

**Illinois Department of Revenue
Regulations**

Title 86 Part 100 Section 100.9730 Investment Partnerships (IITA Section 1501(a)(11.5))

TITLE 86: REVENUE

**PART 100
INCOME TAX**

Section 100.9730 Investment Partnerships (IITA Section 1501(a)(11.5))

- a) For taxable years ending on or after December 31, 2004, an "investment partnership" is exempt from Illinois income taxation. (IITA Section 205(b)) The term "investment partnership" means *any entity that is treated as a partnership for federal income tax purposes and that meets each of the following requirements:*
- 1) *No less than 90% of the partnership's cost of its total assets consists of qualifying investment securities, deposits at banks or other financial institutions, and office space and equipment reasonably necessary to carry on its activities as an investment partnership.* (IITA Section 1501(a)(11.5)(A)(i)) The "asset test" under this subsection (a)(1) is applied for each taxable year by computing the percentage of the partnership's cost of its total assets that consists of qualifying investment securities, deposits at banks or financial institutions, and office space and equipment as of the beginning of the taxable year and as of the end of each month of the taxable year, and then computing the average of those percentages; and
 - 2) *No less than 90% of its gross income consists of interest, dividends, and gains from the sale or exchange of qualifying investment securities.* (IITA Section 1501(a)(11.5)(A)(ii)) The "gross income test" under this subsection (a)(2) is computed separately for each taxable year on the basis of gross income for the entire taxable year, determined using the method of accounting used for federal income tax purposes for the taxable year; and
 - 3) *The partnership is not a dealer in qualifying investment securities.* (IITA Section 1501(a)(11.5)(A)(iii))
 - A) A partnership is a dealer in qualifying investment securities if it regularly purchases qualifying investment securities from or sells securities to customers in the ordinary course of a trade or business or regularly offers to enter into, assume, offset, assign or otherwise terminate positions in qualifying investment securities with customers in the ordinary course of a trade or business. (IRC Section 475(c)(1))
 - B) A partnership that, at any time during a taxable year, holds or derives gross income from any qualifying investment security in which it is a dealer shall not qualify as an investment partnership for that taxable year.
- b) "Qualifying investment securities" means and includes only:

- 1) *Common stock, including preferred or debt securities convertible into common stock, and preferred stock.* (IITA Section 1501(a)(11.5)(B)(i)) "Stock" means shares in an association, joint stock company, or insurance company. (IRC Section 7701(a)(7)) "Stock" includes any interest in a publicly traded partnership that is treated as a corporation under IRC Section 7704.
- 2) *Bonds, debentures, and other debt securities.* (IITA Section 1501(a)(11.5)(B)(ii)) "Debt security" means any note, bond, debenture or other evidence of indebtedness, or any evidence of an interest in or right to subscribe to or purchase any of the foregoing. (See 26 CFR 1.864-2(c)(2)(i) (2007).)
- 3) *Foreign and domestic currency deposits secured by federal, state, or local governmental agencies.* (IITA Section 1501(a)(11.5)(B)(iii)) "Currency deposits secured by federal, state or local government agencies" means any balance in a demand or time deposit at a bank, savings and loan, or similar financial institution and that is insured by the Federal Deposit Insurance Corporation or by a similar deposit insurance agency of a state or local government, including any balance in an otherwise insured account that is in excess of any insurance limit. Deposits secured by a foreign government agency, but not by an agency of the federal or of a state or local government, do not qualify.
- 4) *Mortgage or asset-backed securities secured by federal, state, or local governmental agencies.* (IITA Section 1501(a)(11.5)(B)(iv)) Examples of mortgage-backed securities secured by a federal agency include securities issued or backed by the Federal Home Loan Mortgage Corporation, the Federal National Mortgage Association and the Government National Mortgage Association. Similar securities issued by a similar agency of a state or local government also qualify. Mortgage or asset-backed securities secured by a foreign government do not qualify under this subsection (b)(4).
- 5) *Repurchase agreements and loan participations.* (IITA Section 1501(a)(11.5)(B)(v))
 - A) A repurchase agreement is a secured loan in which the loan agreement takes the form of a purchase by the lender of the collateral with the borrower agreeing to repurchase the collateral at a future date. See *Nebraska Dept. of Revenue v. Loewenstein*, 513 U.S. 123 (1994). A repurchase agreement is a qualified investment security only if the item that is sold subject to repurchase is a qualified investment security.
 - B) A loan participation is an undivided fractional interest in a loan that is acquired by the participant by means of a sale of such undivided fractional interest by the lead lender to the participant, in contrast to a loan syndication, which is a loan made by an agent on behalf of a group of lenders or syndicate in which the member of the lender group or syndicate is a lender in the original loan. Generally, the borrower's obligations in a loan participation run only to the lead lender and not to the participant, and the participant's interest is generally limited to an undivided fractional interest in payments of principal or interest under the loan agreement between the lead lender and the borrower.

