

Private Letter Ruling: Sales of ownership rights in uranium, to which the purchaser cannot obtain possession, are sales of intangible personal property for purposes of IITA Section 304(a)(3)(C-5).

Dear:

This is in response to your letter dated April 20, 2011 in which you request a Private Letter Ruling on behalf of COMPANY1, Inc., Taxpayer Identification Number XX-XXXXXXX (“COMPANY1”) and its subsidiaries. Review of your request for a Private Letter Ruling indicates that all information described in paragraphs 1 through 8 of subsection (b) of 2 Ill. Adm. Code 1200.110 is contained in your request. This Private Letter Ruling will bind the Department only with respect to the combined group that includes COMPANY1. Issuance of this ruling is conditioned upon the understanding that COMPANY1 and/or any related taxpayer(s) is not currently under audit or involved in litigation concerning the issues that are the subject of this ruling request.

The facts and analysis as you have presented them are as follows:

I. FACTS

A. COMPANY1’s Business Operations

COMPANY1 is incorporated in STATE1 and is primarily engaged in the business of trading of uranium products, through a “book-transfer” process, including U₃O₈ (also known as “yellowcake”), UF₆, and enriched UF₆ (“EUP”). COMPANY1 was formed in 19XX. For a number of years, COMPANY1’s principal activity was uranium brokerage, supplemented by small amounts of uranium market consulting activities. Starting in 19XX, COMPANY1 began to develop more as a trading business (i.e., a purchaser and seller of uranium for its own account). Uranium trading became the principal business activity for COMPANY1 following the purchase of a stockpile of uranium in 19XX.

COMPANY1’s headquarters are located in CITY1, STATE2. The company maintains no offices or employees in Illinois. COMPANY1’s connection with Illinois is by virtue of its notional ownership of yellowcake uranium. As discussed in depth below, the yellowcake uranium is held “on-account” in the inventory records of an unrelated federally regulated entity (COMPANY2, a subsidiary of COMPANY3). COMPANY2’s inventory book account records reflect ownership of the yellowcake uranium that is stored in on-site at COMPANY2’s nuclear conversion facility located in CITY2, Illinois. The book account inventory of yellowcake uranium is held by COMPANY1 for trading purposes to fulfill subsequent book account transactions with counterparties. COMPANY1’s customers are typically corporations.

B. Process and Trading of Nuclear Materials in the United States

Nuclear materials, including all forms of uranium which COMPANY1 trades, are highly regulated in the United States. Physical possession of the uranium is federally restricted to a small number of licensed industry participants including miners, converters, enrichers, fabricators, and nuclear utilities (see Exhibit 1, attached). Trading companies such as COMPANY1 can buy, hold, and sell uranium in various forms, but may never take physical possession in any form. Therefore, uranium owned by trading companies must be stored exclusively at the facilities of unrelated entities licensed to hold physical possession.

In order to make nuclear fuel, yellowcake uranium must be converted into UF_6 gas. Currently, the only facility in the United States capable of converting U_3O_8 yellowcake uranium into UF_6 gas is COMPANY2's CITY2 facility. There is no use for UF_6 other than further enrichment and fabrication into a nuclear fuel rod assembly for the generation of nuclear power (see Exhibit 1, attached). There are no uranium enrichers or fabricators in Illinois. Therefore, 100 percent of the UF_6 produced by COMPANY2 must be sent outside Illinois for further enrichment, either to the FACILITY1 ("FACILITY1") facility in CITY3, STATE3, the FACILITY2 facility in CITY4, STATE4, or an overseas enrichment facility. Post-enrichment, the EUP must be sent to a fabrication facility, where the EUP is processed into UO_2 , pressed into pellets, and then used to make fuel rod assemblies. The fuel rod assemblies are then used in a nuclear reactor to produce heat and electrical power.

There is widespread trading of uranium and uranium futures through formal and informal channels. Uranium historically has been traded via a worldwide spot trading market, whereby sales, swaps, credits for delivery, and loans of uranium are transacted at industry-specific grades, and standardized quantities. COMPANY1 participates in the spot market, whereby it engages with its customers in straight sales, swaps, and loans of uranium at various stages in the fuel cycle. Because COMPANY2 is the only facility in the United States where yellowcake uranium can be converted into UF_6 gas, trading in yellowcake necessarily means that substantial quantities of yellowcake are physically located at COMPANY2. The trading transactions engaged in by COMPANY1 are similar to those found on a typical commodities exchange, where legal title to an underlying interest in the physical commodities is continuously changing hands. For all transactions involving yellowcake held at the COMPANY2 facility, physical delivery and transfer of possession to a customer in Illinois never takes place. Physical delivery to an end-user of uranium does not take place until after the uranium is converted and then shipped out of state for further processing and ultimately incorporated into a nuclear fuel assembly.

