DGC

VOUCHER-SAFE

Siddley's New Open Source Digital Bearer Certificates

December 2010

>> How the ConTen Act can Return America to Sound Money p.41 <<

DGC

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(and it's awesome)

Voucher Safe

Design Goals

It seems best to begin with a number of design goals which guided us:

1. The system must not be account-based, but constitute a true digital bearer certificate exchange system, where digital wallets exist but accounts do not.
2. To engender user trust in the system, it must be 100% open source, not only for our code but for any code packages or libraries which are utilized.
3. The system must be distributed so that it cannot be shut down by highly organized crime.
4. All data must be encrypted, and handled in such a way that the user does not need to trust any of the system operators. (The sole exception being the Issuer, which must be trusted to store bona fide backing assets.)
5. Payments must be irrevocable, and untraceable. It must be physically impossible for any component, even the VP, to provide a transaction history for any user. That which is impossible cannot be compelled. (See goals 1 and 3.)
6. The system architecture must provide inherent economic benefits to its operators, while minimizing costs to users.
7. To mitigate the threats of DDoS, spam, and easy traffic analysis, HTTP browser and email traffic should be avoided.
8. Given the increasing ubiquity of wireless hand-held devices such as web-enabled cell phones, it is desirable not to restrict users needlessly to the desktop environment.

Get Started Here: http://www.voucher-safe.com/

The voucher-safe system is now ready to release as a public beta, using sample money, and completely detached from any other DGC.

It's very important to grasp the fact that voucher-safe is NOT a branch of a DGC, or related to any other DGC. It's an entirely separate software entity.

Any DGC company that backs a voucher is simply partnering with voucher-safe to facilitate a reputable issue that can be trusted and is reliable. This combination is a business relationship that will allow evolved digital gold platforms to continue and operate without taking on the associated P2P payment risks.

This is also a very important issue, as we have seen the kind of problems that emerged with e-gold.

We are now at a very special point in Internet payment history as this is a new paradigm, where the issuer and storage facility is NOT involved in payments, and consequently is not a target for immoral authorities. This is an absolute necessity and Voucher-safe.org is the first one of its kind.

The average DGC user would open a voucher-safe and buy vouchers from an exchanger, or sell vouchers to an exchanger... he might never even visit the issuer or digital gold platform that backs the vouchers.

This is a brief interview with one of the designers at Siddley Inc.

(Q) Regarding the new Voucher-Safe Open Source software. Will that only be integrated with one digital gold platform or will the new software be available to integrate with any other digital precious metals or currencies? What I'm really asking is, if next week I come out with [Mark Herpel Gold], MHgold.com, a clone of Pecunix or e-gold, would it be technically possible to use Voucher-safe software with my MHgold product? Could the Voucher-Safe platform spawn a dozen new digital currencies?

The short answer is yes, but under strict supervision.

Independent issuers will need to fit within an acceptable governance and trust regime that we designate. We will maintain full control of the voucher publishing function.

The voucher safe client software will be released as open source for peer review, but the developers have agreed that other components of the system (such as the voucher publisher) will not be released until some time in the future. We need to ensure that the voucher-safe system does indeed stay safe and trustworthy with reputable issuers so it's name doesn't get tarnished.

(Q) Do you anticipate that Voucher-Safe products will be well received by existing third party exchange agents?

I see no reason why not. They are secure, private, and easy to use and the potential for profit is the same as any other exchange product. My perception is that exchangers are driven to support the products their customers request. If there are customers using voucher-safe the exchangers will support them.

(Q) How about retail customers... do you feel this product will be well liked?

Retail customers are as likely to take to the voucher-safe as they have taken to Pecunix or other digital currency systems. These all remain niche products that serve a special purpose for those who use them. The voucher-safe system is in many ways like a digital cash, with the privacy benefits of cash and the convenience benefits of on-line payment. There are a number of internet markets that will benefit from the use of vouchers.

A phone based voucher-safe will also be developed soon, so that voucher payments can be made anywhere your phone connects to the internet. That will probably increase the uptake of the system and introduce it to new markets.

(Q) How long has Voucher-Safe been in development?

About 3 years now.

(Q) Where can I get more information on using Voucher-Safe and all the OS details?

There is a wiki site at http://www.voucher-safe.org that we plan as a portal to keep all the latest technical information up to date. There are also a number of user resources there, such as developer community forums and technical information. Voucher-safe.com is the place for the average user to get started. There they can get simple instructions to get started and avoid all the technical complexities that go on behind the scenes. They can also find help and tutorial resources there.

(Q) Can you briefly any relationship between Voucher-Safe and the digital gold platform that backs the vouchers?

The voucher-safe system is not integrated into the digital gold company at all, they are separate systems. The digital gold platform does however access the voucher-safe system to facilitate the voucher issue and redemption process. There will be a facility in the digital gold platform account that allows a verified user to convert some gold to a voucher and send it to a voucher-safe, or the reverse.

(Q) What level of security and privacy measures have been built into Voucher-Safe?

Voucher safe is extremely secure. It's designed from the bottom up using strong cryptography as the foundation. Privacy is as good as it gets. Voucher-safe payments are peer to peer payments, there is no single server in between the two parties. Consequently there is no third party record of payments, only the two safes directly involved in the payment know the details of the transaction.

(Q) What can you tell me that should make me feel all warm and fuzzy about using this product?

If you care about security and privacy, there is absolutely nothing better than voucher safe at present. When you use an on-line payment system or money system you need to be able to trust the company that is providing the service. Pecunix has provided reliable and trustworthy service for more than 10 years and PXGold is the new offering from Pecunix that combines all the experience of those 10 years into issuing a better product.

Furthermore, the system has been designed such that one does not need to trust the system operators. That is, there is no component in the distributed system that could be hacked or seized or operated maliciously, which would compromise the security or anonymity of user transactions.

I should also mention that the software has been developed in Java specifically to be platform independent, so it should work well on any operating system that can run a recent Java Virtual Machine. We have tested the voucher-safe extensively on Mac, various versions of Windows and multiple versions of Linux. Next year we will get to testing a version to run on the more popular smart phones.

(Q) Are there any close companion products that act like Voucher-Safe already on the market?

Not to my knowledge. There are other attempts at digital cash type payment systems, but none that have the experience, planning and reputation behind them like Pecunix. What we have here is a true digital wallet where each independent wallet holds specific digital vouchers that belong to the wallet owner; this is not a traditional account-based system and there is no "statement of account" anywhere.

I am unaware of any other digital cash like product that stores the cash and all records redundantly "in the cloud" so that the value is protected from any loss or crash of a computer/phone etc. Storing the value and transaction records in the cloud also means that the voucher-safe can be accessed from any computer that has an internet connection, anywhere, any time.

(Q) In other words is there any competition already operating?

Not that I know of.

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Thanks for answering my questions. I'm told we can expect more detailed information on PXGold early in 2011. http://www.voucher-safe.com/

INTERVIEW BY MARK HERPEL

http://www.voucher-safe.com/

Voucher-Safe, Open Source Voucher Payment Project

Inexpensive Secure P2P Digital Bearer Payments

Voucher-Safe is one of the most promising next generation cutting edge payment products available online. The software was developed and created by the Pecunix team.

Voucher-Safe is an online mechanism for the secure, anonymous exchange of digital vouchers peer-to-peer between users, implemented as an extension to XMPP (aka Jabber), an instant messaging service. Because the P2P Voucher System is designed to emulate the model of circulating cash in the digital world, it works similarly. The voucher payment system itself is transaction agnostic, just as it is agnostic as to the nature of the backing asset.

This new system is extremely secure and easy to use. Operation of a "safe" begins with a simple software client download and takes about one minute to set up. Multiple safes are possible and anyone may have as many "safes" as they desire. No customer identifying information is ever required or requested to operate this product. All national currency transactions occur through third party independent exchange agents. No funds flow to the Voucher-Safe operator and it is not possible to execute any financial transactions with the operator.

The design of the P2P Voucher Payment System actually anticipates the needs of regulatory authorities, and complies with their stated design goals for implementing "AML" (anti-money laundering) strategies in virtual worlds and online payment systems. Every component of Vouchers-Safe is open source and standards-based.

The payments are P2P, person-to-person or "peer-to-peer" in network parlance. There are no accounts, merely electronic wallets containing digital objects signed and validated by a publisher/mint.

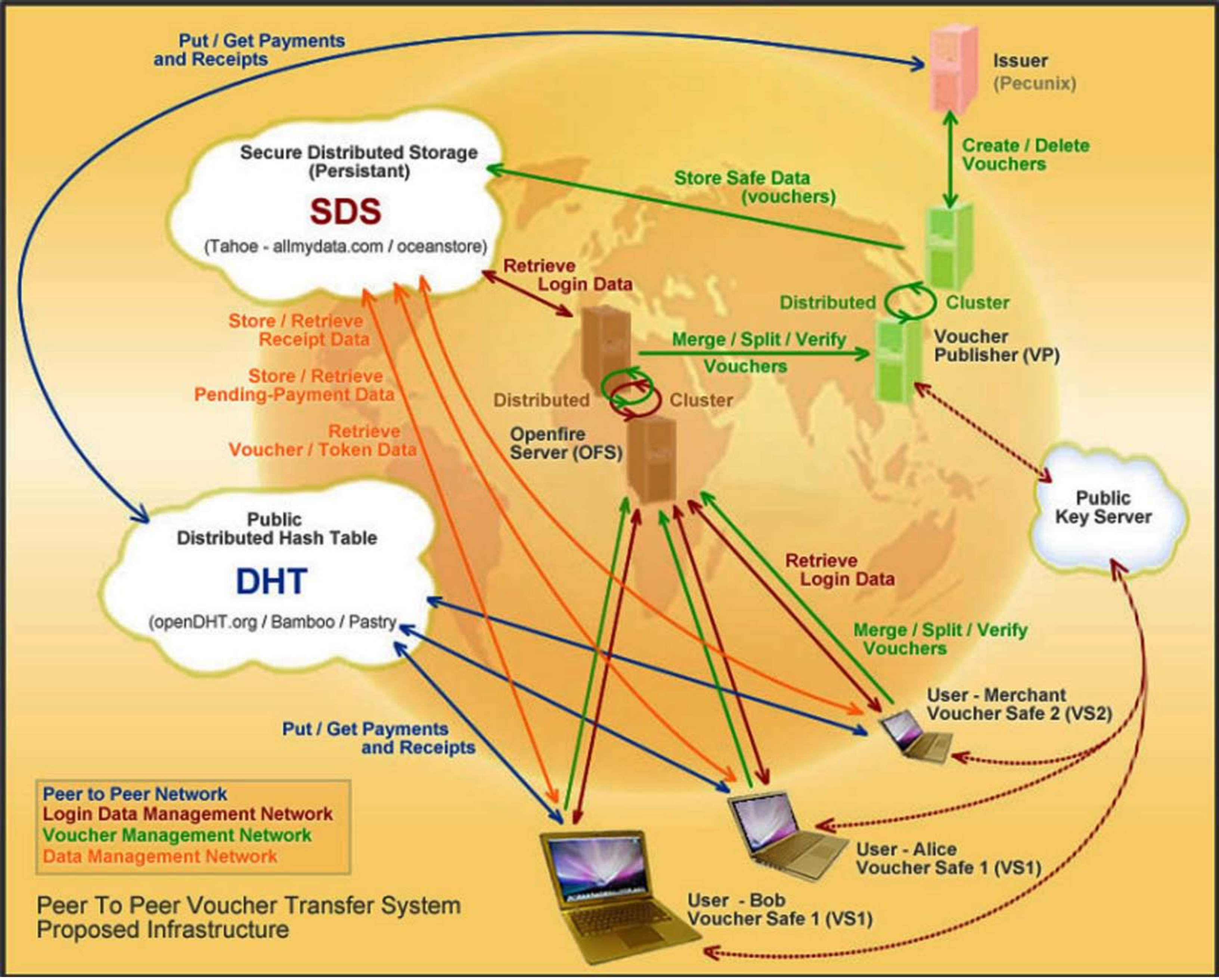
Payments are secure: encryption is used everywhere, and all data representing value or transaction details is always stored encrypted and digitally signed so it cannot be tampered with.

