

General Information Letter: Election to treat all income as business income will apply to gains on sale of division.

October 9, 2008

Dear:

This is in response to your letter dated July 18, 2008, in which you request a Private Letter Ruling on behalf of COMPANY1, Inc. The nature of your request and the information you have provided require that we respond with 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 viewed on the Department's web site at www.Iltax.com.

The facts and analysis as you have presented them are as follows [footnotes omitted]:

On behalf of our client COMPANY1, Inc. (hereinafter referred to as "COMPANY1" or "our client"), we respectfully request the issuance of a private letter ruling ("PLR") by the Illinois Department of Revenue ("Department") pursuant to 2 Ill. Adm. Code 1200.100.

General Information

1. This PLR is not requested for hypothetical or alternatively proposed transactions, but rather to determine the income tax consequences of an actual transaction engaged in by COMPANY1, Inc., as described below.
2. COMPANY1 is not currently engaged in litigation with the Department with regard to this or any other tax matter.
3. The Department has not previously ruled regarding this matter for COMPANY1. Neither COMPANY1 nor COMPANY2 LLP has submitted the same or similar issue to the Department on behalf of COMPANY1.
4. We are aware of no authority contrary to the authorities referred to and cited below.

Statement of Facts

In February 19XX COMPANY1 incorporated in STATE1. In July 19XX COMPANY1 reincorporated in STATE2, that year the public was also first able to purchase shares of COMPANY1 stock at the company's initial public offering. During its history, COMPANY1 has operated in four different business segments as described in the following paragraphs. The segments are: SEGMENT1, which operated from the company's inception through its sale in 20XX; SEGMENT2, comprised of royalties from its SEGMENT1 technology and embedded modem software stacks, which started in 20XX and continues today as an operating segment; SEGMENT3 ("SEGMENT3"), comprised of antennas and scanning receiver products, which started in 20XX with a series of acquisitions and continues today as an operating segment; and SEGMENT4, comprised of data connectivity software for wireless applications, which started with a small acquisition in 20XX and was originally grown until its sale in January 20XX.

SEGMENT1

COMPANY1 started as a provider of SEGMENT1 products for personal computers, which consisted of a hardware chipset containing a proprietary host signal processing software that effectively replaced conventional hardware-based modems, thereby reducing cost. SEGMENT1 business operations were principally conducted in STATE1 and ISLAND. By early 20XX, COMPANY1's Board of Directors concluded that the modem business had limited potential for expansion, as overseas competition had significantly reduced modem sales prices and decreased the income potential for that business. As a result of these factors, on May 8, 20XX COMPANY1 sold certain of its modem business assets to COMPANY3, Inc. ("COMPANY3") for \$XXX million. COMPANY3 purchased COMPANY1's modem inventory, fixed assets, contracts, distributors related to the SEGMENT1 products and limited intellectual property. COMPANY1 did not transfer any of its modem patents and it retained all operating contracts and intellectual property assets associated with embedded modems.

SEGMENT2

In 20XX COMPANY1 began successfully licensing its patented modem technology and its software stacks related to embedded modems, which are modems that go into non personal computer devices such as fax machines and credit card processing machines. These licensing opportunities are why COMPANY1 did not transfer any of its modem patents and it retained all operating contracts and intellectual property assets associated with embedded modems when the company sold its SEGMENT1 segment in 20XX. By the end of 20XX, all of the patented technology had been licensed.

SEGMENT3 ("SEGMENT3")

SEGMENT3 is comprised of antennas and scanning receiver products. The segment designs, distributes, and supports antenna solutions for public safety applications, unlicensed and licensed wireless broadband, fleet management, network timing, and other GPS applications. SEGMENT3's portfolio of receivers, receiver based products, and interference management solutions are used to measure, monitor and optimize cellular networks. SEGMENT3 is COMPANY's largest operating segment. Following the sale of SEGMENT4 in January 20XX, SEGMENT3 represents virtually all of the company's operations.

The antenna operations are principally conducted in CITY1, IL. The antenna product lines were built from the acquisition of COMPANY4 and several antenna product lines from CORPORATION in 20XX, COMPANY5 Ltd. in 20XX, and COMPANY6 Ltd. in 20XX.

The scanning receiver operations are principally conducted in CITY2, STATE3. The establishment of this segment started with the acquisition of COMPANY7, Inc. in 20XX.

SEGMENT4

The SEGMENT4 segment is comprised of data connectivity software for wireless applications. The software is sold to both public and private wireless carriers (i.e. COMPANY8, COMPANY9, COMPANY10, COMPANY11, etc.). SEGMENT4 started with the acquisition of the assets of COMPANY12 Inc., in May 20XX for \$X.X million in cash. The SEGMENT4 segment, including COMPANY12, principally conducted business in CITY3, Illinois. At that

time COMPANY1 also moved its corporate headquarters to CITY3, Illinois. The company grew the segment after the acquisition through organic investment.