- 6) *Foreign currency exchange contracts and forward and futures contracts on foreign currencies.* (IITA Section 1501(a)(11.5)(B)(vi))
- 7) *Stock and bond index securities and futures contracts and other similar financial securities and futures contracts on those securities.* (IITA Section 1501(a)(11.5)(B)(vii))
- 8) *Options for the purchase or sale of any of the securities, currencies, contracts, or financial instruments described in subsections (b)(1) through (7).* (IITA Section 1501(a)(11.5)(B)(viii))
- 9) *Regulated futures contracts.* (IITA Section 1501(a)(11.5)(B)(ix)) A regulated futures contract is a contract bought, sold or traded on a regulated exchange, such as the Chicago Board of Trade.
- 10) *Commodities (not described in section 1221(a)(1) of the Internal Revenue Code) or futures, forwards, and options with respect to such commodities, provided, however, that any item of a physical commodity to which title is actually acquired in the partnership's capacity as a dealer in such commodity shall not be a qualifying investment security.* (IITA Section 1501(a)(11.5)(B)(x)) IRC section 1221(a)(1) provides that stock in trade of the taxpayer or other property of a kind that would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of the taxpayer's trade or business are not capital assets.
- 11) *Derivatives.* (IITA Section 1501(a)(11.5)(B)(xi)) A derivative is:
 - A) An interest rate, currency (of a kind customarily dealt in on an organized commodity exchange), equity, commodity or notional principal contract; or
 - B) An evidence of an interest, or a derivative financial instrument (including any option, forward contract, short position and any similar financial instrument), in any:
 - i) Commodity;
 - ii) Currency of a kind customarily dealt in on an organized commodity exchange;
 - iii) Share of stock under subsection (b)(1);
 - iv) Partnership or beneficial ownership interest in a widely held or publicly traded partnership or trust;
 - v) Note, bond, debenture or other evidence of indebtedness; or
 - vi) Notional principal contract.
- 12) *A partnership interest in another partnership that is an investment partnership.* (IITA Section 1501(a)(11.5)(B)(xii))

- c) Items that are not "qualified investment securities" include:
- 1) Loans, other than loan participations and repurchase agreements that are characterized as loans.
 - 2) Bank deposits that are not insured by the federal government or by one of the states.
- d) Cost of Assets. For purposes of applying the "cost of assets" test in IITA Section 1501(a)(11.5)(B)(i), the cost of an asset shall be determined for federal income tax purposes without regard to depreciation or amortization of the asset, except that the cost of an asset shall include any accrued interest or discount, and shall be reduced by any premium amortization, that has been recognized in the computation of federal taxable income of the partnership and that is included on the partnership's balance sheet as of the date the cost of assets is determined.
- e) Gross Income. For purposes of applying the "gross income" test in IITA Section 1501(a)(11.5)(A)(ii):
- 1) "Gross income" means income minus costs of sales or basis in an asset sold or traded, but without reduction for any other expenses or deductions. For purposes of this Section, gross income does not include any item of income that is excluded from base income of the partnership, either because it is excluded from federal taxable income of the partnership or because it is subtracted from taxable income in computing base income, and gross income does not include income that results from transactions outside the ordinary course of an partnership's regular activities. For example, amounts received from the sale of an entity's office equipment shall be disregarded, whether or not the gain is characterized as business income.
 - 2) "Interest" means "compensation for the use or forbearance of money". See *Deputy v. du Pont*, 308 U.S. 488, 498 (1940). Interest includes the amortization of any discount at which an obligation is purchased and is net of the amortization of any premium at which an obligation is purchased. Any amount in excess of the purchase price received in payment of an obligation purchased at an arm's-length discount shall be rebuttably presumed to be interest. Interest includes any amount received upon the sale, exchange or other disposition of an obligation to the extent that such amount represents the accrual of interest on the unpaid balance of the obligation since the most recent payment made on that obligation.
 - 3) "Dividend" means any item defined as a dividend under IRC section 316 and any other item of income characterized or treated as a dividend under the Internal Revenue Code.
 - 4) "Gain from sale or exchange" of qualifying investment securities is the sum of all gains realized on the sale or exchange of qualifying investment securities, without reduction or offset for losses realized on such sales or exchanges.
 - 5) For purposes of the gross income test, gross income derived from investment in a partnership, subchapter S corporation, trust or estate shall be characterized as if the taxpayer received the income directly and, in the case of any item of income reported to the taxpayer by the partnership, subchapter S corporation,

trust or estate for federal income tax purposes as net of related expenses, include only such net amount.

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