Payments are in bearer form, meaning cash-like: anonymous, irrevocable, and untraceable.

Payments are extremely inexpensive. In the demonstration system[12-1-2010], making a payment costs 13 tokens, with the value of a token set at 0.0005 grams of fine gold (approximately US $0.015 per token). Thus sending a payment costs less than twenty cents. Compare sending a Western Union or paying with a credit/debit card. Receiving and validating a payment costs 5 tokens, or about eight cents.

The Issuer holds the stored value and creates vouchers up to but not exceeding the available backing. The Issuer has no knowledge of anything beyond the amounts and serial numbers of the vouchers currently in circulation.

The Issuer: this is the party who stores the assets backing the vouchers. The Issuer is responsible for keeping track of all vouchers in circulation, assigning their serial numbers, and ensuring that the aggregate weight or value of all vouchers does not exceed the



backing. The Issuer knows nothing about users or owners, only voucher amounts and serial numbers.

The Voucher Publisher (VP): the VP processes all voucher transactions, signs all vouchers with its private key, and encrypts each with the public key of the owning voucher safe (VS). It also issues signed usage tokens (bought with vouchers) and permits other system components to redeem accumulated tokens for vouchers.

The Publisher also has no idea which voucher safes (wallets) contain which vouchers, except within the context of a particular transaction at the moment it is performed. Once vouchers are minted, their value circulates in the wild, just like with paper money. This is extremely important for the operational safety of the system operators. Their accountability ends with running an honest warehouse that does not indulge in fractional reserve accounting. They bear no responsibility for the actions of individual voucher users, and can bear none, because it is physically impossible for them to track those actions, even as a national mint cannot. The Issuer and VP together constitute a digital mint. They are not a bank, and they are not a payment system. The open source software and the users are the payment system.

What is a Voucher?

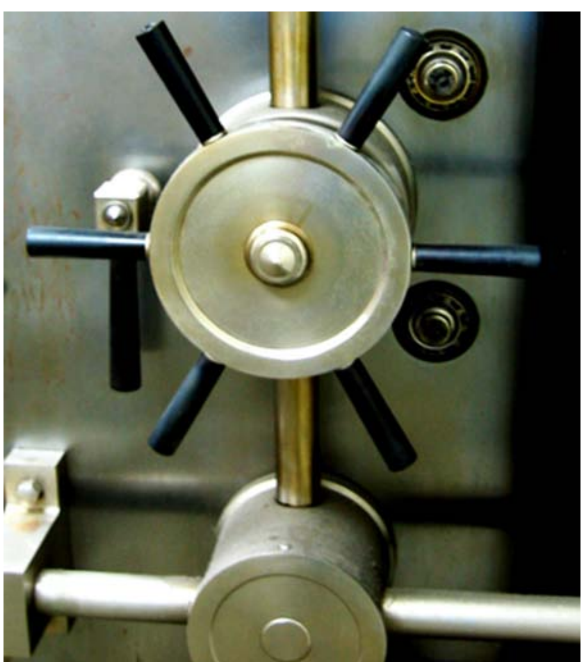
A voucher is an encrypted digital representation which stands for or represents something else. A voucher is said to be "backed" by whatever underlies it, such as gold or silver. Vouchers are digital bearer certificates circulated and validated by a Publisher. A voucher payment system makes it possible for any value located in one place to be spent somewhere quite different. Vouchers are minted based on a quantity of the backing asset lodged with the Issuer/custodian, and the total value of all vouchers circulating cannot exceed the amount in custody. Vouchers expire after six months. This is meant to be a transactional system, not a savings account.

Digital vouchers represent their backing asset, and as such constitute another level of indirection which allows an abstraction of value to circulate, rather than the value itself. This turns out to solve a number of thorny problems with online payment systems generally.

Voucher Operations

Once a client is logged into a Voucher-Safe that customer has access to the contents of the safe and can then perform operations with the vouchers and tokens in its safe. These operations include: Validation, Split, Merge, Payment (to another VS), Token Purchase, and Reclamation (of an outbound payment which was never picked up by its payee before it expired).

A P2P voucher system does not inherently violate accepted principles for preventing money laundering, and would not do so unless an Issuer or Exchange broker failed to implement required AML policies. In which case the responsibility would belong to that party. http://www.voucher-safe.com/



RUSSIAN GOVERNMENT APPROVES DRAFT E-PAYMENT RULES

Written by Sayan Guha 15 November 2010
This article originally appeared in BSR Russia.
http://www.bsr-russia.com/en/banking-a-finance/item/1176-government-approves-draft-e-payment-rules.html

After a long delay, the government on Thursday approved the draft E-payment bill to regulate electronic payments. The bill was first introduced in the month of April this year by the Finance Ministry, but ran into trouble after it was rejected by the Central Bank and E-payment association leaders. According to the projections of E-money association, transaction volume is expected to grow by 40% this fiscal year.

The presidium approved the National Payment System bill, chaired by Prime Minister Vladimir Putin.
Viktor Dostov, the Chairman of the Russian E-Money Association later said, “We consider this bill a reasonable compromise between strict regulation and the market reality”. The total amount of transactions had hit 40 billion Rubles ($1.3 billion) in 2009.

Once the new rule comes into effect, market operators will have to obtain license from the Central Bank similar to a non-banking credit company. To qualify for a license, the e-payment operator’s equity capital base should be 18 million Rubles or more. This should not be a problem for the bigger and established operators; however, smaller operators may find it difficult to meet the equity capital requirement.

The final bill, when it comes to effect is unlikely to affect e-wallet users, unless the transaction amount exceeds 15,000 Rubles. Most transactions are between 700 and 800 Rubles and will not affect the average user.

The Central Bank of Russia, which is set to become the regulator of E-payment operators, had promised earlier that E-money transactions will be easier than bank transactions. However, the draft bill is silent on that aspect, Mr. Dostov pointed out.

10-31-2010, The State Bank of Viet Nam has issued a new regulation forbidding commercial banks from lending cash against gold collateral, in a move aimed at easing pressure on the foreign exchange market, as well as lowering risks to the banking system.

Instead of depositing gold at banks, people will keep gold under their pillows

From VietNamNet Bridge - While some experts believe that the Circular No 22, forbidding commercial banks from lending cash against gold collateral, will bring positive effects to the market, others argue that the legal document will take a big volume of gold out or circulation, which will be a big waste.

New circular will put pressure on the market

When issuing the new regulation on borrowing and lending in gold, Nguyen Ngoc Bao, Director of the Monetary Policy Department under the State Bank of Vietnam said that to date, 23 credit institutions have mobilized and lent in gold. By the end of September 2010, the total deposits in gold had reached 92.6 tons, worth 73 trillion dong. Meanwhile, the outstanding loans in gold had only accounted for 60 percent of the mobilized capital.

With the new decision, commercial banks, especially the ones in the south, now have to stop accepting more deposits and think of taking back the loans in gold.

Experts have warned that in the context of the current high and fluctuating gold prices taking back a big volume, estimated at 55 tons will have big impacts on the market.

An expert from Bao Tin Minh Chau Company said that recently, when the State Bank allowed to import only several tons of gold, this was enough to cool down the market. However, the estimated 55-ton volume of gold banks are going to take back is too big.

As such, the demand for gold will increase, while the quotas for importing gold are not likely to be granted. Even if the State Bank allows to import gold, the volume will not be large.

Governor of the State Bank of Vietnam Nguyen Van Giau, before issuing the new legal document, said that gold mobilization and lending can be seen only in Vietnam.

In reality, the demand for mobilizing capital in gold and lending in gold are quite commonplace in Vietnam. Therefore, when the central bank prohibits gold borrowing and lending, banks will lose profit, while deposits will lose a safe investment channel.

New regulation will not be able to prevent uncertainties

The State Bank of Vietnam, when issuing the new legal document, said that the new policy aims to settle the problems in gold circulation and reduce the gold and foreign currency speculation, thus helping stabilize the market.
However, experts still have doubts about the possible effects of the new document.

In Vietnam, gold can be divided into two kinds: merchandise gold and the gold kept among people. Merchandise gold is being used as a type of currency which is used to trade, contribute capital and to lend to others. Meanwhile, a big volume of gold is still lying among people as their assets.

Once banks are not allowed to lend in gold, they will not accept gold deposits any more. As such, instead of depositing gold at banks, people will keep gold under their pillows. This also means that a big volume of capital will be put out of circulation and control, which should be seen as a big waste.

The State Bank believes that the new regulation will stop people from hoarding, because they cannot deposit it for profit. However, some experts do not think this will happen, saying that it is not so easy to change the way of thinking of Vietnamese people, who have the habit of hoarding gold as their assets.

by Le Khac
http://english.vietnamnet.vn/en/business/1040/instead-of-depositing-gold-at-banks--people-will-keep-gold-under-their-pillows.html

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Going Back to a Gold Standard?

Adrian Ash, 11 Nov '10

http://goldnews.bullionvault.com/gold_standard_111120101

Three reasons you need your own private Gold Standard, rather than waiting on "sound money" from government...

SO DID GOLD's first foray over $1,400 mean we're going back to a Gold Standard? asks Adrian Ash at BullionVault.

Nope. Not in the West, nor anytime soon anywhere, and for three simple reasons.

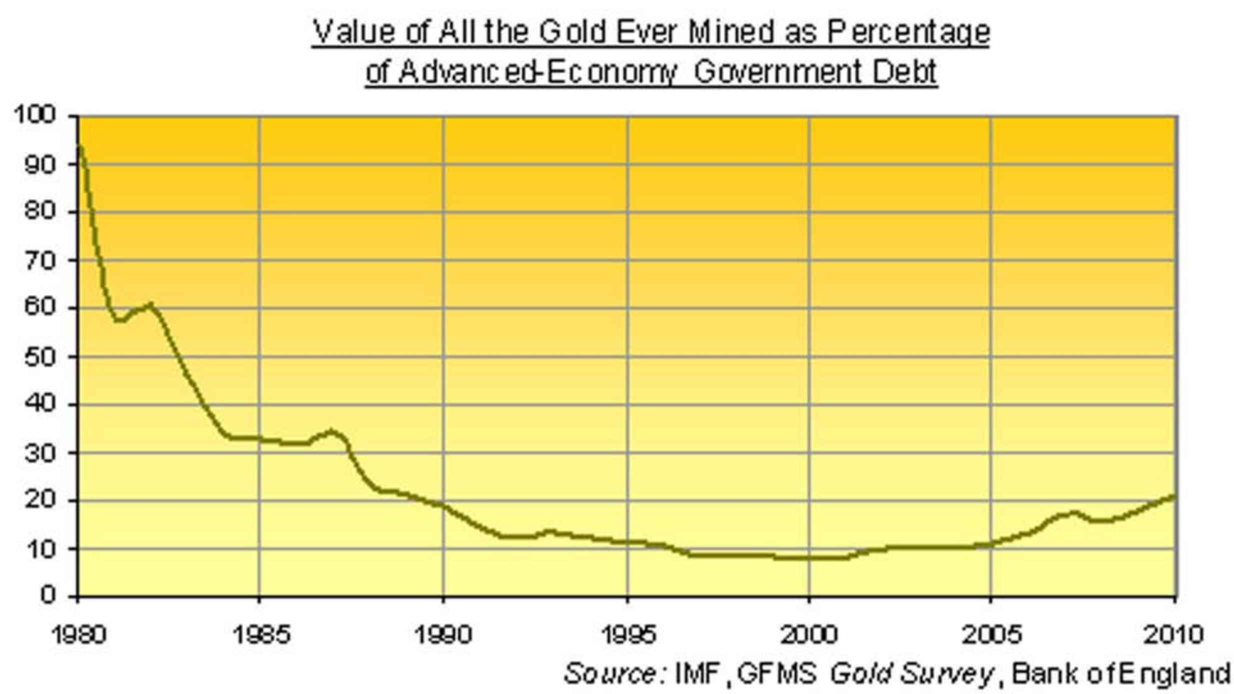
First, Gold Prices aren't high enough. Second, modern governments don't hold enough of the stuff – not for their tastes, at least. And third, the pace of physical monetization, out of jewelry and mined ore into coin and large-bar form, just isn't great enough. Yet.

