own inventory in Utah, while the mining company of PLR 00-011 would not. Therefore, the Company will be affected by the Utah property factor.

II. CONSISTENT WITH THE PREVIOUS PRIVATE LETTER RULING, PLR 00-011, THE COMPANY WOULD NOT INCUR A UTAH SALE WHEN AGENT EXCHANGES CREDITS FOR PHYSICAL POSSESSION OF THE DORÉ OR WHEN THE COMPANY LATER SELLS THE CREDITS TO INTERNATIONAL COMPANY, A NON-UTAH BUYER.

For the sales factor, the Company would not incur a Utah sale when it transfers the electronic bullion credits to INTERNATIONAL COMPANY, a non-Utah buyer. Also, the Company would not incur a Utah sale when it transfers physical possession of its doré inventory to AGENT for further refining and receives credits in return, as customary in the industry. For the sales factor, the facts of this current situation are sufficiently similar to those of Private Letter Ruling 00-011.

As discussed previously, in PLR 00-011 a mining company mined and refined its gold into "gold doré" bars in 2ND STATE. It proposed to hire a company ("Utah company") to sample and verify the bars' content at the company's Utah location. To provide this service, the Utah company would take physical possession of the bars and issue credits to the mining company. This Commission considered the issue of "whether [this] exchange of credits for gold doré would be considered a 'Utah sale' for corporate franchise purposes." We found that the exchange would not be a Utah sale, stating:

> We recognize that there are unique circumstances surrounding the gold industry that obfuscates whether the transfer of credits for gold doré is a sale for corporate franchise purposes. Nevertheless, if [the mining company] and [the Utah company] enter into a contract for the purchase of sampling and verification services (as described above) without contracting for the sale of the gold doré, we will neither view the proceeds from the gold [the mining company] auctions to non-Utah buyers as a Utah sale nor attribute such revenues to the numerator of the sales factor of the UDITPA three-factor formula for purposes of the Utah corporate franchise tax.

In PLR 00-011, we treated neither the Utah company's issuance of credits for physical possession of the gold doré nor the mining company's sale of those credits as Utah sales.

In the current situation, we are treating the proposed refining arrangement similar to the treatment of the sampling and verification arrangement of PLR 00-011. In PLR 00-11, the Utah company would issue credits and take physical possession of the doré. Under your proposed arrangement, AGENT would credit the Company's account with the specified measure of gold and silver based upon weight, assay and agreed commercial metal return terms of the doré bars. In both arrangements, the out-of-state mining companies would receive a credit or credits from a refining company with a Utah facility as the refining company takes physical possession of the doré. This exchange of a credit or credits for physical possession of doré is not a Utah sale. Although the current situation involves further refining, not just sampling and verifying, the result is the same.

III. THE COMPANY WOULD NOT INCUR A UTAH SALE WHEN IT TRANSFERS ELECTRONIC BULLION CREDITS TO INTERNATIONAL COMPANY IN EXCHANGE FOR THE CONTRACTED PURCHASE PRICE.

Based on the facts presented, the Company would have no Utah sales. In making this finding, and with respect to the application of the sales factor, we first look to the nature of the income. In this case three issues must be considered. First, we will examine whether the transaction is the sale of tangible personal property in the form of gold bullion or the sale of intangible property in the form of credits. At the same time we must establish where the transaction took place, within Utah or outside of Utah. Next, if the sale is considered to be in Utah, we must establish whether the sales factor as provided under §§ 59-7-311 and 59-7-317 fairly represent the extent of the Company's business activity in Utah.

A. Apportionment of Tangible Property Sold in Utah

Utah Code Ann. § 59-7-317(1) defines the sales factor as follows:

> . . . the sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the tax period, and the denominator of which is the total sales of the taxpayer everywhere during the tax period.

Utah Code Ann. § 59-7-318(1) defines sales in the state for tangible personal property, stating:

> Sales of tangible personal property are in this state if:
> (a) the property is delivered or shipped to a purchaser, other than the United States Government, within this state regardless of the f.o.b. point or other conditions of the sale; or
> (b) (i) the property is shipped from an office, store, warehouse, factory, or other place of storage in this state, and
> (ii) (A) the purchaser is the United States Government; or
> (B) the taxpayer is not taxable in the state of the purchaser.

In addition, subparagraph (10)(d) of Rule 8 provides further clarification as to when a sale occurs in Utah:

> Sales of Tangible Personal Property in this State.
> (i) Gross receipts from the sales of tangible personal property (except sales to the United States government; see Subsection (10)(e) are in this state:
> (A) if the property is delivered or shipped to a purchaser within this state regardless of the f.o.b. point or other conditions of sale; or
> (B) if the property is shipped from an office, store, warehouse, factory, or other place of storage in this state and the taxpayer is not taxable in the state of the purchaser.
> (ii) Property shall be deemed to be delivered or shipped to a purchaser within this state if the recipient is located in this state, even though the property is ordered from outside this state.
> (iii) Property is delivered or shipped to a purchaser within this state if the shipment terminates in this state, even though the property is subsequently transferred by the purchaser to another state.
> (iv) The term "purchaser within this state" shall include the ultimate recipient of the property if the taxpayer in this state, at the designation of the purchaser, delivers to or has the property shipped to the ultimate recipient within this state.
> (v) When property being shipped by a seller from the state of origin to a consignee in another state is diverted while en route to a purchaser in this state, the sales are in this state.
> (vi) If the taxpayer is not taxable in the state of the purchaser, the sale is attributed to this state if the property is shipped from an office, store, warehouse, factory, or other place of storage in this state.

