IT 02-7
Tax Type: Income Tax
Issue: Investment Company

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS

THE DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS	**No. 00-IT-0102**
	FEIN 23-0458500
v.	**TYE. 6/30/96, 6/30/97**
	Charles E. McClellan
"Carpathian Tools Corp.", Taxpayer	**Administrative Law Judge**

RECOMMENDATION FOR DECISION

Appearances: Rickey Walton, Special Assistant Attorney General, for the Department of Revenue; Richard C. Kariss of Dechert, Price & Rhoads, for "Carpathian Tools Corp."

Synopsis:

This matter arose from a protest filed by "Carpathian Tools Corporation" ("Carpathian" or "taxpayer") to a Notice of Deficiency issued by the Department for income tax liabilities for the years ended June 30, 1996 and June 30, 1997. A pre-trial conference was held on August 29, 2001, setting forth six issues to be addressed. After the pre-trial conference, the taxpayer conceded all but two of the issues. The two issues remaining are whether "Carpathian Investments, Inc." (""CII"") and "Einstein Investments", Inc. ("Einstein"), two wholly owned subsidiaries of "Carpathian", are

financial organizations within the meaning of § 1501(a)(8) of the Illinois Income Tax Act.[1]

On November 7, 2001, the parties filed a stipulation of facts and a stipulation of documents in lieu of an evidentiary hearing. A briefing schedule also was set on that date. "Carpathian" filed its brief on December 6, 2001. The Department filed its response on January 7, 2002, and "Carpathian" filed a reply on January 18, 2002.

On January 24, 2002, each party filed a motion to strike portions of it's opponent's brief. The Department's motion requested that an exhibit and a footnote in "Carpathian's" brief be stricken, and that an order be entered to accept the documents in the stipulation as originally filed. The Department also asked that an order be entered clarifying that the pre-trial order did not preclude it from arguing a unitary business group issue. In its motion, "Carpathian" asked that all portions of Department's motion pertaining to the unitary business issue be stricken because it had conceded that issue as well as all of the other issues except for the issues involving ""CII"" and "Einstein". Over the Department's objections, I denied the Department's motion, and granted "Carpathian's" motion.

I recommend that the Notice of Deficiency be made final.

Finding of Facts:

1. "Carpathian" is a Delaware corporation with its headquarters and commercial domicile in "Someplace", Pennsylvania. Stip. ¶ 1.

[1] Unless otherwise noted, all statutory references are to 35 ILCS 5/101, *et seq*., the Illinois Income Tax Act ("IITA" or the "Act").

2. “Carpathian” is primarily engaged in the business of the manufacture, fabrication and distribution of specialty metal. Stip. ¶ 2.
3. ““CII””, “Einstein”, “Great Barrier Supply Company, Inc.” (“Great Barrier”), “Carpathian Special Products Corporation”, “Dilantin Incorporated”, and “ABC Holdings, Inc.”, were wholly owned subsidiaries of “Carpathian” during the years at issue. Stip. ¶ 14.
4. Officers and directors of “Carpathian” were also officers and directors of “CII” and “Einstein”. Stip. ¶¶ 4-13, 25, 26, 81.
5. On October 13, 1989, “CII” was incorporated in Delaware. Stip. ¶¶ 15-18.
6. “CII” maintains its corporate domicile and headquarters in Delaware. *Id*.
7. “CII” was created to act as a vehicle for intercompany financing, as well as holding other intangibles including stock of various affiliates, and to perform other investment activities as directed. *Id*.
8. “Carpathian” capitalized “CII” for $5,000 and made additional capital contributions to “CII” from time to time. Stip. ¶¶ 19, 21.
9. Between July 31, 1995 and June 30, 1997, “CII” made 24 loans to “Carpathian” for between $3.2 million and $7.5 million pursuant to the terms of a revolving promissory note dated December 6, 1989, that authorized “Carpathian” to borrow up to $400 million from “CII”. Stip. ¶¶ 22-24.
10. During the years at issue, “CII” had thirteen employees that conducted daily business activities including “CII’s” accounting activities. Stip. ¶¶ 27, 28.
11. “CII” maintained its bank accounts at “First Bank” in Wilmington, Delaware. Stip. ¶ 29.

12. "Carpathian" timely made all principal and interest payments that were required under the "CII" note. Stip. ¶ 30.