Gold Pricing & Value

Backing the world's broad-money supply with gold – even at the 40% cover-ratio set by the United States in the interwar years – would require a price nearer to $4000 per ounce than $1400. That's with all the gold ever mined in history locked inside central-bank vaults, by the way. Full cover for a reserves-backed "bullion standard" would need prices above $10,000 per ounce.

Nor against financial assets is gold priced highly enough to warrant becoming the world's sole monetary arbiter. Now valued at $7.6 trillion, the near-170,000 tonnes of gold ever mined in history is worth only 3.9% of total investable wealth. That figure compares with well over 20% before 1930 – a valuation which at current mining-production rates (and with constant asset prices) would require a gold price of $6650 per ounce by 2015, or $6230 by 2020 on BullionVault's maths. *(see chart below)*

So, although recovering from what was, a decade ago, the weakest role it ever played in the world's financial system, gold remains dwarfed by other, more widely-held and heavily-weighted assets – most obviously



the US Dollar and Treasury bonds.

Official-Sector Gold Holdings

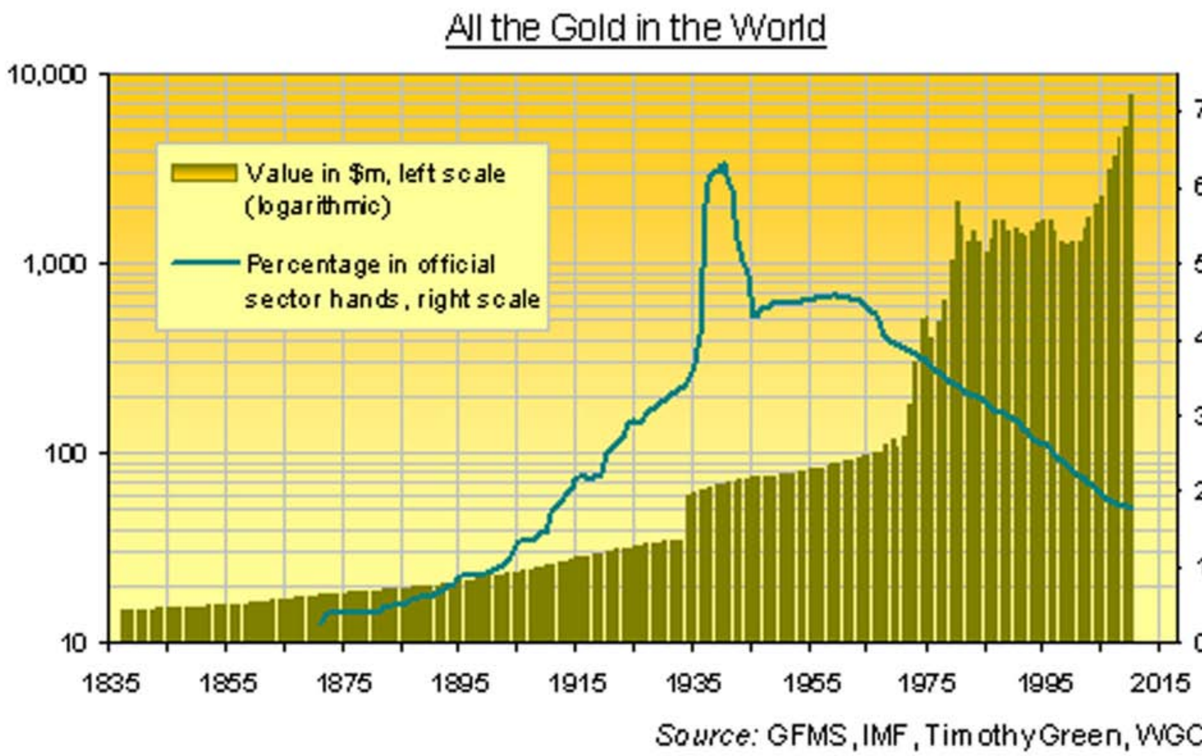
As a proportion of the above-ground total (a cube now measuring some 20.65 meters along each edge), world governments haven't held this little gold since 1911.

Yes, that period marked high tide for the classical gold-coin standard. But with the ebb came the Federal Reserve, the welfare state, and "mixed-economy" planning – historical facts which have scarcely retreated, even as the nationalized gold stocks they first confiscated fell back. (see chart below)

Demolishing these pillars of "soft money" in the next five or 10 years, let alone unwinding the centralized urge to control price-levels, GDP growth and the free transfer of capital, looks less likely than even another quadrupling of gold prices.

Nor do the largest gold holders – those states nearest to a practical level of cover – show any enthusiasm for mobilizing their gold hoards as part, never mind the base of their monetary systems. The No.1 official holder, the United States, last flirted with talk of a return to gold in the early '80s. But back then, gold's private-investment weighting was six times greater than today, and double-digit interest rates gave cash savers positive real returns on their money (post-inflation) for the first time in a decade.

Such a "hard money" backdrop remains a long way off today, despite the fact that the US could actually back its currency in circulation with a 40% cover-ratio at current prices ($1390 per ounce, in fact). Money is much more than just notes and coins today, of course, and to cover M2 – meaning primarily household cash savings, held on deposit and in money-market accounts – the Treasury's 8,133 tonnes of gold would need to be valued almost 10 times higher per ounce ($13,230). Absent that kind of price, and given the deflation-fearing consensus amongst central bankers and the academics they listen to, it ain't going to happen. We need devalued currency, not sound money, believe the people who could decide such a change.



Physical Monetization of Gold

This dim outlook for a dictated return to some level of "Gold Standard" in the rich West, however, won't prevent private savers, nor emerging-economy states, from continuing to build their own gold reserves.

Demand for "monetary" gold (i.e. coin and bar) worldwide is now running at twice the pace of five years ago, eating perhaps 49% of 2010's total global-market supplies in the form of low-margin units for trading and storage, rather than as jewelry, bonding wire, dental fillings, or flakes floating in schnapps.


The Worlds
Local Exchanger
FINE
GOLD
999.9
NET WT
1000g

But is that pace enough? A little under a century ago, Joseph Kitchen (he of the wonderfully-named 'Kitchen Cycle' in commodity prices) studied bullion flows and found that – in a world where gold had been money, formally, for over 200 years – monetization of newly-mined gold was running well above 45%. Jewelry recycling no doubt topped that level, while existing monetary units surely retained their form.

Furthermore, at present, a little over a third of the world's above-ground gold is currently held in coins or bars (as measured by best estimates for investment plus central-bank stocks). But even at current rates of investment fabrication, it would take 15 years to raise that physically monetized level to 44%, the average proportion held by central banks between 1945 and 1971, the first (if not last) period when interventionist, welfare states in the West yoked their money supplies to gold.

So must gold play no role in money? Indexing a notional, government-only Bancor currency or Special Drawing Right against a basket of, say, Dollars, Euros, Yuan and gold might seem wise, but it appeals to the same thinking which gave us the United States' exorbitant privilege of Dollar issuance, plus that explosion of state intervention in all economic activity which we're still very much living with today. Whereas, in time, the sheer weight of privately-held gold reserves may in fact tip us back towards the origins of the classical Gold Standard. Because that historical "accident" (as gold-market historian Timothy Green calls it in his Ages of Gold) developed out of freely-decided convention – not central-bank diktat or academic theorists sitting in Princeton, Berkeley or on Southwark Bridge – with private actors trading goods and settling debts with transfers of bullion.

Even in 1900, private holdings of Gold Coins still exceeded central-bank hoards worldwide, only losing ground as Europe's second thirty-year war drew near and nation states began hoarding for war, vaulting for victory. It wasn't until Great Britain re-introduced gold convertibility in 1925 that the Bank of England issued paper notes to represent its gold holdings – rather than enabling free circulation of metal in coin – thereby shifting the world from a gold-coin to a bullion standard.

So never say never. Because the largest hoarders of gold by far today are the newly-enriched consumers of emerging Asia's two largest economies. India's world-beating appetite is beginning to devour low-margin investment coins and bars once more (some 30% of the subcontinent's gold purchases, according to Sunil Kashyap at Scotia Mocatta). Chinese households have bought more gold in the last two-and-half years than the People's Bank holds in total – and here too, cost-efficient coins and bars are gaining fast on non-investment forms. *(see chart on next page)*

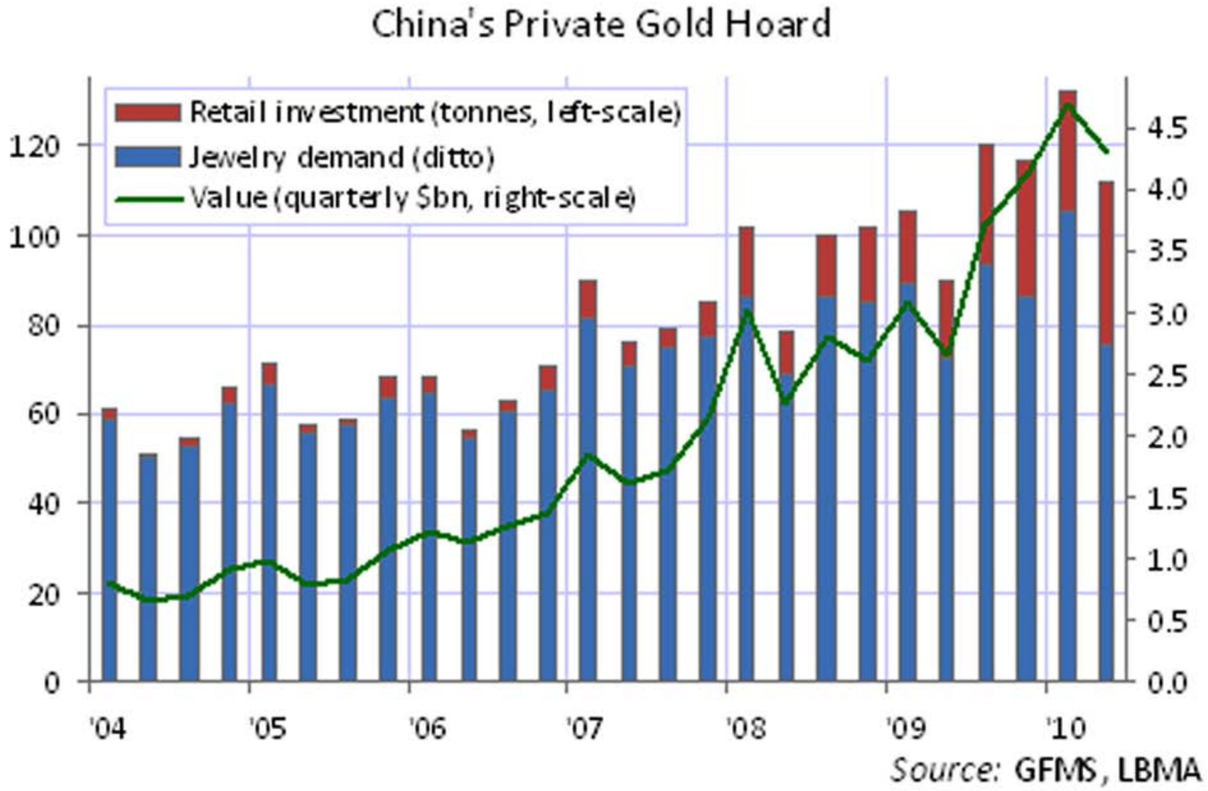
Actively encouraged by Beijing, China's rapid private accumulation of both gold and silver should remind economic historians that only structurally sound, growing economies have ever employed precious metals successfully as their monetary standard. We'll have to wait and see whether China quite fits that bill. But gold has never been a panacea for weak, over-indebted states, as the disaster of Britain's return to gold in 1925 proved.

Put another way...
"Our gold standard is not the cause but the consequence of our commercial prosperity..."
as prime minister Benjamin Disraeli noted in a speech to Glasgow industrialists fifty years earlier.