Historically, COMPANY1 has been subject to certain economic risks including decreases in the average selling price of its products. In an effort to manage the economic risks COMPANY1 has sought to diversify its business and broaden its product offerings that enable cost-effective access in both wired and wireless environments. However, given the economic risks present within the technology industry, periods arise where the most appropriate business decision is to reduce product diversification and focus on specific product lines. In 20XX, COMPANY13, Inc. presented COMPANY1 with an unsolicited offer to purchase SEGMENT4. COMPANY1's Board of Directors deemed the offer to be in its shareholders' best interest, viewing the sale as an opportunity to fulfill strategic business initiatives and refocus on its wireless broadband solutions. As a result, COMPANY1 completed a sale of its SEGMENT4 division on January 4, 20XX. Under the terms of the asset purchase agreement, COMPANY13, Inc. purchased substantially all of the assets of SEGMENT4 for total consideration of \$XX.X million in cash. In connection with the sale of SEGMENT4, COMPANY1 moved its headquarters from CITY3 to CITY1, Illinois.

Pertinent Law and Regulations

Section 201 of the Illinois Income Tax Act ("IITA") states in pertinent part that "[a] tax measured by net income is hereby imposed on every individual, corporation, trust and estate for each taxable year ending after July 31, 1969 on the privilege of earning or receiving income in or as a resident of this State."

Section 1501(a)(20) of the IITA provides that the term "resident" includes individuals, estates and trusts.

Section 1501(a)(14) states that a "nonresident means a person who is not a resident."

Section 1501(a)(18) defines the term "person" to include corporations.

IITA Section 1501(a)(24) states that a "taxpayer" means any person subject to the tax imposed by this Act."

Section 1501(a)(1) of the IITA sets forth the statutory definition of the term "business income." This Section provides:

The term 'business income' means all income that may be treated as apportionable business income under the Constitution of the United States. Business income is net of deductions allocable thereto. Such term does not include compensation or the deductions allocable thereto. For each taxable year beginning on or after January 1, 2003, a taxpayer may elect to treat all income other than compensation as business income. This election shall be made in accordance with rules adopted by the Department and, once made, shall be irrevocable.

Section 1501(a)(13) provides "[t]he term 'nonbusiness income' means all income other than business income or compensation."

IITA § 303 sets forth the manner in which the nonbusiness income of any person other than a resident is allocated. Section 303(b)(3) states that “[c]apital gains and losses from sales or exchanges of intangible personal property are allocable to this State if the taxpayer had its commercial domicile in this State at the time of such sale or exchange.”

IITA § 304 sets forth the manner in which the business income of a corporation is apportioned between Illinois and one or more other states. IITA § 304(h) states that for tax years ending on or after December 31, 2000 the business income of a corporation is apportioned by the sales factor. Section 304(a)(3) states in relevant part that the “sales factor” is “a fraction, the numerator of which is the total sales of the person in this State during the taxable year, and the denominator of which is the total sales of the person everywhere during the taxable year.”

IITA § 304(a)(3)(C) provides the statutory rules for apportioning income from sales other than sales of tangible personal property and certain intangibles apportioned pursuant to § 304(a)(3)(B-1). Section 304(a)(3)(C) states that such sales are “in this State if (i) the income-producing activity is performed in this State; or (ii) the income-producing activity is performed both within and without this State and a greater proportion of the income-producing activity is performed within this State than without this State based on performance costs.”

IITA § 304(f) states that “if the allocation and apportionment provisions of subsections (a) through (e) and of subsection (h) do not fairly represent the extent of a person’s business activity in this State, the person may petition for, or the Director may require, in respect of all or any portion of the person’s business activity, if reasonable:...(4) the employment of any other method to effectuate an equitable allocation and apportionment of the person’s business income.”

Section 100.3380 of the Department’s rules (86 Ill. Adm. Code 100.3380) was adopted pursuant to the Director’s authority under IITA § 304(f). Section 100.3380(c) sets forth a number of special rules for determining the sales factor. Section 100.3380(c)(2) provides that “where gross receipts arise from an incidental or occasional sale of assets used in the regular course of the person’s trade or business, such gross receipts shall be excluded from the sales factor. For example, gross receipts from the sale of a factory or plant will be excluded.”

Requested Rulings

1. COMPANY1 may elect to treat the gains from the sale of its SEGMENT4 division as “business income” pursuant to the election afforded by IITA § 1501(a)(1).
2. The gross receipts received by COMPANY1 from the sale of all the business assets of its SEGMENT4 division must be excluded from the numerator and the denominator of the sales factor pursuant to § 100.3380(c)(2) of the Department’s rules.