Under § 59-7-318(1), sales in the state might occur in two general ways: first, property shipped to a purchaser in Utah may create a sale under § 59-7-318(1)(a); and second, property shipped from Utah may create a sale under § 59-7-318(1)(b).

The relevant portions of the statute and rule center on property being delivered from the state since the purchaser, INTERNATIONAL COMPANY, is not within this state, nor is the property delivered or shipped to a location within the state. In this case the product being delivered to the state is doré. The product being purchased, however, is bullion, which is processed in Utah, but not specifically delivered from the state.

It is clear that the Company is in the business of mining and selling gold and silver. What is not so clear is whether the purchase of bullion credits by INTERNATIONAL COMPANY is a sale in this state. The unique characteristics of the product make it difficult to determine where the tangible property is transferred. To begin, the gold and silver are in a raw state (doré) when it leaves the physical possession of the Company. Next, there is no market whatsoever for doré. Also, because bullion is a fungible commodity, the actual gold and silver that was shipped to Utah for additional refining is not identical either to the bullion to which INTERNATIONAL COMPANY obtains a claim through the purchase of the credits or to the bullion transferred to an end user when the credits are finally redeemed.

Further complicating the issue is that if the sale of the credits is deemed to be a sale of tangible personal property, then a second issue arises, whether each transaction on the commodities market would have to be considered similarly. Presumably, these sales or trades are accounted for and apportioned in the sales factors of commodities dealers and brokerage firms.

Finally, if we assume the initial transfer of title to the bullion takes place in the U.K. and understanding that the Company is subject to tax in the U.K., the sale of the bullion cannot be "thrown back" to Utah to be included in the numerator, as provided. We also see no basis for considering the income to be considered "nowhere" income for purposes of UDITPA simply because of the fungibility.

Given these complexities, it seems that the only possible time that the sale of bullion could clearly be sourced would be when physical possession is taken at the time the credit is presented and bullion is withdrawn from a repository. Even in this case, however, there is no actual sale, but rather a withdrawal from an account.

B. Intangible Property

Although the final product, bullion, is tangible personal property, it is not clear that INTERNATIONAL COMPANY even purchases tangible property. Since the credits may be redeemed at any gold or silver repository in the world, the credits could be considered tangible personal property. Utah Code Ann. § 59-7-319 has similar provisions for determining the source of a sale of intangible property. Under this interpretation, it is clear that the transfer of intangible property is from 2ND STATE to the U.K. Accordingly, the sale of credits by the Company to INTERNATIONAL COMPANY would not be in Utah.

C. Extent of the Company's Business Activity in Utah

Subparagraph (11) of Rule 8 provides:

> (a) Section 59-7-320 provides that if the allocation and apportionment provisions of UDITPA do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for, or the tax administrator may require, in respect to all or any part of the taxpayer's business activity, if reasonable:
> ...
> (iv) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

The primary operations of the Company are the mining of ore and production of doré in 2ND STATE. Its Utah operations consist of paying a fee to have a subcontractor refine the gold doré. Therefore, given the unique facts and operating practices inherent in this industry, even if the sale of credits were deemed to be a Utah sale, consideration must be given to using a method or special rule that would fairly reflect Utah apportionable income with respect to the sale of gold and silver bullion or credits that are redeemable for the physical commodity.

D. Determination of a Sales Factor

Based on the issues and concerns addressed above, we do not feel that inclusion of the sale of the credits in the numerator of the sales factor of the Company is appropriate in this case. If it is based on the sale of bullion as tangible property, not only is the sourcing of the physical property questionable, it may not fairly represent the extent of the Company's business activity in Utah.

The Commission believes it is possible to establish a reasonable basis to source the sales. We conclude that the sale of the credits represents the sale of bullion. In the present situation, regardless of whether the property is tangible bullion or intangible credits, we find that the transfer of title and the right of possession takes place in the U.K. While there may be arguments as to whether other apportionment methods might be more accurate or appropriate, we see none. Accordingly, we find that the numerator of the Utah sales factor relating to the sale of bullion or certificates under these facts is "0." We note as an aside, however, that the sale of credits to a purchaser in Utah would be counted in the unitary group's numerator.

CONCLUSION

In summary, we have concluded that the Company would be deemed to be doing business in Utah as a result of the proposed refining arrangement because 1) the arrangement would be a transaction, and 2) the Company would own personal property within Utah. We also find that no Utah sale would result from the proposed refining arrangement, which involves the issuance of electronic bullion credits from AGENT, or from the transfer of those credits to INTERNATIONAL, a non-Utah buyer. Accordingly neither of these events will be included in the numerator of the sales factor of the unitary group.

Our conclusions are based on the facts as described. Should the facts be different, a different conclusion may be warranted. If you feel we have misunderstood the facts as you have presented them, if you have additional facts that may be relevant, or if you have any other questions, please contact us.

For the Commission,

Marc B. Johnson
Commissioner

cc. NAME, COMPANY.

MBJ/aln
08-008