Still, Western investors fearing what Asia's rise could do to their own standard of living might also consider getting the jump on China's rapid accumulation of privately-held gold. For as long as gold is used to store value, rather than directly for buying and selling, then seeking out the most efficient, most secure route to owning it, and converting your gold into widely-accepted currency as you need, looks the next best thing to enjoying gold-backed currency – your own private Gold Standard in a world of central bankers hell-bent on devaluing your savings.

Get started now, with this free gram of physical Gold Bullion at the award-winning, mining-industry backed world No.1, BullionVault...

Adrian Ash, 11 Nov '10
Adrian Ash runs the research desk at BullionVault, the world's No.1 gold ownership and trading service. Formerly head of editorial at London's top publisher of private-investment advice, he was City correspondent for The Daily Reckoning from 2003 to 2008, and is now a regular contributor to many leading analysis



sites including Forbes. Adrian's views on the gold market have been sought by the Financial Times and Economist magazine in London; CNBC, Bloomberg and TheStreet.com in New York; Germany's Der Stern and FT Deutschland; Italy's Il Sole 24 Ore, and many other respected finance publications.

Anybody Seen Our Gold?

The gold reserves of the United States have not been fully and independently audited for half a century. Now there is proof that those gold reserves and those of other Western nations are being used for the surreptitious manipulation of the international currency, commodity, equity, and bond markets. The objective of this manipulation is to conceal the mismanagement of the U.S. dollar so that it might retain its function as the world's reserve currency. But to suppress the price of gold is to disable the barometer of the international financial system so that all markets may be more easily manipulated. This manipulation has been a primary cause of the catastrophic excesses in the markets that now threaten the whole world. Surreptitious market manipulation by government is leading the world to disaster. We want to expose it and stop it.

Who are we?
We're the Gold Anti-Trust Action Committee Inc., a non-profit, federally tax-exempt civil rights and educational organization formed by people who recognize the necessity of free markets in the monetary metals. For information about GATA, visit http://www.GATA.org

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GATA

GOLD STANDARD TIME

by Howard Katz
November 22nd, 2010
http://www.shtfplan.com/howard-katz/gold-standard-time_11222010

The expression, “gold bug,” has two meanings. In politics, a gold bug is someone who favors the gold standard. The phrase was first used in the election of 1896 to indicate the supporters of William McKinley, who favored the gold standard, as opposed to the supporters of William Jennings Bryan, who favored adding silver to the system to increase the money supply. On July 9, 1896, Bryan gave a famous speech at the Democratic convention in Chicago in which he said:

“You shall not crucify mankind upon a cross of gold.”

Then he went down to flaming defeat, not once but three times.

In the 1960s, the phrase “gold bug” acquired a meaning in the speculative markets. It referred to a speculator who believed that the price of gold was going up. In this sense, James Dines was “the original gold bug.” As it happened, most gold bugs in the speculative sense were also gold bugs in the political sense, but it is important to distinguish between the two meanings.

Readers of the articles in this web site are gold bugs in the speculative sense; however, we are about to enter a new period in American history where the two meanings become intertwined, and this is extremely important for anyone who wants to understand the financial markets. The decisive event occurred on November 17, 2010 when the Wall Street Journal ran an editorial entitled, “Ron Paul’s Golden Opportunity.” (WSJ, 11-17-10, p. A-19.)

Now you all know what has been going on in the markets over the past few weeks. The Fed has begun another program of the massive printing of money, this one labeled QE2 and estimated to amount to $600 billion (although larger numbers are mentioned). If we consider the (more than) doubling of the U.S. money supply which has occurred between mid-2008 and November 2010, then QE2 will bring the total increase in money up to approximately a triple. And this leads me to expect an increase in consumer prices (from current levels) to approximately triple over the next 3 years. First, commodity prices will rise. Second, producer prices will rise. And finally, consumer prices will rise. The first phase of this has already started.

As we all know, Bernanke’s QE2 has provoked a world-wide protest. Central bank heads and prominent (establishment) economists around the world have condemned it. There has been talk (in the Financial Times) of restoring the role of gold in the world monetary system. Most important, the Wall Street Journal has taken a number of pro-gold positions, the most important of which is the Nov. 17 article, mentioned above.

The economic environment over the coming 3 years will be in turmoil. The rise in prices will create great public dissent. I can remember the rise in prices of 1979 (13.3%) and the public outrage it occasioned. As a result of that outrage, the Democrats were defeated in 1980, and the nation entered (what is called) a conservative era. Unfortunately, the conservative movement, which had based itself on the balanced budget, was betrayed by Ronald Reagan, who instituted massive government deficits, doubled the U.S. money supply and violated his promise to adhere to Milton Friedman’s rule (2%-6% growth in money supply per year).

Now a tripling of the money supply over 3 years computes (when the compounding factor is reversed) to about 40% increase per year. If 13% got people outraged in 1979, then we can surmise what 40% will do. The country will be up in arms, and the chances for Democratic revival, now very slim, will become non-existent. There is even a possibility that the Democratic Party will cease to exist and that the Republicans will split in two (perhaps a Tea Party Republican and an establishment Republican), thus completely changing the political landscape of America.

But what does this mean for speculators in the precious metals? Let us take a look at the long term chart of the S&P 500.

Here are the last almost 30 years of the advance in the S&P 500, from 100 to 1500. Note that after 18 years to the upside the S&P 500 has stalled, and there has been a small decline over the past decade (while gold has multiplied by more than a factor of 5). What is this telling us?

It is always important to keep in mind von Mises' principle that an economic system high on paper money and easy credit is like a person high on drugs. As his body adjusts to the drug, he gets less high from the same dose. To get a bigger high he needs a much bigger dose. That is what is going on with QE2. It is the bigger dose of money and credit which is now necessary to bring increased profits to the paper aristocracy. Can it bring the U.S. stock market to new highs? Perhaps, but it is a fundamentally losing battle. The world is now against Ben Bernanke. He can fight for a limited time, but remember that the entire argument of his side of the debate is that the world is on the verge of an imminant "deflation." As prices rise by 40% per year, this argument will become laughable. It will be cited in the economic books as the ultimate in human stupidity. Bernanke's supporters, few now, will become non-existent. They will be seen as being like the people who were still bullish on stocks in early September 1929.

As the movement against Bernanke builds steam, it may take many forms. It is now being suggested that the Fed drop its commitment to reduce unemployment and adopt a single commitment (to reduce "inflation") like the European Central Bank. As a point of information, the U.S. from 1793 to 1933 had 140 years of stable prices (WPI). For much of that time, unemployment was so low that there was no word for it. And the American economy, with no central bank for most of this period, became the greatest, not only in the world but in all human history. Indeed, it was precisely at the time that we abolished the second central bank (1836) that we started to overtake Britain for the economic leadership of the world. Both countries had a basic free economy (undercut in the U.S. by human slavery in the South), but Britain retained her central bank while the U.S. abolished hers, and that was the difference. This shows the wisdom of Thomas Jefferson in making the decision to fight the bank in 1791. Thank you Mr. Jefferson. To you America owes an important part of her greatness.

As Bernanke is forced to tighten credit, it must be kept in mind that commodities are responsive to the money creation power of the Fed while stocks are more responsive to the credit easing/tightening power of the Fed. Therefore, as Bernanke tightens, first stocks will go down, but gold and silver will continue up for some time. A good example of this is 1973-74 when gold continued higher while stocks had a serious bear market. Another example is 1979.

With the Paul family, father and son, putting pressure on the Fed to tighten, the astute speculator will be watching the Fed closely. However, do not make the mistake of anticipating the tightening. The markets are so stupid that they do not discount a Fed tightening (or easing). As a result, you don't need to guess. You can wait for the Fed to act and still lose very little of the move. As a result, I intend to maintain a bullish position in silver and gold until the facts tell me otherwise. But at some point I expect to switch from a bullish position in the precious metals (which will probably have a blow-off top) to a bearish position on stocks.

Interestingly, stock bear markets are easy to play. Stocks round over slowly and go into a steeper and steeper decline. One simply waits until the pattern is unmistakable and then lays out one's line. But today hardly anyone has any experience with bear markets. They just hold on tight and wish. They buy and hold for the long pull because they are idiots whose heads are screwed on backwards and who were born in 1982. Well, from 1885 (the earliest that we have real-time records) to 1933, when the U.S. left the gold standard, the DJI was flat (usually moving back and forth between 40 and 100). There is no long term uptrend in stock prices. When the Fed was given the money printing power in 1933, this allowed it to steal from bondholders and give to stockholders. It is this power which puts stocks up. Since most people who buy stocks also buy bonds, the Fed is taking money out of their back pocket and putting it into their front pocket. And they are too stupid to figure this out.

A Fed tightening raises interest rates. Since the earnings yield on stocks is competitive with the interest rate on bonds, this earnings yield must go up, which means that P:E ratios must go down. Woops. This is the explanation for the low P:E ratio on the DJI in 1982.

The Fed tries like the dickens to steal from bondholders and give to stockholders, and this is what gives the appearance of a long term uptrend in stock prices. But since the great majority of stockholders consider it responsible to "balance" their portfolios with bonds, they are simply treading water. They are victims of the paper money illusion, and they think they are getting richer while they are getting poorer. The recent depreciation of the Zimbabwe currency is a case in point. Prices went up by over a trillion times. The unemployment rate rose to 90%. Starvation swept the country, and the expected lifespan fell from 60 years to 40 years over a decade. The system finally collapsed when doctors and nurses quit their jobs (because they were not being paid in money of any value) and a cholera epidemic swept the country. This finally got people mad enough to stop the paper money. If this happens in the U.S., I am sure Bernanke will call it "economic growth." (Notice the complete blackout on this in the U.S. media. This is because it is information the paper aristocracy does not want you to know.)

So over the next few years the speculative gold bugs have to pay close attention to the political gold bugs and chart their successes and failures. If the political gold bugs can force Bernanke into a tightening, then the whole ball game will change, and at some point a bearish position on stocks may be even better than a bullish position on gold or silver. (In our example above, early 1973 was such a time.)

A word to those who think that it is the job of the Fed or the Government to make the stock market go up. This is a widespread view, and Fed chairmen are rated according to whether the market went up on their watch. As above, during the period when the country was on a gold standard and had real time stock market indexes the market was flat. That is, if a given company made an extra profit, it did so by superior productive achievement. Customers switched over to the successful company and away from its competitor. Thus one stock would go up and the other down. This is why after almost 50 years on a gold standard (1885-1933) stock prices (the DJI and its predecessors) were unchanged. But

as soon as we abandoned gold, stocks began an incredible advance. Thus, F.D.R. instituted a policy of robbing from the American working man and giving his wealth to the big corporations; however, the nation's media lied to the people and told them the exact opposite. The media are still lying, but judging by the results of the Nov. 2 election the people seem to be waking up.

In these exciting markets, one must think quickly and accurately and move with decision. To guide you through these unprecedented markets, I publish the One-handed Economist, a fortnightly newsletter predicting the various financial markets (stock, bond and commodity with special emphasis on gold and silver). You may subscribe by visiting my web site, www.thegoldspeculator.com and pressing the Pay Pal button ($300) or by sending $290 ($10 cash discount) to The One-handed Economist, 614 Nashua St. #122, Milford, N.H. 03055.

Thank you for your interest.

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Visit the Author's Website:
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Howard S. Katz holds a BA in mathematics from Harvard University. He became interested in Austrian economics and started a successful investment newsletter, The Specualtor which focused on gold and gold stocks. He is a lifelong advocate of gold and gold stock investing. Later, he published The Gunslinger for investors interested in gold and gold stocks. In addition, Mr. Katz authored three books on gold, the gold standard and money in politics: "The Paper Aristocracy", "The Warmongers" and the soon to be published "Wolf in Sheep's Clothing". He was involved in the Objectivist movement in New York in the 1960s and was an early member of New York's Free Libertarian Party. He has been interviewed on numerous radio programs. He currently Chief Investment Officer, editor and publisher of the gold and gold stock investment newsletter, The One-handed Economist.

1 kilo gold bar from GoldMoney (pictured above)
1 kilo gold bar from GoldMoney during the Edelmetallmesse.