Non-physical owners, such as COMPANY1, are credited with legal title to the uranium products that they have purchased in a book account at the third-party facility where the uranium is located. While at these third-party facilities, the physical uranium is mixed and commingled, making individual identification of any party's specific uranium inventory impossible. Trades are effectuated by parties that inform COMPANY2 to process "book transfer" account entries in COMPANY2's inventory books to restate ownership of yellowcake from the account of the buyer into the account of the seller.

In addition to the spot market, since May 2007 the New York Mercantile Exchange ("NYMEX") has facilitated organized trading of futures contracts for yellowcake uranium. The standardized uranium futures contracts traded on the NYMEX platform consist of contracts for 250 pounds of yellowcake uranium. Prices are quoted under the trading symbol "UX" in U.S. dollars and cents with financial settlement occurring at month-end. During 2010 there were a reported 6.5 million pounds of U_3O_8 contracted on the NYMEX futures platform under the UX symbol. By comparison, almost 50 million pounds of uranium traded in the spot market in 2010.¹

C. COMPANY1's Trading Activities in Illinois

COMPANY1's only business activities conducted in Illinois arise from its purchases of yellowcake uranium, holding of the uranium in book entry form for resale, and sales of

yellowcake. In these transactions, legal title to the material passes to COMPANY1 or its counterparties while the uranium is physically possessed by COMPANY2 at its CITY2 facility.

While COMPANY1 holds title to yellowcake at COMPANY2, it may sell, swap, or trade the yellowcake for cash or other uranium products at different stages of the fuel cycle, and possibly trade yellowcake for materials located elsewhere in the U.S. or overseas. COMPANY1 contracts for both one-off trades as well as long-term supply of yellowcake with its counterparties. COMPANY1's counterparties are limited to other trading companies, uranium suppliers and producers, or nuclear utilities. The nuclear utilities will either process the uranium along to the end of the fuel cycle by contracting with a fabricator for the creation of fuel rods and a reactor fuel assembly, or, in some cases, sell uranium back into the spot market. COMPANY1 does not sell nuclear fuel rods. COMPANY1 does not contract with fabricators for the production of nuclear fuel assemblies. All EUP that COMPANY1 purchases is eventually resold to a third-party. For tax years ended 12/31/2007 through 12/31/2010, none of the nuclear utilities that COMPANY1 dealt with as counterparties had or currently have reactors located in Illinois.

D. COMPANY1's Illinois Corporate Income Tax Compliance

COMPANY1 has filed Illinois forms IL-1120, Corporation Income and Replacement Tax Returns, for tax years ended 12/31/2008 and 12/31/2009, and filed an extension for the tax year ended 12/31/2010. COMPANY1 had calculated its sales factor for apportionment purposes on its originally-filed Illinois returns based on the belief that the correct methodology for sourcing sales to Illinois was the invoice location (i.e., billing address) of the customer.

Based on the outcome of this private letter ruling, COMPANY1 will amend its 2008 and 2009 Illinois forms IL-1120 as necessary, and will file the 2007 Illinois form IL-1120, required pursuant to its Voluntary Disclosure commitment, accordingly. COMPANY1 will also file its 2010 and future Illinois forms IL-1120 consistent with the outcome of the ruling. COMPANY1 has already initiated the Voluntary Disclosure process as of the time of this letter.

II. RULINGS REQUESTED

COMPANY1 is requesting the following rulings from the Department:

1. COMPANY1 derives "items of income from intangible personal property" under 35 ILCS 5/304(a)(3)(C-5)(iii) in relation to the uranium transactions described herein;
2. COMPANY1 is a "dealer in the item of intangible personal property" under 35 ILCS 5/304(a)(3)(C-5)(iii)(a) in relation to the uranium transactions described herein; and
3. COMPANY1's items of income derived from the uranium transactions described herein are sourced under 35 ILCS 5/304(a)(3)(C-5)(iii)(a) based on the location of its customer's "commercial domicile," which is presumed to be "the billing address of the customer, as shown in the records of the dealer" (i.e., COMPANY1).

