

General Information Letter: In the provision in IITA Section 304(a)(3)(C-5)(iii)(a) regarding a dealer in an item of tangible personal property, the phrase “within the meaning of Section 475” clarifies the meaning of “dealer.”

September 19, 2008

Dear:

This is in response to your letter dated August 7, 2008, in which you request a General Information Letter (GIL). A GIL is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), which may be accessed from the Department’s web site at www.Iltax.com.

Your letter states as follows:

This letter is a follow-up to your response dated August 1, 2008 to my GIL request dated July 1, 2008. The purpose of this follow-up is to clarify certain aspects of your response to my GIL request.

Under Section 304(a)(3)(C-5)(iii)(a) of the Illinois Income Tax Act (“Act”), it states that: “In the case of a taxpayer who is a dealer **in the item of intangible personal property within the meaning of Section 475** of the Internal Revenue Code, the income or gain is received from a customer in this state.” Under the last antecedent rule, the qualifying phrase “within the meaning of Section 475” modifies the phrase “the item of intangible personal property” or “intangible personal property.” Illinois Bell Telephone v. Allphin, 93 Ill.2d 241 (1982); Edward Don & Co. v. Zagel, 95 Ill. App. 3d 589 (1st Dist. 1981).

Therefore, under this Section, if the item of intangible personal property is the type covered within the meaning of Section 475 of the Internal Revenue Code (“Code”), the income or gain from such property will be sourced to the location the customer receives such property if the seller of such property is a dealer in such property.

Section 475 of the Code specifically states that it applies to dealers in securities. I.R.C. § 475. “Security” is defined in Section 475 as:

- (A) the share of stock in a corporation;
- (B) partnership or beneficial ownership interest in a widely held or publicly traded partnership or trust;
- (C) note, bond, debenture, or other evidence of indebtedness;
- (D) interest rate, currency, or equity notional principal contract;
- (E) evidence of an interest in, or a derivative financial instrument in, any security described in subparagraph (A), (B), (C), or (D), or any currency, including any option, forward contract, short position, and any similar financial instrument in such a security or currency; and
- (F) position which –

- (i) is not a security described in subparagraph (A), (B), (C), (D), or (E),
- (ii) is a hedge with respect to such a security, and
- (iii) is clearly identified in the dealer's records as being described in this subparagraph before the close of the day on which it was acquired or entered into (or such other time as the Secretary may by regulations prescribe).

As the above indicates, the only item of intangible personal property that Section 475 of the Code applies to are securities sold by dealers in such securities. As a result, sellers of intangible memberships in benefit and service programs would not be selling securities covered by Section 475 of the Code.

Based on the above, we are unclear whether you are concluding that memberships in such clubs are in substance "securities" under Section 475 of the Code or whether it is the Illinois Department of Revenue's position that any intangible personal property sold by dealers in such property are sourced under Section 304(a)(3)(C-5)(iii)(a) to the location the customer receives such property notwithstanding the fact that Section 475 only applies to securities.

Can you please clarify this for us.

RULING

Section 304(a)(3)(C-5)(iii) of the Illinois Income Tax Act ("IITA" ; 35 ILCS 5/304(a)(3)(C-5)) states:

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

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

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

Whether gross receipts from sales of intangible personal property under IITA Section 304(a)(3)(C-5)(iii) are assigned to Illinois for sales factor purposes depends on whether the taxpayer "is a dealer in the item of intangible personal property within the meaning of Section 475 of the Internal Revenue Code." Section 475 of the Internal Revenue Code does not define the term "intangible personal

property.” Section 475(c)(1) defines the term “dealer in securities” as a taxpayer that:

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

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

Accordingly, if the taxpayer is a dealer within the meaning of IRC Section 475, the gross receipts are assigned to Illinois under IITA Section 304(a)(3)(C-5)(iii)(a) if the customer is in Illinois. If the taxpayer is not a dealer within the meaning of IRC Section 475, the gross receipts are assigned to Illinois under Section 304(a)(3)(C-5)(iii)(b) if the income-producing activity is in Illinois. For this purpose, a taxpayer is a dealer with respect to an item of intangible personal property if the taxpayer is actually a dealer with respect to the item under IRC Section 475, or would be a dealer with respect to the item under IRC Section 475 if the item were a security as defined in IRC Section 475(c)(2). This is consistent with the purpose of IITA Section 304(a)(3)(C-5)(iii) to create a dichotomy between taxpayers that are in the business of selling the particular item of intangible property and taxpayers not in such business. The purpose of the Section is not to create a customer-based sourcing rule only for dealers in securities, while leaving other taxpayers, including those whose business it is to sell the particular intangible item, to apply the income-producing activity test. Taxpayers in the business of selling a certain intangible item assign gross receipts based on the location of their customers, while taxpayer's not in the business of selling such item assign gross receipts based on the income-producing activity.

The Department's letter of August 1, 2008 concluded that the taxpayer described therein must assign its gross receipts from sales of membership interests under IITA Section 304(a)(3)(C-5)(iii)(a) because the taxpayer is in the trade or business of selling membership interests. The conclusion is not based on a determination that the membership interests constitute securities as defined under IRC Section 475(c)(2). For purposes of IITA Section 304(a)(3)(C-5)(iii)(a), the taxpayer is a dealer with respect to membership interests within the meaning of IRC Section 475 because the taxpayer would be a dealer under such section with respect to the membership interests if the membership interests were the meaning of securities under Section 475(c)(2).

As stated above, this is a GIL. A GIL does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you have questions regarding this GIL you may contact Legal Services at (217) 782-7055. If you have further questions related to Illinois income tax laws, visit our website at www.revenue.state.il.us or contact the Department's Taxpayer Information Division at (217) 782-3336.

Sincerely,

Brian L. Stocker
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