Check out GoldMoney News on Flickr http://www.flickr.com/photos/goldmoneynews/

Good Delivery silver bar from GoldMoney (pictured below)
Good Delivery Silver bar 1000 troy ounces (31,1 kilos) at the GoldMoney booth during the Edelmetallmesse.

Why gold is better than cash?

by Alasdair Macleod

http://www.financeandeconomics.org/

The question most often asked of gold bulls is, "At what price will you take your profits?" It is a question that betrays a lack of understanding about why anyone should own gold. Nevertheless, the simple answer must be, "When paper money stops losing its value". This response should alert anyone who asks this question to the idea that owning fiat cash is the speculative position, not ownership of precious metals.

This sums up the problem. Instead of gold, people commonly think of paper money as the only medium of exchange and as a store of value; cash is after all their unit of account. They see the gold price rising when they should be seeing the value of paper money falling. Because cash is everyone's unit of account it is wrongly seen as the ultimate risk-free asset. This is also the fund manager's approach to investment: his investment returns are calculated in paper money, so he cannot account for a superior class of asset. He is also taught to spread investment risk across a range of inferior asset classes to enhance returns. Therefore the investment manager wrongly assumes that precious metals is one of those inferior asset classes. All modern investment management works on these assumptions.

This helps explains why managed portfolios today have very little exposure to precious metals, but there are other reasons. Investment funds in total have grown rapidly since the 1970s on the back of money and credit creation. This monetary expansion has fuelled both new funds for investment as well as asset prices generally, while gold and related investments became unfashionable in gold's twenty year bear market between 1980 and 2000. The combination of these two factors reduced precious metals exposure in managed portfolios to very low levels. Gold was therefore ignored as an asset class when modern portfolio theory evolved in the 1990s, and is simply not considered by the current generation of fund managers.

Consequently, investment funds of all types invest in bond markets, stock markets, property assets, securitisations, foreign currencies and to a minor extent general commodities. From time to time they may have had temporary and speculative exposure to precious metals, but very few fund managers actually understand that gold is the ultimate hedge against cash losing its value. After all, if you account in paper money, paper money has to be the risk-free position. The understanding that cash is not risk free is left to private individuals not misinformed by modern portfolio practice.

The world-wide accumulation of hoarded wealth in the form of gold and silver ingots, coins and jewellery has been growing at an accelerating rate over the last thirty years. This has compromised the central banks who were actively suppressing the price: the result is that large amounts of gold and silver have passed from governments to private individuals. None of this can be properly captured in the statistics, partly because the central banks involved refuse to provide accurate information about their sales, swaps and leases, and partly because the individuals that hoard precious metals do so secretly, and are therefore beyond the scope of meaningful statistics.

The reason these individuals hoard precious metals is the basic hypothesis of this article: they will dishoard gold when paper money stops losing its value. We should therefore consider the extent and speed of this loss. In 1973 there were US$1,120 of demand deposits plus cash currency for every ounce of gold owned by the US government[i]. Today, including excess reserves held at the Fed and the $600bn to be printed over the next seven months, the figure stands at $26,512[ii]. In 1973 there were twelve times as many dollars as there was gold at the market price, compared with nearly 20 times today, so paper dollars are more overvalued in gold terms today than at the time when the gold price was only $100.

The quantity of paper money will continue to grow as the world wrestles with its problems. As every day passes, one's worst fears of yesterday materialise. Governments, driven by social pressures rather than dispassionate economics, are forced into ever-increasing financial rescues; but by far the biggest problem facing them is the seeming inevitability of a full-scale banking collapse.

That is what has the panjandrums of Euroland in a panic

over Ireland. We are told by the Bank for International Settlements that total Irish debt to foreign investors stands at $791bn, the substantial majority of which is owed by the banking sector. Ireland on its own might not derail European banks, but the domino effect of the spreading problem most probably will.

This obviously cannot be allowed to happen. Forget the rights and wrongs of "too big to fail": politicians and therefore central banks have no option but to intervene. But what can they do? They cannot fund a rescue with taxes, and they are already borrowing as much as the bond markets can stand. There is only the nuclear option left, however it is dressed up: shore up the system by printing as much money as it takes. Printing money is simply the way governments buy time.

This analysis may turn out to be unfortunately right, or hopefully wrong; but it is more right today than it was last month and also progressively so for the months before that. The rising interest in precious metals is entirely consistent with the growing likelihood that the printing of fiat currencies will continue to accelerate in order to buy off default. While the translation of monetary inflation into price inflation is rarely an even result, we know from both economics and the experience of history that the two are linked as cause and effect respectively. So we can conclude that paper money will continue to lose its value for the foreseeable future.

But accelerating price inflation does not just affect cash as an asset class. Bonds, which are commonly the largest component of a conventional portfolio, will loose value faster than cash. Equities will be lucky to keep up with cash values while bond yields rise and the adverse effects of accelerating inflation result in recession. Property will be hit by rising bond yields and rent increases that can only lag inflation. Only commodities, which are a minor asset class for portfolios, can be reasonably expected to outperform cash. Furthermore, equities and property are commonly used as collateral against the very high levels of borrowings in the private sector, which ties their prices to interest rates, and therefore to cash. Furthermore history confirms that gold and silver are easily the best performers in times of rising inflation[iii].

So in the middle of today's banking and economic crisis, those unfortunates who have delegated the management of their investments to professional fund managers have only bought for themselves the illusion of financial security. They are almost entirely exposed to cash and assets that are dependant on cash itself, because they own negligible amounts of gold and related investments. This means that systemically, portfolios have become totally dependant on the stability of fiat currencies.

This makes gold and silver, not cash, the ultimate risk-free investment class. Paper money may be the medium of exchange and the unit of account, but in these increasingly uncertain times gold and silver are the safest stores of value and will continue to be hoarded, irrespective of price, for as long as these uncertain times continue.

So if anyone asks you when you might take your profits in gold and silver, smile sweetly and just say, "When paper money stops losing its value".

21 November 2010
http://www.financeandeconomics.org/Articles%20archive/2010.11.22%20gold%20and%20cash.htm

[i] See table "Gold backing for 26 major currencies" (page 216 of "You can profit from a monetary crisis" by Harry Browne, published by Macmillan in 1974).
[ii] Today's instantly accessible cash is $6.934 trillion, comprised of deposits held in domestic offices less time deposits of $4.323 trillion, plus non-interest bearing deposits held in foreign offices at $71 bn, figures provided by the FDIC. To these are added currency in circulation of $974bn and excess reserves at the Fed of $966bn, figures obtained from the Fed, together with the QE2 figure of $600bn. Gold held by the Fed is listed at 8,133.5 tonnes.
[iii] See the German experience 1918 to 1923.

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WikiLeaks:
We Don't Want To Know

by Paul Rosenberg

The WikiLeaks disclosure of diplomatic cables this week has stirred strong feelings in millions of people, and many of those feelings run deep. So deep, in fact, that many of us fail to understand them. They trouble us and irritate us, but we are not very clear as to why.

The first few days of this have been rather shocking: When do Sarah Palin and Hillary Clinton agree on anything? But they are both furious with Julian Assange. Offers are being placed upon his head, Interpol has placed him on its Wanted list, and pundits world-wide are raging.

When animus runs deeper than politics in the modern world (when anything runs deeper than politics in the modern world), it is worth stopping for a moment to consider it. As someone who has given years of study to this subject, I will postulate a primary reason, which is this:

> WikiLeaks exposes the truth of how institutions really operate, and many of us don't want to know. We need not to know.

If we are forced to see how governments actually behave, we will have to admit that they are morally inferior to ourselves... and most of us need to avoid that thought. We are happy to complain about one party or another, one faction or another, but we need to see the uberstructure as a nearly sacred thing. But the more that WikiLeaks uncovers, the less we can retain that illusion. The all-too-common reaction is that this must be forbidden, and thus WikiLeaks must be stopped.

WHY SHOULD THIS BE SO?

Most of us work long and hard to find the truth in our daily lives. We want to know if we are getting a good deal in business, if our kids are behaving, or if our relatives are misbehaving. My argument above, however, says that people don't want to know the truth. So, how can this be right, if we all seek the truth nearly all the time?

The answer is simply that government is different. It is seen as a superior entity… and an entity whose superiority we rely upon. If you are tempted to think that this is a silly idea, look back in time a few

hundred years: How many of us relied on the inherent moral superiority of the Church? How many of us were happy to point out the foibles of the local priest or abbey, but then said, “if only His Holiness knew”? We held the structure itself to be a superior entity, and we relied upon that superiority.

The parallels are precise.

I explained this phenomenon at some length in a book of history I wrote two years ago, called Production Versus Plunder. In it, I described a Great Trade between people and the powers that ruled them. That Great Trade was and is this:

The state and/or church presents themselves to men as a superior entity – higher than man. To be joined to them provides sanction from a higher source than that of their internal conflicts.

In our times we often hear this expressed in this way: People need to belong to something larger than themselves. They need to sublimate their confusion and conflicts into a higher entity.

Humans are internally conflicted beings. Whether we blame this upon evolution, the fall of Adam, or something else, we all know that conflict is inherent in human nature, and we all act to deal with it: We spend significant portions of our lives in churches or synagogues, reading books or watching self-help television, in a psychologist’s office, or discussing our problems with our friends. The fact is inarguable.

It is also inarguable that mass institutions have secured the reverence of men and women through all of recorded history. Whether church, state, a god-king or some other variation, human history is dominated by devotion to the institution. And there is a reason for this: The larger entity gives us absolution for our internal conflicts. We may be conflicted and confused, but at least we are a patriot, or a son of the church, or a proud black man, or…

Under the Great trade, our internal conflicts become lost as we are subsumed into the uberentity. It is the great assurance, and it is ever-so-easy to accept, since perhaps every human you’ve ever known has done the same.

This trade is the magic secret of politics and of rulership. People wanted the Divine Right of Kings. They need to think of their Leader as a superior being. Rulers and politicians merely play their roles as public theater.

WikiLeaks is removing this illusion. They are exposing the fact that the uber-entity is not morally superior. It is composed of your silly neighbors and behaves just as badly… or worse.

WHY WE EVADE THIS KNOWLEDGE

Why wouldn’t someone want to know that he or she was morally superior to the uber-entities that manipulate their lives? For one simple reason: If the uber-entity is not superior, responsibility reverts to themselves. So, it is preferable to avoid this choice, unless you have the stomach for heroics.

I DO NOT CONDEMN

Please do not think that I am criticizing people for evading this choice. We have all been raised under one version or another of the Great Trade. We have seen very few people (if any) that rejected it. It has seems a force of nature to us.

Nonetheless, the Great Trade is based upon a lie – that the uber-entity is morally superior – and WikiLeaks is exposing that lie. (If this exposure is mishandled by Assange and his team, it remains that the lie of the Great Trade is being exposed. Such errors are irrelevant to this point.)

Most of us have, in fact, spent a great deal of time and energy improving ourselves. In fact, many of us no longer need the Great Trade. We have outgrown it. The hundreds of hours we’ve spent in self-analysis have not been in vain.

There’s not a state on this planet that is morally superior to a decent man or woman. WikiLeaks is publicizing that fact, and those of us who have developed ourselves to any significant degree should accept that truth. We can handle it.

WebMoney Keeper Mobile - Stay Paid. Be Mobile.

http://www.wmtransfer.com
http://www.webmoney.ru

telepat
www.telepat.com

HOW THE CONTEN ACT CAN RETURN AMERICA TO SOUND MONEY

http://constitutionaltender.blogspot.com/

Ron Paul, in his paper "The Political and Economic Agenda for a Real Gold Standard" (originally delivered at the Mises Institute's 1985 conference on the gold standard), discusses the steps which the economist Ludwig von Mises laid out for us to be able to return to a sound currency (which was in his 1952 epilogue to "The Theory of Money and Credit").

What's particularly relevant about this discussion is that, where the attempts at the national level to implement these steps have been halting at best, the Constitutional Tender Act actually builds on what HAS been accomplished and uses it to implement those steps starting at the STATE level... where they actually have the chance to SUCCEED.