III. LEGAL ANALYSIS

In computing a taxpayer's Illinois corporation income and replacement tax liability, a taxpayer

is instructed to apportion its business income to the state based on its Illinois sales factor.² The sales factor in Illinois is a fraction, the numerator of which represents the total sales in Illinois during the tax year, the denominator of which is the total sales everywhere.³

In general, sales of tangible personal property are assigned to Illinois for sales factor purposes if [t]he property is delivered or shipped to a purchaser . . . within [Illinois]”⁴ In general, interest, net gains and other items of income from intangible personal property (other than from patents, copyrights, trademarks, and similar items) are sourced to Illinois for sales factor purposes if (a) “in the case of a taxpayer who is a dealer in the item of intangible personal property within the meaning of I.R.C. § 475, the income or gain is received from a customer in [Illinois],” or (b) “in all other cases, if the income-producing activity of the taxpayer . . . is performed both within and without [Illinois], if a greater proportion of the income-producing activity of the taxpayer is performed within [Illinois] than in any other state, based on performance costs.”⁵

In order to determine the receipts sourcing rule applicable to the uranium transactions, COMPANY1 will address the issues in the following order:

- COMPANY1’s status as a dealer in the item of intangible personal property,
- Status of the uranium transactions as generating items of income from intangible property, and
- Sourcing of the receipts from the uranium transactions based upon the commercial domicile, presumed to be the billing address of COMPANY1’s counterparties.

COMPANY1 is a dealer in the item of intangible personal property in regards to the uranium transactions under 35 ILCS 5/304(a)(3)(C-5(iii)(a). I.R.C. § 475 broadly applies to dealers and traders of securities. A dealer in securities is specifically defined as a taxpayer who (a) “regularly purchases securities from or sells securities to customers in the ordinary course of a trade or business,” or (b) “regularly offers to enter into, assume, offset, assign or otherwise terminate positions in securities with customers in the ordinary course of a trade or business.”⁶ I.R.C. § 475 also may apply to dealers and traders in commodities, including both physical commodities and notional principal and derivative contracts based upon physical commodities. The only additional requirement for dealers and traders in physical commodities (as compared to dealers and traders in notional principal and derivative contracts in such commodities) is that the commodity itself must be “actively traded.”⁷ Moreover, the definition of “actively traded,” is not limited to commodities that are traded on an organized exchange, and applies to all commodities for which there is an active resale market.⁸ The option for a dealer in commodities to electively treat itself in the same manner as a dealer in securities under I.R.C. § 475 indicates a recognition by the United States Congress that taxpayers dealing in commodities are engaging in transactions that have the same essential character as transactions entered into by securities dealers. Because uranium is an actively traded physical commodity, COMPANY1 is eligible to elect treatment under I.R.C. § 475, and thus is a dealer for purposes of Illinois apportionment rules.

Illinois also has issued a General Information Letter (“GIL”) on the application of the intangible sourcing rules in the context of a membership business.⁹ While not binding, the GIL is instructive and lends support to the conclusion that COMPANY1 may source its income from

trading operations under the 'dealer in intangible' sourcing rules. The taxpayer in the GIL operated a membership business, and earned income from membership service agreements.¹⁰ The income from the membership service agreements was treated as income from intangible personal property (other than patents, copyrights, trademarks or similar intangibles), even though the taxpayer did not in fact transfer title to intangible property in the transactions for which it recorded gain, and even though the intangibles at issue were essentially "self-created."¹¹ In other words, the taxpayer in the GIL did not buy, hold, and sell intangible personal property. Notwithstanding the self-created nature of the intangibles at issue, the Illinois Department of Revenue ruled that the taxpayer was a 'dealer' as that term is applied in 35 ILCS 5/304(a)(3)(C-5)(iii)(a), because it received income from selling the benefits of the membership service agreements in the ordinary course of its business.¹²

Treatment of COMPANY1 as a 'dealer in intangible personal property' under Illinois law should apply with greater force because COMPANY1, unlike the taxpayer at issue in the GIL, is buying, and holding book entry inventory, and selling the rights to the book transfer of uranium. These activities are exactly the type of activities engaged in by securities dealers. Securities dealers act as "market-makers" in particular securities by buying, holding, and selling the securities. COMPANY1 operates in exactly the same fashion, acting as a market-maker for liquidity in particular types/grades/forms of uranium. Therefore, COMPANY1 is a "dealer" in intangible personal property for Illinois sales factor purposes similar to the taxpayer in the 2008 GIL. In addition, if the uranium transactions were considered security transactions under I.R.C. § 475, COMPANY1 would clearly qualify as a "dealer in securities" and as a "dealer" for purposes of the Illinois statute.

