

General Information Letter: Composite returns cannot be filed on behalf of corporations or partnerships that are partners in a partnership.

August 28, 2001

Dear:

This is in response to your letter dated August 20, 2001 in which you state the following:

The purpose of this letter is to request the state's permission to file a non-resident composite return in a unique situation that would result in efficiencies and savings to our client and to the state of Illinois.

The Limited Partnership (hereinafter "LP") at the top of the accompanying organizational chart is the taxpayer. LP is a manufacturer of "products." LP has two groups of ultimate partners. First, LP has an S Corporation (hereinafter "S Corp") partner that has 6 individual members. Second, LP has a group of 156 individual members as its partner. Of these individual members, 27 also have an interest in a related party investment partnership (hereinafter "IP") and they are also seeking inclusion in this composite filing.

LP is seeking your help in finding a simplified and efficient means by which it may remit applicable corporate and personal income taxes to the state of Illinois on behalf of as many partners as possible. While achieving efficiency, LP also desires to avoid filing multiple returns to the fullest extent possible. It appears that the filing of a composite return by LP, on behalf of its ultimate partners (including the mutual partners of IP) would best serve this purpose.

Although the ownership structure includes several types of entities (individuals, LLC, partnerships, C Corporations, and foreign corporations), all of the taxable income derived from LP will ultimately be attributable to LP's ultimate partners. For this reason, we propose that LP be allowed to account for all of the taxable income and applicable tax liability attributable to the non-residents on a composite return to be filed by LP. It should be noted that any individuals, corporations, partnerships, or trusts which may be required to file a return in the state of Illinois for any purpose other than for this filing requirement will not be included in this composite return.

We realize that normal technical filing requirements may discourage permitting this type of centralized reporting of the pass-through income of ultimate owners. We submit, however, that this organizational structure presents an ideal opportunity for the state of Illinois to adopt an innovative and constructive approach to an otherwise complicated and difficult tax compliance problem. This innovative approach would be beneficial both to the state of Illinois and to LP and to process, approximately 163 fewer returns. The state of Illinois would still receive the proper amount of tax to which it is entitled.

LP and its ultimate partners are requesting similar treatment in all other applicable states. Composite return filings as requested in these states including the state of Illinois could result in substantial tax compliance cost savings to the ultimate partners, along with similar savings and efficiencies to the state of Illinois with no financial detriment to the state.

According to the Department of Revenue ("Department") regulations, the Department may issue only two types of letter rulings: Private Letter Rulings ("PLR") and General Information Letters ("GIL").

The regulations explaining these two types of rulings issued by the Department can be found in 2 Ill.Adm.Code §1200, or on the website <http://www.revenue.state.il.us/legalinformation/regs/part1200>.

Due to the nature of your inquiry and the information presented in your letter, we are required to respond with a GIL. GILs are designed to provide background information on specific topics. GILs, however, are not binding on the Department.

## **Discussion**

The regulations pertaining to the filing of composite returns on behalf of partners may be found at 86 Ill.Adm.Code §100.5100, or on the above listed website. A copy of said regulation is enclosed for your files.

Said regulations set forth eligibility requirements for the filing of a composite return (IIT Reg. Sec. 100.5100(b)):

Eligibility. The right to be included in a composite return is limited to nonresident and resident individuals, trusts, and estates who are partners of the same partnership, shareholders of the same S corporation, or individuals transacting an insurance business in Illinois under a Lloyd's plan of operation. The eligibility of resident individuals, trusts, and estates is conditioned upon compliance with subsection (c) of this Regulation.

Example: The Acme partnership consists of a general partner and fifty (50) limited partners. The general partner is a regular corporation, and the limited partners consist of twenty-six (26) nonresident individuals, twenty (20) resident individuals, an S Corporation, a partnership, a nonresident trust, and an estate. The twenty-six (26) nonresident individuals, the nonresident trust, and the nonresident estate are automatically eligible to be included in a composite return. The twenty (20) resident individuals may be included in the composite return with the nonresidents if the Department grants their petition. None of the other entities may be included in the composite return.

Upon reviewing the above quoted eligibility requirements, it is apparent that eligibility for inclusion in a composite return filed in the State of Illinois requires that the individual or entity must be a partner of the filing partnership. Thus, an individual or entity who may be an "ultimate partner" is ineligible unless that individual or entity is in fact a direct partner of the filing partnership. The direct partner must meet an additional eligibility requirement. The direct partner must also be a nonresident individual, nonresident trust, or nonresident estate in order to be automatically eligible for inclusion in the filing of a composite return. Resident individuals may also be included upon the granting by the Department of a petition for such inclusion. All other types of partners, including other partnerships, limited partnerships, LLCs, C Corporations and S Corporations, are ineligible.

Direct partners of the subject LP who are nonresident individuals, nonresident trusts or nonresident estates are automatically eligible for inclusion in a composite return. Any direct partner who is a resident individual may be included upon the granting by the Department of a petition requesting such inclusion. (See IIT Reg. Sec. 100.5100(c)). All direct partners who do not meet such criteria may not be included in a composite return. Finally, because the Illinois composite return regulations are not multi-tiered, the investment partnership as well as any individual or entity that is not a partner of the subject LP may not be included in a composite return.

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As stated above, this is a general information letter which does not constitute a statement of policy that either applies, interprets or prescribes tax law. It is not binding on the Department. Should you desire a PLR, it would be necessary to provide us with a request that complies with the requirements of IIT Reg. Sec. 1200.110 of our rules. Should you have additional questions, please do not hesitate to contact our office.

Sincerely,

Matthew S. Crain  
Staff Attorney -- Income Tax