The first step we need to take, writes Paul, is "Gold Coinage":

> The heart of Mises's proposal to restore gold to our monetary system is a gold coinage. He wrote,
>
> > **Gold must be in the cash holdings of everyone. Everybody must see gold coins changing hands, must be used to having gold coins in his pockets, to receiving gold coins when he cashes his paycheck, and to spending gold coins when he buys in a store.**[7]
>
> In this one detail — the critical importance of the gold coinage — I believe lies the key to establishing a new gold standard.
>
> We should make no mistake about it: the more progress we make toward reestablishing the gold standard, the more aggressive our opposition will become. Some vested interests, as you know, have a lot to lose if we succeed in getting the monetary system reconstructed on a gold basis. The first political step is, therefore, to get the coinage into circulation.
>
> One objective might be to aim for every American to become a gold owner. We must encourage a broader base of political support for gold ownership and the availability of gold for personal economic objectives. Certainly a broader base of gold ownership in the country would help to reduce the threats of discriminatory taxation or regulation of gold ownership and gold coin transactions, which are seriously favored in Congress today.

Under the Constitutional Tender Act (a proposed State law which re-applies the U.S. Constitution's negative mandate in Article I, Section 10, that "No State shall... make any Thing but gold and silver Coin a Tender in Payment of Debts"), the State would be required to only use gold and silver coins (or their equivalents, such as checks or electronic transfers) for payments of any debt owed by or to the State (e.g., taxes, fees, contract payments, etc.). All contracts, tax bills, etc. would be required to be denominated in legal tender gold and silver U.S. coins, including Gold Eagles, Silver Eagles, and pre-1965 90% silver coins. All State-chartered banks, as well as any other bank that is a depository for State funds, would be required to offer accounts denominated in those types of gold and silver coins, and to keep such accounts segregated from other types of accounts such as Federal Reserve Notes.

So, with the ConTen Act, the foundation is now laid. Dr. Paul goes on:

> **What we must first do is get the coinage into circulation, and then build the political base to lock the government's fiscal folly with golden handcuffs. People have always understood the tangible value of gold coins in circulation. They don't need to agree or even understand the fine points of monetary theory to own gold coins, trade gold coins, or use gold coins to satisfy part of their marginal-utility demand for cash balances.**
>
> **Most people understand very little about economics or monetary theory. When they see supposed experts in disagreement, the status quo wins by default, because nobody with the power to change it has the courage of conviction. The majority of voters see the debate among experts and hesitate to support any leaders with comprehensive reform schemes. This is why all efforts to rebuild a gold monetary system have met with frustration and stalemate in the past.**

And this is the beauty of the Constitutional Tender Act: instead of being a top-down, federal-level effort, it is a bottom-up, State-level effort, thus giving it a higher likelihood of eventual success (see my paper presented at the Mises Institute's Austrian Scholars Conference, "Ending the Federal Reserve From the Bottom Up: Re-introducing Competitive Currency by State Adherence to Article I, Section 10"). Upon going into effect, the ConTen Act would introduce currency competition with Federal Reserve Notes, by outlawing their use in transactions with the State. Ordinary citizens of the State, being required to pay their State taxes in gold and silver coins, would find it necessary to open bank accounts in those denominations. Businesses operating within the State, being required to pay their State sales taxes and license fees in gold and silver coins, would need to do the same; and in order to acquire such coins, they would begin to offer their goods and services in "dual currency" denominations, where customers could choose to pay in Federal Reserve Notes (which would still be necessary to pay Federal fees and taxes) or gold and silver coins (including checks and debit cards based on bank accounts denominated in such coins). Customers, having found the need to open such accounts in order to deal with the State, would be able to engage in commerce using those accounts.

Over time, as residents of the State use both Federal Reserve Notes and silver and gold coins, the fact that the coins hold their value more than Federal Reserve Notes do will lead to a "reverse Gresham's Law" effect, where good money (gold and silver coins) will drive out bad money (Federal Reserve Notes). (Gresham's law is stated as, "Where legal tender laws exist, bad money drives out good money." A reverse of this would be, "In the absence of legal tender laws, when people are given the free choice between using and accepting good money or using and accepting bad money, bad money becomes less popular than good money, and is driven out of the marketplace.") As this happens, a cascade of events can begin to occur, including the flow of real wealth toward the State's treasury, an influx of banking business from outside of the State (as citizens residing in other States carry out their desire to bank with sound money), and an eventual outcry against the use of Federal Reserve Notes for any transactions. At that point, the Federal Reserve system will have become unwanted and irrelevant, and can be easily abolished by the people's elected Representatives in Washington, D.C. -- and thus open the door for a return to **sound money, nationwide.**

All of this can take place because Dr. Paul helped bring about the minting once again of legal tender U.S. gold and silver coins, which can now be used to return every State to its Constitutional mandate for honest money. He recognized that this first step was a necessity: "There must certainly be no restrictions on the private production of coins, but I believe that getting the US Mint further into the act, producing a gold coinage with some of the mystique of the government, will be useful in the further political stages of monetary reform. Honest money, after all, is a political objective; it is fitting that people should demand honesty from their government, as well as an economic policy that permits individuals to compete honestly." Now, with the Constitutional Tender Act, that political objective is within reach.

A Solari Report - Selected Tax Issues to Consider When Investors Move or Exchange Precious Metals Holdings

By Carolyn A. Betts and Catherine Austin Fitts

November 8, 2010

I. INTRODUCTION

In our May 2010, *Solari Special Report* "GLD & SLV: Disclosure in the Precious Metals Puzzle Palace: An Analysis of the Precious Metals ETFs" we raised questions about the safety of investments in precious metals in the form of shares of exchange-traded funds, which represent undivided interests in pools of precious metals held by custodians with direct accountability for holdings only to the fund sponsors.

In our August 2010 *Solari Special Report*, "Options for Storing Precious Metals" we explored some of the different forms of more direct precious metals holdings and third-party storage facilities that facilitate such holdings. These included:

- bank and nonblank safe deposit boxes and vaults for storage of bullion, coins and other precious metals where the purchases are either made independently by investors or facilitated by the storage facility;
- allocated and unallocated accounts with precious metals refineries (*e.g.,* Perth Mint) and other combination bullion purchase and storage facilities;
- segregated and non-segregated precious metals accounts with custodians that hold coins and bars for institutional investors, typically holding for IRA and other qualified accounts; and
- "digital" holdings in the form of undivided interests in allocated pools of precious metals or specifically-identified, numbered bars (*i.e.*, GoldMoney).

We saw that, generally speaking, less expensive storage fees apply to unallocated and/or unsegregated account holdings, and that in some cases the physical precious metals held in unallocated accounts may actually be "borrowed" from the investor for use by others. Some holdings are identified by certified coin number or bar number, while others are fungible with the holdings of other customers, either on a segregated or unsegregated basis. Some storage facilities permit an investor to convert a precious metals holding from one form to another, *e.g.,* from an unallocated account or undivided interest in a pool to specifically-identified, numbered bars or coins to which the investor can take physical delivery (upon the payment of a fabrication fee). For institutional investors, shares of gold and silver ETFs may be exchanged for bullion, and bullion may be exchanged for ETF shares.

Another form of precious metals holding is a commodity future, consisting of an option to purchases metals at a designated future date at a stated price. In theory, the holder of such an option can take delivery of the metals, although options contracts generally are settled without any of the underlying commodity changing hands.

So, what happens from a tax standpoint when an investor converts his or her holdings of precious metals from one form to another? This question arises when holders of unallocated positions decide to shift their holdings into an allocated form or into jurisdictions which they perceive to be more respectful of their property rights.

The significance of this question is that if such an exchange is deemed to be the sale of one holding and a separate purchase of a new one, any gain is taxable for the year of the exchange at long term capital gains tax rates (assuming the holding period is at least twelve months). In the case of virtually all forms of precious metals holdings,[i] long term capital gains are taxed at the higher 28% rate for collectibles, rather than at the usual 15% rate currently in effect through 2010 for other capital asset classes.

In this Report, we identify and summarize certain IRS revenue rulings and other guidance that may apply to precious metals exchanges and the determination whether and under what circumstances the conversion of precious metals holdings from one form to another may result in a non-taxable[ii] exchange under section 1031 of the Internal Revenue Code ("Code"). We also provide links to articles that provide more generalized explanations of basis, identification requirements and timing issues, the use of "qualified intermediaries," the concept of "boot" (where part of the exchange is in the form of cash, because the items being exchanged are not of exactly equal value), and taxation of precious metals in general.

This report deals only with U.S. federal law and is not intended as a substitute for an analysis by an expert legal or tax advisor relative to a particular situation, but rather is intended to assist investors and practitioners in identifying some of the relevant issues and questions to be considered before entering into an exchange.

We have not done due diligence on the companies and arrangements described herein as examples and highly recommend that an investor do his or her own due diligence before choosing a company or advisor with which to do business. There may be additional, important issues we have not identified (including tax ramifications under applicable US state law and laws of other countries), investment situations we have not considered and forms of precious metals holdings and exchanges we have not thought of. Readers are strongly urged to seek tax counsel before making any investment or purchase decision that may have significant tax consequences.

II. INTERNAL REVENUE CODE SECTION 1032: REQUIREMENTS GENERALLY FOR SECTION 1031 LIKE-KIND EXCHANGE TREATMENT

Section 1031(a)(1) of the Code provides that, in general:

> "No gain or loss shall be recognized on the exchange of property held for productive use in a trade or business or for investment if such property is exchanged solely for property of like kind which is to be held either for productive use in a trade or business or for investment."[iii]

Generally, the requirements for a Code section 1031 exchange are:

a. Exchange of property held for productive use in a trade or business or for investment – this applies to both the relinquished property and the replacement property.
b. The taxpayer may be an individual, C or S corporation, limited or general partnership, limited liability company, partnership or trust.
c. The property relinquished must be of "like kind" to the property received in the exchange.
d. For delayed exchanges, the replacement property must be identified (in writing) within 45 days and the exchange completed not more than 180 days after transfer of the exchanged property, or the due date (including extensions) of the tax return for the year of the sale of the relinquished property, whichever is earlier. The written identification must be delivered to the seller of the replacement property or a "qualified intermediary" or other third party who is not an agent or advisor of the taxpayer. The relinquished property must be disposed of before the replacement property is acquired. To accomplish this, a third-party facilitator ("qualified intermediary") may be used to hold title to the identified replacement property pending disposition of the property to be replaced.[iv] If the taxpayer takes control of the proceeds of the sale of the relinquished property before the exchange is complete, the tax-deferred nature of the exchange may be lost.
e. The basis of the replacement property is the basis of the property relinquished, with certain adjustments [for costs of sale, etc.]
f. If property other than like-kind property or cash is received or paid in addition to the like-kind property exchange, the "boot" is taxed.
g. Special rules apply to exchanges between related persons.
h. Exceptions:

1. stock in trade or other property held primarily for sale,
2. stocks, bonds, or notes,
3. other securities or evidences of indebtedness or interest,
4. interests in a partnership,
5. certificates of trust or beneficial interests, or
6. choses in action.
7. Real property outside the United States and real property located in the United States are not of like kind. In general, personal property used predominantly within the United States and personal property used predominantly outside the United States is not property of a like (section 1031(h)).

On the subject of what properties are of "like kind," in the words of the Internal Revenue Service (herein, "Service: or "IRS"):

> "Section 1.1031(a)-1(b) of the Income Tax Regulations provides that as used in section 1031(a) of the Code, the words 'like kind' have reference to the nature or character of the property and not to its grade or quality. One kind or class of property may not, under that section, be exchanged for property of a different kind or class."

Generally, the rules for like-kind exchanges of real property are more liberal than are those for personal property. Virtually any real property may be exchanged for another real property and still qualify for section 1031 treatment, although an exchange of real property located in one country for real property in another does not qualify.

A like-kind exchange is reported to the Service on Form 8824[v] and filed with the taxpayer's return for the year of the exchange.

III. IRS GUIDANCE AND INTERPRETATIONS OF SECTION 1031 RELEVANT TO EXCHANGES OF PRECIOUS METALS

A. IRS Revenue Rulings on Taxation of Precious Metals and whether Exchanged and Replaced Metals Are of "Like Kind" [in order of date]

(1) ***Rev. Rul. 74-218,*** 1974-1 C.B. 202 – Currency in its usual and ordinary acceptation is defined as gold, silver, other metals or paper used as a circulating medium of exchange. Silver coins received for real property are to be treated as property and not as money; the amount realized by the taxpayer from the exchange was the fair market value of the silver coins ($6,000) rather than the face amount of the coins ($2,000).