Turning to whether COMPANY1 derives income from intangible personal property, the proper interpretation of 35 ILCS 5/304(a)(3)(C-5)(iii) is to treat dealers and traders in commodities, such as COMPANY1, as deriving items of income from intangible personal property and as dealers in such intangibles, thus making such taxpayers subject to the intangibles sourcing rule. The transactions COMPANY1 engages in at COMPANY2 could be considered to be sales of tangible personal property because they involve the transfer of legal title to uranium. However, COMPANY1, under no circumstances, is ever able to possess or use the yellowcake at COMPANY2 in any way other than to transfer it to a third party. In addition, the utilities and uranium trading companies that purchase uranium from COMPANY1 are precluded by U.S. regulatory requirements from ever taking physical possession of the uranium in the form sold by COMPANY1.

In practical terms, COMPANY1 is purchasing and selling the intangible right to the book entry recorded in COMPANY2's inventory records. COMPANY1's interest in the yellowcake is purely as a trader; its rights in the yellowcake are essentially restricted to a single right to transfer subsequent ownership, and COMPANY1 is precluded by regulatory provisions from ever taking possession of the uranium to which it holds legal title. Although title to uranium may pass at COMPANY2, the "book transfer" delivery of the uranium is metaphysical, because no physical delivery takes place upon execution of the uranium sale contract. The only real activity triggered by a "book transfer" uranium sale is the change in intangible ownership rights recorded in COMPANY2's inventory records, or in the case of long-term supply contracts, future commitments to transfer ownership rights and supply commodities. This position is additionally supported by the fact that numerous traders with inventory at COMPANY2 participate in similar trades to the extent that there is a well-established spot market both for

yellowcake and the other forms of uranium located elsewhere downstream in the nuclear fuel cycle. Based on COMPANY1's operations at COMPANY2, the proper treatment of the income received in regards to its yellowcake transactions is that of deriving income from intangible property.

Pursuant to 35 ILCS 5/304(a)(3)(C-5)(iii), the proper sourcing methodology for COMPANY1 to use with respect to its transactions involving yellowcake uranium is to source the sales to the location of the customer's commercial domicile, which shall be presumed to be the billing address unless COMPANY1 has actual knowledge of the customer's commercial domicile. As discussed in Footnote 5 above, for transactions occurring during 2007, the sourcing of the receipts from the uranium transactions is the location of the income producing activity, based upon costs of performance.

IV. CONCLUSION

For the reasons discussed, we request that the Department provide the rulings requested:

1. COMPANY1 derives "items of income from intangible personal property" under 35 ILCS 5/304(a)(3)(C-5)(iii) in relation to the uranium transactions described herein;
2. COMPANY1 is a "dealer in the item of intangible personal property" under 35 ILCS 5/304(a)(3)(C-5)(iii)(a) in relation to the uranium transactions described herein; and
3. COMPANY1's items of income derived from the uranium transactions described herein are sourced under 35 ILCS 5/304(a)(3)(C-5)(iii)(a) based on the location of its customer's "commercial domicile," which is presumed to be "the billing address of the customer, as shown in the records of the dealer" (i.e., company1).

DEPARTMENT RULING:

According to the facts in your letter, COMPANY1, Inc. (hereinafter "COMPANY1") is primarily engaged in the business of trading uranium products which are highly regulated in the United States because uranium can be converted into nuclear material. In fact, you state uranium trading companies such as COMPANY1 are federally restricted from ever taking physical possession of any form of uranium.

Your letter mentions that uranium trading transactions are similar to "a typical commodities exchange, where legal title to an underlying interest in the physical commodities is continuously changing hands." COMPANY1's only Illinois business activities arise from holding title to yellowcake at COMPANY2 where COMPANY1 sells, swaps or trades the yellowcake for cash or other uranium products at the different stages of its fuel cycle.

COMPANY1's Illinois business activities are sales of intangible personal property as uranium cannot be physically possessed by trading companies. Furthermore, uranium products are traded on the spot market and the NYMEX futures platform. The relevant portion of the Illinois Income Tax Act ("IITA") regarding sourcing of sales of intangible personal property is 35 ILCS 5/304(a)(3)(C-5) and reads as follows:

For taxable years ending on or after December 31, 2008, sales, other than sales governed by paragraphs (B), (B-1), (B-2), (B-5), and (B-7), are in this State if any of the following criteria are met:

...

