STATE OF CALIFORNIA

330.5255

BOARD OF EQUALIZATION

In the Matter of the Petition for Redetermination Under the Sales and Use Tax Law of:	)	DECISION AND RECOMMENDATION
[X]	)	No. S- -- XX-XXXXXX-020
Taxpayer	)	

Petitioner entered into a contract with the [Y], an out-of-state company, regarding the acquisition of nuc1ear fuel for use in generating electricity. The contract is cast in the form of a lease of the fuel from [Y] to petitioner. In the original decision and recommendation, which is incorporated herein by this reference, we concluded that the contract is a true lease for sales and use tax purposes, rather than a financing transaction, for two reasons: (1) the transaction is a simple lease from [Y] to petitioner, not a sale or leaseback; and (2) petitioner will not acquire title to the leased property at the end of the term without substantial consideration. Petitioner requests reconsideration and has presented additional evidence and arguments on each point.

Protested Item

The protested tax liability for the period October 1, 1979, through September 30, 1982, is measured by:

	Item	State, Local and County
E.	Lease receipts paid to an unlicensed, out-of-state lessor for nuclear fuel	$126,464,075
F.	Tax paid on the cost of a portion of Item E	(52,834,525)
		$ 73,629,550

Summary and Analysis

1. Petitioner purchased uranimum ore from independent mining companies. The purchase contracts provided that title in the ore would pass to petitioner. Petitioner contracted with various other companies to have the ore processed into nuclear fuel. The processing contracts provided that title in the property would remain in petitioner. Petitioner then sent a bill of sale to [Y] which provided, inter alia, that petitioner would "warrant and defend the true ownership by [Y] of the additional nuclear fuel against the claims and demands of every person."

Despite the title clauses in these contracts, we originally found that petitioner had never acquired title to the nuclear fuel in its own right, but only as an agent or representative of [Y].

Accordingly, we found that the nuclear fuel had been purchased by [Y] directly from the mining and processing companies, and had not been purchased by petitioner for sale to [Y] and leaseback.

Our findings were based in part on section 6 of the lease contract, which provides that title in the nuclear fuel will not "vest in" petitioner. Petitioner now points out that section 6 refers only to "nuclear fuel," a term which is expressly defined in the lease. Petitioner notes that there is nothing in any provision of the lease 'which would preclude petitioner from acquiring title to unprocessed uranimum ore, or from retaining title in the ore throughout the various processing stages, until such time as the ore becomes "nuclear fuel".

We also relied in part on section 4 of the lease, which requires petitioner to provide [Y] with a "vendor's bill of sale" evidencing the passage of title to [Y]. We noted that petitioner had never formally transferred title to [Y], but only warranted to defend [Y]'s "true ownership". Petitioner has now submitted an affidavit from [Y]'s management to the effect that [Y] regarded such warranty as sufficient to pass title from petitioner to [Y].

Our original findings were also based on our understanding that petitioner had never recorded the purchases or sales of nuclear fuel on its books of account. Petitioner has now submitted copies of its financial statements showing that each purchase of ore or processing services was recorded as an asset, and remained so recorded until reimbursement was received from [Y], which may have required four to twelve weeks.

Finally, we also relied on certain representations which petitioner had made to the California Public Utilities Commission (PUC). Specifically, in a series of applications requesting the PUC to find that the lease was true lease and not a guarantee or issuance of indebtedness, petitioner advised the PUC that title in the nuclear fuel would pass directly to [Y] from the suppliers of uranimum ore. Petitioner now argues that these statements were mistaken attempts to paraphrase section 6 of the lease, and that the statements should be ignored as inconsistent with that section.

More importantly, petitioner argues that the erroneous representations did not influence the PUC's action on petitioner's applications. As evidence, petitioner cites an application which another company submitted to the PUC regarding a substantially identical nuclear fuel lease. In that case, the company expressly advised the PUC that it had or would acquire title to the nuclear fuel, would transfer title to the leasing company, and would lease the nuclear fuel back. The PUC found, as in petitioner's case, that the transaction was a true lease and not a guarantee or issuance of indebtedness.

After reviewing the new evidence and arguments, we now agree that petitioner acquired title to the property in question and transferred such title to [Y]. The contracts between petitioner and the mining and processing companies all provided that petitioner would acquire title to the uranimum ore, and would retain title throughout the processing. Petitioner recorded the uranimum ore and processing services as assets on its books of account. The documents

which petitioner transferred to [Y], warranting to defend [Y]'s title, were regarded by the parties as sufficient to pass title in the nuclear fuel from petitioner to [Y].

We recognize that our conclusion is inconsistent with petitioner's representations to the PUC. We agree with petitioner, however, that these representations were mistaken and were not supported by the facts. Furthermore, given the PUC's action on the application of the other company, it is apparent that the mistaken representations did not materially influence the PUC's understanding or characterization of the transaction. Accordingly, we see no reason why petitioner should be bound by those representations in this proceeding.

One other point needs to be discussed. In the original decision and recommendation, we stated that this transaction was not a sale and leaseback because the property which petitioner sold to [Y] (uranimum ore) was not the same as the property leased back (nuclear fuel). Upon further reflection we find that this statement was incorrect. While petitioner originally acquired title to uranimum ore, it retained title throughout the various processing stages. Petitioner did not transfer title to [Y] until the ore had already become "nuclear fuel" as defined in the lease. For these reasons, we conclude that the transaction between petitioner and [Y] was a sale and leaseback of nuclear fuel.

2. Section 17 of the lease provides that upon termination of the lease, [Y]'s "entire interest" in the fuel is to "automatically transfer to and be invested in" petitioner without the necessity of any further action, unless the parties have previously agreed that the interest should be transferred to some third person. However, petitioner is also required to pay a "stipulated loss value" to [Y]. We originally concluded that the lease does not qualify as an exempt financing transaction because petitioner will not acquire title to the property at the end of the lease without paying substantial consideration, namely, the "stipulated loss value."

Petitioner now points out, and we agree, that the lease defines the term "stipulated loss value" in such a way that it exactly equals the unpaid payments due under the lease. Specifically, the "stipulated loss value" equals the amount advanced by [Y] for fuel purchases minus the advances already repaid by petitioner as burn up charges. Therefore, once petitioner repays the amounts advanced by [Y] (plus the associated finance charges), the "stipulated loss value" will be zero.

We also originally pointed out that most of the nuclear fuel will be consumed before the end of the lease period, so that petitioner will not acquire or reacquire title. It has now been brought to our attention, however, that in previous opinions of the Board's legal staff, the consumable nature of leased property has not precluded a lease from qualifying as an exempt financing transaction provided that all the other requirements were satisfied.

For these reasons, we now conclude that petitioner will reacquire title to the leased property at the end of the lease term, to the extent such property remains in existence, without paying any consideration other than that already due under the lease.

3. In the original decision and recommendation, we made no express findings as to whether the other requirements tor treatment as a loan had been satisfied. Based on the evidence outlined therein, however, we believe that these requirements were satisfied. Specifically, both petitioner and [Y] accounted for the transaction as a loan for federal income tax purposes, and the transaction was not usurious when considered as a loan.

For these reasons, we find that the lease of nuclear fuel was an exempt financing transaction and not a taxable lease for sales and use tax purposes.

Recommendation

It is recommended that audit items E and F be deleted from the measure of tax. Necessary adjustments are to be initiated by _____.

_____ 12/23/85
James E. Mahler, Hearing Officer Date