(2) ***Rev. Rul. 76-214***, 1976-1 C.B. 218 – The exchange of Mexican 50-peso gold coins for Austrian 100-corona gold coins, both of which are official government restrikes [and

"bullion-type" coins], qualifies for nonrecognition of gain under section 1031(a) of the Code.

(3) ***Rev. Rul. 76-249***, 1976-2 C.B. 21 – A taxpayer who receives U.S. silver coins having a value in excess of their face value in exchange for appreciated real property realizes a taxable gain based on the excess of the fair market value of the coins over the adjusted basis of the real property.

(4) ***Rev. Rul. 79-143***, 1979-1 C.B. 264 – The exchange of U.S. $20 gold coins (numismatic-type coins) for South African Krugerrand gold coins (bullion-type coins) does not qualify for nonrecognition of gain as a like kind exchange under section 1031 of the Code.

In this ruling, the Service provided the following reasoning:

> "[A]lthough the coins appear to be similar because they both contain gold, they actually represent totally different types of underlying investment, and therefore are not of the same nature or character. The bullion-type coins, unlike the numismatic-type coins, represent an investment in gold on world markets rather than in the coins themselves. Therefore, the bullion-type coins and the numismatic-type coins are not property of like kind."

(5) ***Rev. Rul. 82-96*** – The exchange of gold bullion for Canadian Maple Leaf gold coins (which are legal tender in Canada to the extent of face value of $50 each) qualifies for nonrecognition of gain or loss as a like kind exchange under section 1031(a) of the Code.

In this ruling, the Service provided the following reasoning:

> "[B]ecause the value of the gold content in each Canadian Maple Leaf gold coin greatly exceeds its face value, it is not a circulating medium of exchange. Therefore, the Canadian Maple Leaf gold coin is property rather than money for purposes of section 1031(a) of the Code. Because the Canadian Maple Leaf gold coins are bought and sold for their gold content, they are bullion-type coins. Therefore, the nature and character of the gold bullion and the Canadian Maple Leaf gold coins are the same, and they qualify as 'like kind' property as that term is used in section 1.1031(a)-1(b) of the regulations."

(6) ***Rev. Rul. 82-166*** – The exchange of gold bullion held for investment for silver bullion held for investment does not qualify for nonrecognition of gain as an exchange of like kind property.

In this ruling, the Service provided the following reasoning:

> "[T]he values of the silver bullion and the gold bullion are determined solely on the basis of their metal content. Although the metals have some similar qualities and

> uses, silver and gold are intrinsically different metals and primarily are used in different ways. Silver is essentially an industrial commodity. Gold is primarily utilized as an investment in itself. An investment in one of the metals is fundamentally different from an investment in the other metal."

B. Potentially Relevant IRS Revenue Guidance on Real Property Exchanges

Private Letter Ruling No. 2007-06001 (PLR 200706001) – exchange of undivided 25% interest in real property for 100% fee simple interest in another parcel of real property is like kind exchange.

C. Other Internal Revenue Service Rulings of Interest

Rev. Rul. 72-456 – Money paid out in connection with an exchange under section 1031 of the Code is offset against money received in computing gain realized and gain recognized and is also added in determining the basis of the acquired property [based upon section 1.1031(d)-2 of the Income Tax Regulations]. If, upon an exchange of properties of the type described in section 1031 of the Code, the taxpayer received other property (not permitted to be received without the recognition of gain) and gain from the transaction was recognized as required under section 1031(b) of the Code, the basis of the property transferred by the taxpayer, decreased by the amount of any money received and increased by the amount of gain recognized, must be allocated to and is the basis of the properties (other than money) received on the exchange [based upon section 1.031(d)-1(c) of the Income Tax Regulations].

Private Letter Ruling No. 2008-07005 (February 15, 2008 release date) – Taxpayer's receipt of 100 percent of the interests of the partners in a partnership that holds real property, by a disregarded entity created by Taxpayer to receive the real property, will be treated as the receipt of property that is like kind to the real property disposed of by Taxpayer, provided all other requirements of section 1031 are met.

D. Law Firm Tax Opinions

The tax section of the iShares silver exchange traded fund,[vi] provided by the law firm of Clifford Chance US LLP, New York, states that an exchange of silver for shares (called "iShares") in the fund (which is a trust the interests of which represent undivided interests in the underlying assets, consisting of silver bullion) is non-taxable, and that a redemption of iShares in exchange for the underlying silver likewise generally will not be taxable. Presumably, Clifford Chance's conclusion is based on its conclusion that such exchanges satisfy the requirements for a like-kind exchange under Code section 1031.

The tax section of the SPDR Gold Trust gold exchange traded fund prospectus (starting on page 31), provided by the law firm of Carter Ledyard & Milburn LLP, states:

> "In the case of a Shareholder that acquires its Shares as part of a creation, the delivery of gold to the Trust in exchange for the underlying gold represented by the Shares will not be a taxable event to the Shareholder, and the Shareholder's tax basis and holding period for the Shareholder's pro rata share of the gold held in the Trust will be the same as its tax basis and holding period for the gold delivered in exchange therefore. For purposes of this discussion, it is assumed that all of a Shareholder's Shares are acquired on the same date, at the same price per Share and, except where otherwise noted, that the sole asset of the Trust is gold. . . A redemption of some or all of a Shareholder's Shares in exchange for the underlying gold represented by the Shares redeemed generally will not be a taxable event to the Shareholder."

On the treatment of brokerage costs, the tax section states:

> "Any brokerage or other transaction fee incurred by a Shareholder in purchasing Shares will be treated as part of the Shareholder's tax basis in the underlying assets of the Trust. Similarly, any brokerage fee incurred by a Shareholder in selling Shares will reduce the amount realized by the Shareholder with respect to the sale."

Again, we assume that the basis for this opinion is Code section 1031 and that Carter Ledyard & Milburn concludes that the acquisition as part of a "creation" (which is an exchange by an "authorized participant" of physical gold for at least 100,000 Shares of the SPDR Gold Trust representing undivided interests in the underlying gold).[vii]

The tax section of the prospectus for Sprott Physical Gold Trust (a Canadian mutual fund trust) states on page 96:

> "As described under "Redemption of Units," a U.S. Holder may have units redeemed for cash or physical gold bullion. Under Section 302 of the Code, a U.S. Holder generally will be treated as having sold his, her or its units (rather than having received a distribution on the units) upon the redemption of units if the redemption completely terminates or significantly reduces the U.S. Holder's interest in the Trust. In such case, the redemption will be treated as described in the relevant section below depending on whether the U.S. Holder makes a QEF election, a mark-to-market election or makes no election and therefore is subject to the Default PFIC Regime. . .."

> "Gain realized on the sale, exchange, redemption or other disposition of the units would be treated as ordinary income, and any loss realized on the sale, exchange, redemption or other disposition of the units would be treated as ordinary loss to the extent that such loss does not exceed the net mark-to-market gains previously included by the U.S. Holder. Any loss in excess of such previous inclusions would be treated as a capital loss by the U.S. Holder. A U.S. Holder's ability to deduct capital losses is subject to certain limitations. Any such gain or loss generally should be treated as U.S.-source income or loss for U.S. foreign tax credit limitation purposes."

E. Cases

California Life Insurance Co. v. Commissioner, 680 F.2d 85, (9th Cir.1982) – Gold coins and Swiss francs were not of like kind. The coins are exchanged in the marketplace only by numismatists, and are valued primarily for their rarity, as collector items. The Swiss francs, on the other hand, are currently circulating currency, and to their investors they represent investments in the Swiss national economy.

Starker v. United States, 602 F.2d 1341, 79-2 U.S. Tax Case. (CCH) paragr. 9541, 44 A.F.T.R.2d 79-5525 (9th Cir. 1979) – The sale of the relinquished property and the acquisition of the replacement property do not have to be simultaneous. Further:

> "The bundle of rights associated with ownership are obviously not excluded from section 1031; a contractual right to assume the rights of ownership should not, we believe, be treated as any different than the ownership rights themselves. Even if the contract right includes the possibility of the taxpayer receiving something other than ownership of like-kind property, we hold that it is still of a like kind with ownership for tax purposes when the taxpayer prefers property to cash before and throughout the executory period, and only like-kind property is ultimately received."

IV. ISSUES FOR PRECIOUS METALS EXCHANGES OF VARIOUS TYPES

The following are some hypothetical exchanges of precious metals holdings and some of the issues we see in connection with such exchanges:

A. Hypothetical Exchange of Unallocated Account Holding for Bullion Bars or Coins.

Hypothetical Facts:

An investor holds gold or silver in an unallocated account or certificate program with one facility (*e.g.,* Kitco or Perth Mint [viii]) and elects to take delivery from the same facility in the form of bullion bars or coins, paying the facility a fabrication fee and shipping and insurance costs. A certificate fee and storage fees may have been paid by the investor prior to the exchange and while holding the metals in unallocated or certificate form.

Issues/Analysis:

This is a "simultaneous swap" transaction and therefore involves no timing issues and no qualified intermediary or other third-party facilitator. There is no inequality in value between the pool or certificate holdings and the value of the bullion bars or coins (except to the extent of fees) and, therefore, there is no "boot" under Rev. Rul. 72-456. Both the unallocated account or certificate and the bullion bars or coins arguably "represent an investment in gold on world markets rather than in the coins themselves" under Rev. Rul. 979-143 and, therefore, no issues of unlike exchanges of bullion or bullion-type coins for numismatic-type coins seems to exist.

One may analogize this situation to the exchange of ETF shares for bullion in the case of the iShares silver ETF and SPDR shares of the gold ETF (see above) and conclude that if the opinions of counsel for these ETFs as described above are correct, this exchange, too, would qualify for tax deferral under section 1031. One may also analogize this situation to the exchange of a fractional undivided interest in real estate for a 100% fee simple interest in real estate, which, under Private Letter Ruling No. 2007-06001 (see above) is a like-kind exchange. Notwithstanding the foregoing arguments, however, the Service has issued no revenue rulings on the treatment under section 1031 of exchanges of allocated or unallocated accounts or certificates for physical bullion or coins and, therefore, there is no assurance that the Service would approve the exchange as of "like kind." We do not know whether the Service would make a distinction in this respect between allocated accounts and unallocated accounts, but we would argue that if the investor's initial purchase entitled him or her to convert between allocated accounts and unallocated accounts (with or without payment of a fee, which, for purposes of determining like-kind character, should not be relevant), then the exercise of such a right does not change the "kind or character" of the investment under the like-kind exchange rules.

The basis of the investor in the bullion bars or coins would appear to include the fabrication, storage, insurance and shipping fees under Code section 1031(d) and Rev. Rul. 72-456.

B. Hypothetical Exchange of Unallocated Account Holding or Certificate for Bullion Bars or Coins to Be Purchased from a Different Precious Metals Dealer.

Hypothetical Facts:

An investor holds the same interests as in the first scenario, but wishes to exchange his or her pool certificate or unallocated account balance for bullion bars or coins to be acquired from a third-party dealer instead of the original facility.

Issues/Analysis:

All of the issues relevant in the first scenario apply to this case. In addition, this is a multiparty transaction/delayed exchange involving an actual sale and purchase, and not a simultaneous swap, so the rules for identification and timing of the purchase of the replacement property (the bullion or coins) as described above would seem to apply. Therefore, the sale of the unallocated account holding or pooled certificate should occur before the purchase of the replacement property (bullion bars or coins) and the purchase of the replacement property should occur within the IRS's prescribed time period. A qualified intermediary transaction should be effected if possible, with the investor arranging for the proceeds of sale to be directly conveyed to the bullion or coin dealer without control over the funds by the investor. The dealer may have a process for facilitation of such a transaction by a qualified intermediary and for the written identification of the replacement property to be delivered to the qualified intermediary. [In our search of dealer websites, we found no reference to such an exchange system for precious metals, but we did find instances of qualified intermediary/facilitators (*e.g.,* Entrust Group and Exeter 1031 Exchange that appear to perform this function with respect to real estate and precious metals.[ix]

C. Hypothetical Exchange of Unallocated Account Holding for Digital Gold or Silver.

Hypothetical Facts: An investor holds the same interests as in the first scenario, but wishes to exchange his or her pool certificate or unallocated account balance for digital gold or silver at GoldMoney.