(iii) In the case of interest, net gains (but not less than zero) and other items of income from intangible personal property, the sale is in this State if:

(a) in the case of a taxpayer who is a dealer in the item of intangible personal property within the meaning of Section 475 of the Internal Revenue Code, the income or gain is received from a customer in this State. For purposes of this subparagraph, a customer is in this State if the customer is an individual, trust or estate who is a resident of this State and, for all other customers, if the customer's commercial domicile of a customer during a taxable year, the customer shall be deemed to be a customer in this State if the billing address of the customer, as shown in the records of the dealer, is in this State; or

(b) in all other cases, if the income-producing activity of the taxpayer is performed in this State or, if the income-producing activity of the taxpayer is performed both within and without this State, if a greater proportion of the income-producing activity of the taxpayer is performed within this State than in any other state, based on performance costs.

Accordingly, if the taxpayer is a dealer within the meaning of IRC Section 475, the gross receipts are assigned to Illinois under IITA Section 304(a)(3)(C-5)(iii)(a) if the customer is in Illinois. If the taxpayer is not a dealer within the meaning of IRC Section 475, the gross receipts are assigned to Illinois under Section 304(a)(3)(C-5)(iii)(b) based on the location of the income-producing activity.

IRC Section 475(c)(1) defines the term "dealer" with respect to securities as a taxpayer who

(A) regularly purchases securities from or sells securities to customers in the ordinary course of a trade or business; or

(B) regularly offers to enter into, assume, offset, assign or otherwise terminate positions in securities with customers in the ordinary course of a trade or business.

Based on the facts in your letter, COMPANY1 is a dealer within the meaning of IRC Section 475. IITA Section 304(a)(3)(C-5)(iii)(a) applies, requiring gross receipts received from a customer in Illinois to be sourced to Illinois. Our decision is based on your particular facts. The General Information Letter No. IT 08-0025-GIL you rely on is not applicable.

In conclusion, all three ruling requests sought in your letter are granted:

1. COMPANY1 derives "items of income from intangible personal property" under 35 ILCS 5/304(a)(3)(C-5)(iii) in relation to the uranium transactions described herein;
2. COMPANY1 is a "dealer in the item of intangible personal property" under 35 ILCS

5/304(a)(3)(C-5)(iii)(a) in relation to the uranium transactions described herein; and

3. COMPANY1's items of income derived from the uranium transactions described herein are sourced under 35 ILCS 5/304(a)(3)(C-5)(iii)(a) based on the location of its customer's "commercial domicile," which is presumed to be "the billing address of the customer, as shown in the records of the dealer" (i.e., COMPANY1).

The factual representations upon which this ruling is based are subject to review by the Department during the course of any audit, investigation, or hearing and this ruling shall bind the Department only if the factual representations recited in this ruling are correct and complete. This Private Letter Ruling is revoked and will cease to bind the Department 10 years after the date of this letter under the provisions of 2 Ill. Adm. Code 1200.110(e) or earlier if there is a pertinent change in statutory law, case law, rules or in the factual representations recited in this ruling.

I hope this information is helpful. If you have questions concerning this Private Letter Ruling, you may contact me at (217) 782-2844. If you have further questions related to the Illinois sales tax laws, please visit our website at www.tax.illinois.gov or contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Terry D. Charlton
Chairman, Private Letter Ruling Committee

¹ Ux Weekly, vol. 25 Issue 15, April 11, 2011, page 8.

² 35 ILCS 5/304(a), (h).

³ 35 ILCS 5/304(a)(3)(A).

⁴ 35 ILCS 5/304(a)(3)(B)(i).

⁵ 35 ILCS 5/304(a)(3)(C-5)(iii)(a). Note that for transactions occurring during 2007, prior to the adoption of specific sourcing rules for income derived from intangible property, all income other than from sales of tangible personal property was sourced in accordance with the income producing activity/cost of performance methodology. In the event that the Department rules that COMPANY1 is deriving income from intangible property, for 2007 COMPANY1 will source its uranium receipts based upon costs of performance.

⁶ I.R.C. §475 (c)(1)

⁷ I.R.C. §475 (e)(2)(A).

⁸ See H.R. Rep. 220, 105th Congress, 1st Session, 515-516 (1997) (noting that conference agreement expanded the definition of a commodity beyond those "customarily dealt in on an organized commodity exchange" to include all commodities that are "actively traded").

⁹ See Ill. Dept. of Rev., General Information Letter No. IT 08-0025-GIL (Aug. 1, 2008).

¹⁰ Id.

¹¹ Id.

¹² Id.