Analysis

COMPANY1 earns income in the State of Illinois and is a taxpayer subject to the IITA. As a corporation, COMPANY1 is a non-resident of Illinois for Illinois income tax purposes. As a non-resident, COMPANY1 is required to determine the amount of business income apportionable

to Illinois by comparing sales in Illinois to sales everywhere. The taxable year in which COMPANY1 recognized gain on the sale of its SEGMENT4 division began after January 1, 20XX. Pursuant to Illinois law, COMPANY1 may elect to treat all income other than compensation as business income. After making the statutorily allowed election, COMPANY1's income from the sale of its SEGMENT4 division would constitute apportionable business income for Illinois purposes.

However, pursuant to § 100.3380(c)(2) COMPANY1 must exclude income from the sale of its SEGMENT4 division from the numerator and denominator of its sales factor as "an incidental or occasional sale of assets used in the regular course of the person's trade or business...." COMPANY1's sale of certain business assets in 20XX does not make the sale at issue fall outside the parameters of § 100.3380(c)(2). COMPANY1 provides wireless communications hardware and software products, it does not engage in the business of buying and selling business assets. In fact, the sale at issue is only COMPANY1's second significant sale of business assets since its 1994 inception. In IT 01-0043 GIL, the Department's Legal Division opined that the gain from a deemed sale of assets under IRC § 338(h)(10) may be excluded from the sales factor pursuant to § 100.3380(c)(2) in an appropriate case. The Department's Legal Division reemphasized the application of § 100.3380(c)(2) in IT-07-0001-PLR, when it concluded that the proceeds from the sale of a corporate subsidiary may be excluded from both the numerator and denominator of the taxpayer's sales factor when apportioning its income. The current facts mandate exclusion of the gain from the Illinois sales factor.

RULING

I. Business Income Election

Section 1501(a)(1) of the Illinois Income Tax Act ("IITA" ; 35 ILCS 5/1501(a)(1)) states in pertinent part:

For each taxable year beginning on or after January 1, 2003, a taxpayer may elect to treat all income other than compensation as business income. This election shall be made in accordance with rules adopted by the Department and, once made, shall be irrevocable.

The election provided under IITA Section 1501(a)(1) allows the taxpayer to elect to treat all of its income for a taxable year beginning on or after January 1, 2003 as business income, and not merely certain items of income for a taxable year. In this case, you have requested a ruling that COMPANY1 may elect under IITA Section 1501(a)(1) to treat the gains from the sale of its SEGMENT4 division as business income. IITA Section 1501(a)(1) does not allow such an election. However, COMPANY1 may elect to treat all of its income as business income for the taxable year that includes the sale of the SEGMENT4 division. You have indicated that the sale of the COMPANY4 division occurred on January 4, 20XX. Gain or loss from the sale therefore would be included in taxable income for a taxable year beginning on or after January 1, 2003. Provided that COMPANY1 properly makes the election in accordance with Department rules, all of its income for its taxable year that includes the sale of the SEGMENT4 division, including any gain or loss from that sale, will be treated as business income.

Department Regulations Section 100.3015(b) provides as follows regarding the business income

election:

The election under this Section shall be made on the original return filed by the person making the election for the taxable year to which the election applies or on a corrected return filed prior to the due date (including extensions) for the return pursuant to Section 100.9400(f)(3) of this Part. An election made on an original return may also be revoked on a timely-filed corrected return. After the extended due date for filing the return has passed, the election may still be made on an original return, but an election that has been made on the original or corrected return may no longer be revoked.

Accordingly, provided that COMPANY1 properly makes the election as provided in Regulations Section 100.3015(b) for its taxable year that includes the sale of its SEGMENT4 division, all of its income for such taxable year, including the gains from the sale of the division, is business income.

II. Occasional Sale Exclusion

Department Regulations Section 100.3380(c)(2) provides the following special rule related to computation of the sales factor:

Where gross receipts arise from an incidental or occasional sale of assets used in the regular course of the person's trade or business, such gross receipts shall be excluded from the sales factor. For example, gross receipts from the sale of a factory or plant will be excluded.

The purpose of this provision is to exclude from both the numerator and denominator of the sales factor gross receipts from transactions that, while generating business income, do not arise from transactions and activity that may be regarded as the taxpayer's regular or ordinary course of business. The sale of substantially all of the assets of a division as part of a single transaction or series of integrated transactions would not generally be considered to constitute a taxpayer's regular or ordinary course of business. As a result, gross receipts arising from a sale in complete liquidation of a division must be excluded from both the numerator and denominator of the sales factor under Department Regulations Section 100.3380(c)(2). In this case, then, COMPANY1 must exclude from its sales factor the gross receipts from its sale of the SEGMENT4 division.

As indicated 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 further questions regarding this GIL, feel free to contact this office at (217) 782-7054.

Sincerely,

Brian L. Stocker
Associate Counsel (Income Tax)