Issues/Analysis:

Most of the issues present in the first and second scenarios are present in this case, except that here, the investor is exchanging one non-physical holding (albeit unallocated) for another non-physical holding (which is in allocated form), and the digital gold or silver may be considered to be a hybrid of currency and an investment in precious metals on world markets, since it can be used as a medium of exchange between investors who maintain "holdings" of digital gold. It is difficult to predict the Service's position in this scenario. The argument in favor of like-kind exchange treatment of this multi-step transaction is that the unallocated account or pool certificate is convertible into the same "kind" of precious metal (*i.e.*, gold or silver bullion bar or coin) as the GoldMoney "holding." Note that, in any case, the allocated account or pool certificate must represent an interest in the same type of precious metal (*i.e.*, gold or silver) as the digital currency in order to avoid the adverse result described in Rev. Rul. 82-166 (described above).

D. Hypothetical Exchange of Numismatic Coins for Pooled Interests in the Same Type of Metal Bullion, for Bullion, or for Digital Gold or Silver of the Same Metal Type.

Hypothetical Facts:

The holder of numismatic coins wishes to exchange them for any other of the bullion-type investments described herein, either gold-for-gold or silver-for-silver.

Issues/Analysis:

It appears, based upon Rev. Rul. 79-143, that there is no way for this transaction to qualify for like-kind exchange treatment under section 1031.

E. Hypothetical Exchange of Shares in a Gold or Silver ETF for Bullion Bars or Coins of the Same Metal Type.

Hypothetical Facts:

A shareholder in a gold or silver ETF wishes to exchange his or her shares for bullion bars or coins of the same type of metal (i.e., gold-for-gold or silver-for-silver).

Issues/Analysis:

This scenario involves issues similar to those raised in the first scenario, except that this case is complicated by the fact that the typical individual investor in ETF shares is not entitled to exchange his or her shares for gold or silver bullion held by the ETF trust. One may argue that since institutional investors and other large holders of ETF shares are entitled to exchange gold or silver for shares in amounts of at least 50,000 (for iShares) or 100,000 (for SPDR) shares, that this right in itself is dispositive of the issue whether the ETF shares are of "like kind" with the underlying precious metals and that the fact that the holder of a relatively small number of shares does not hold a different "kind" of interest from the interest held by the large institutional investor. We have no guidance upon which to base a prediction whether the Service would accept this argument.

F. Hypothetical Exchange of Unallocated or Allocated Account Holding/Pooled Certificate or Bullion Bars/Coin held in US storage facility for Unallocated or Allocated Account Holding/Pooled Certificate or Bullion Bars/Coin held in a non-US storage facility.

Hypothetical Facts:

An investor holds bullion or an interest in a pool of bullion in one of forms described in the previous scenarios through a storage facility in the US and wishes to exchange such interest for a similar interest held in another country.

Issues/Analysis:

In addition to the issues described above, this scenario raises the issue whether the location of the holding is relevant in qualifying the exchange as a like-kind exchange under Code section 1031. Code section 1031(h)(2)(A) provides that, in general, personal property used predominantly within the United States and personal property used predominantly outside the United States is not property of a like kind. So, the question boils down to whether investment property located outside the US is "used" predominantly outside the US. The Service has provided no guidance we have found on this issue and we do not know the location of the Mexican gold pesos and Austrian gold coronas described in Rev. Rul. 76-214, so we cannot determine whether the physical location of the coins was relevant to the Service's ruling that the two coins were of like kind.

In addition to the like kind exchange issues, note that the investor may have to make a filing of a Report of Foreign Bank and Financial Accounts (Form TD F 90-22.1) with the Department of Treasury with respect to holdings in "foreign financial institutions."[x]

G. Hypothetical Exchange of Unallocated or Allocated Precious Metals Account Holding/Pooled Certificate or Bullion Bars/Coins for Shares in Precious Metals Mutual Fund or Master Limited Partnership.

Hypothetical Facts:

An investor holds the same interests as in the first scenario, but wishes to exchange his or her pool certificate or unallocated pooled account balance for shares in a mutual fund trust (*e.g.*, Sprott Physical Gold Trust.

Issues/Analysis:

The rules for section 1031 like-kind exchanges exclude stocks, bonds, notes and partnership interests from like-kind exchange treatment and, therefore, this exchange would not qualify because a mutual fund is a type of stock, and a master limited partnership is a type of partnership. The reason a [grantor] trust like that used for exchange traded funds is not disqualified is that an interest in a trust is not an interest in a separate entity, but rather represents an undivided interest in a pool of assets, similar to a tenancy-in-common interest in real estate (*see, e.g.,* Private Letter Ruling No. 2007-06001 described above).

H. Hypothetical Exchange of Gold Numismatic-Type Coins for Silver Numismatic-Type Coins.

Hypothetical Facts:

An investor who holds gold collectible coins (*i.e.,* "numismatic-type" coins wishes to exchange them for silver collectible coins.

Issues/Analysis:

The Service has provided no specific guidance on this point, but it has been suggested that such an exchange may qualify as a like-kind exchange:

> "In the numismatic context, a trade of a silver numismatic coin for a gold numismatic coin, such as a Morgan Dollar for a Saint-Gaudens Double Eagle, is likely permitted. Although one is silver and the other is gold, both are valued for their numismatic worth as well as their metal content."[xi]

Since, in Rev. Rul. 82-166 the Service ruled that the exchange of gold bullion for silver bullion is not a like-kind exchange because silver and gold are intrinsically different metals and primarily are used in different ways, this is an intriguing suggestion. The argument to be made is that gold numismatic coins and silver numismatic coins, unlike the metals themselves, *are* used in the same way and are valued in the same manner. Whether the Service would agree with this position is uncertain, of course.

IX. CONCLUSION

Investing in precious metals often involves tax considerations that are new or unfamiliar to many individual and institutional investors. Because gains on precious metals as tangibles involve higher tax rates than is the case for financial assets and because we are in a long term bull market for precious metals resulting in potential capital gains, it is especially important that investors familiarize themselves with the tax issues of the precious metal options they consider and seek counsel of trustworthy tax professionals if significant tax consequences are at stake. This includes ensuring that their ability to move their holdings between depositories and/or jurisdictions does not give rise to unexpected or avoidable taxable events.

We hope that gathering the research in this article will help your tax professionals advise you on the unique considerations that may be relevant to changes in your precious metals holdings. We also hope that the complexity of this subject does not deter you from holding or investing in precious metals, which should be an integral part of household assets, business reserves and modern portfolios.

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LINKS

Wikipedia on Section 1031 Like-kind Exchanges

Holland and Knight article

James F. Ivers III, "The Gold Standard: Income Tax Treatment of Investments in Gold and other Precious Metals" (April 20, 2010), *The Wealth Channel*, [Note that this article also includes information on what types of gold and silver investments may be held in qualified investment vehicles like IRAs).

Don Dion, "Currency, Precious Metal and Futures ETFs: Don't Get Caught in the Tax Trap," *Seeking Alpha* (May 9, 2008)

Robert W. Wood, "Ten Things to Know about Like Kind Exchanges," *Forbes.com* (January 26, 2010)

BDO Seidman Slide Presentation on 1031 Like-kind Exchanges

[i] This includes precious metals trust-form ETFs that hold precious metals (as opposed to ETFs that hold mining stocks or precious metals futures), coins and bars, digital gold and silver, jewelry and gold, silver and platinum "certificates" representing allocated and unallocated holdings, but does not include precious metals mutual fund shares, ETFs that hold mining stocks or precious metals futures and common shares of mining companies. An exception to this rule is taxation of gold and silver held through passive foreign investment companies (like Central Fund of Canada) when filing a "QEF" election, in which case the sale qualifies for taxation at ordinary income tax rates. *See*, this IRS publication on passive foreign investment companies and the prospectus for Central Fund of Canada, page 15, "QEF Election."

See, Office of Chief Counsel Memorandum, CC:ITA:B01:LAAyres (May 2, 2008), which provides that shares of precious metals ETFs in trust form that invest in precious metals are taxed as collectibles (available at http://www.irs.gov/pub/lanoa/pmta01809_7431.pdf). *See also*, Rev. Rul. 90-7,1990-1 C.B. 153 (a certificate holder in an investment trust that has a single class of ownership interests and a fixed portfolio of stocks does not recognize gain or loss when the certificates are exchanged for a proportionate share of each of the trust's assets); Rev. Rul. 85-13, 1985-1 C.B. 184 (a grantor acquired the corpus of a trust in exchange for the grantor's unsecured promissory note. The grantor is considered to have borrowed the corpus of the trust and, as a result, is treated as the owner of the trust under § 675(3). Because the grantor is treated as the owner of the trust, the grantor is deemed the owner of the trust assets for federal income tax purposes.); and Rev. Rul. 84-10, 1984-1 C.B 155 (a beneficial owner of a widely held mortgage trust is treated for federal income tax purposes as having a proportionate share of equitable ownership in each of the mortgages of the trust).

[ii] The term "non-taxable" exchange is something of a misnomer, since the tax is actually only deferred until a later date when a taxable disposition takes place. An exception is that an intervening death of the exchangor does result in a tax-free step up in basis to the exchangor's heir.

[iii] *See,* Section 1031 of the Internal Revenue Code for a copy of the full section. Note that this is not an official version of the statute, but has been included for convenience of the reader.

[iv] For a more detailed explanation, *see*, IRS Fact Sheet No. 2008-18 and IRS materials on this subject.

[v] *See*, IRS Instructions for Form 8824.

[vi] Page 32 of the prospectus (http://www.sec.gov/Archives/edgar/data/1330568/000119312510051321/d424b3.htm#rom37182_55). The tax treatment described in the prospectus was provided by the law firm of For a more detailed description of the iShares fund, *see,* Catherine Austin Fitts and Carolyn Betts, "GLD and SLV: Disclosure in the Precious Metals Puzzle Palace," *The Solari Report*, (July 8, 2010), Section III.

[vii] Another interesting and generally relevant aspect of the tax discussion concerns determining basis in shares purchased on different dates when fewer than all of the taxpayer's shares are disposed of. Carter Ledyard's tax analysis states:

> If a Shareholder owns multiple lots of Shares (i.e., Shares acquired on different dates and/or at different prices), it is uncertain whether the Shareholder may use the "specific identification" rules that apply under Treas. Reg. Section 1.1012-1(c) in the case of sales of shares of stock, in determining the amount, and the long-term or short-term character, of any gain or loss recognized by the Shareholder upon the sale of gold by the Trust, upon the sale of any Shares by the Shareholder, or upon the sale by the Shareholder of any gold received by it upon the redemption of any of its Shares. The IRS could take the position that a Shareholder has a blended tax basis and holding period for its pro rata share of the underlying gold in the Trust. Shareholders that hold multiple lots of Shares, or that are contemplating acquiring multiple lots of Shares, should consult their own tax advisers as to the determination of the tax basis and holding period for the underlying gold related to such Shares."

[viii] Note that, according to their respective websites, in the case of Kitco non-allocated pool accounts, "there is always physical bullion present in [the Kitco] vaults to account for 100% of the outstanding client balances in all Kitco Pool Accounts," whereas in the case of Perth Mint, the Mint may (and probably does) "borrow" the investors' precious metals for use in its industrial operations, so that no actual metals are held in segregated safekeeping for certificate holders.

[ix] Reference to these qualified intermediaries is made solely to provide information about the types of services that may be available and does not represent an endorsement of these service providers, upon which we have done no due diligence.

[x] *See*, Donald W. Dee, "1031 Exchanges and How They Apply to Numismatic Coins and Bullion," under the section entitled "Section 1031 Exchanges and Coins," available at the Steptoff Investment Group LLC.