13. On July 20, 1995, "Carpathian" and "CII" agreed to extend the term of the "CII" note until July 31, 1998. Stip. ¶ 32.

14. On August 15, 1996, "CII" and "Carpathian" agreed to amend the "CII" note to increase the amount that "Carpathian" was authorized to borrow from $400 million to $600 million. Stip. ¶ 33.

15. On November 9, 1995, "Great Barrier" borrowed $8,862,688 from "CII" evidenced by a promissory note in that amount. Stip. ¶ 34.

16. On January 29, 1996, "Great Barrier" borrowed $1,060,000 from "CII" evidenced by a promissory note in that amount. Stip. ¶ 35.

17. On March 24, 1997, "CII" and "Great Barrier" consolidated the two previous loans into a revolving credit promissory note under the terms of which "Great Barrier" could borrow up to $50,000,000. Stip. ¶ 37.

18. "Great Barrier" made timely payments of principal and interest required by the terms of the notes. Stip. ¶¶ 36, 38.

19. On December 8, 1995, "CII" executed a $1.2 million revolving promissory note with "Dynamo Solar Simplex, Inc." ("DSSI"), a company in which "Carpathian" owned a one-third interest. Stip. ¶ 43.

20. "DSSI" was engaged in the business of distributing computer equipment and providing computer-related services during the years at issue. Stip. ¶ 45.

21. "DSSI" made timely payments of principal and interest as required by the note. Stip. ¶ 44.

22. On April 14, 1992, "CII" acquired 100% of the stock of "Carpathian Tools International" (USVI) ("CTIC"), a corporation formed under the laws of the United States Virgin Islands that is organized as a foreign sales corporation to sell "Carpathian's" products off shore. Stip. ¶¶ 49, 64.
23. On April 30, 1992, "CII" acquired 100% of the stock of "Carpathian Tools (Canada) Ltd.", a corporation formed under the laws of Canada. Stip. ¶ 50.
24. On June 26, 1990, "CII" acquired 1% of the stock of "Carpathian" Tools (Deutchland) GmbH", a corporation formed under the laws of Germany. Stip. ¶ 47.
25. On July 12, 1990, "CII" acquired 1% of the stock of "Carpathian" Tools (Europe) S.A.", a corporation formed under the laws of Belgium. Stip. ¶ 48.
26. On October 1, 1992, "CII" acquired 1% of the stock of "Carpathian" Tools (U.K.) Ltd.", a corporation formed under the laws of the United Kingdom. Stip. ¶ 51.
27. On March 15, 1993, "CII" acquired 1% of the stock of "Carpathian" Tools (France) SARL", a corporation formed under the laws of France. Stip. ¶ 52.
28. On July 28, 1993, "CII" acquired 1% of the stock of "Amigos Formidos, S.A. de C.V.", a corporation formed under the laws of Mexico. Stip. ¶ 53.
29. On July 28, 1993, "CII" acquired 1% of the stock of "Montini Muchos, S.A. de C.V.", a corporation formed under the laws of Mexico. Stip. ¶ 54.
30. On October 13, 1993, "CII" acquired 1% of the stock of "Carpathian" Tools (Italy) s.r.l.", a corporation formed under the laws of Italy. Stip. ¶ 55.
31. On November 22, 1993, "CII" acquired 1% of the stock of "Carpathian Tools (Taiwan) Ltd.", a corporation formed under the laws of Taiwan. Stip. ¶¶ 56, 100.

32. "Carpathian Tools (Taiwan) Ltd.", was engaged in the business of providing technical consultation and market information services during the years at issue. Stip. ¶ 57.

33. On December 4, 1996, "CII" acquired 1% of the stock of "Grupo Carpathian Tools, S.A. de C.V.", a corporation formed under the laws of Mexico. Stip. ¶ 58.

34. "CII" employed substantially all of its available capital in investments and extensions of credit to "Carpathian" and its subsidiaries. Stip. ¶ 59.

35. "CII" was not registered with the U.S. Securities and Exchange Commission ("SEC") as an investment company pursuant to the Investment Company Act of 1940 (15 U.S.C. § 80a-1 et seq.) during the years at issue. Stip. ¶ 60.

36. During the years ended June 30, 1996 and June 30, 1997, "CII" earned the following income:

Payer	Type of Income	Amount 1996	Amount 1997
"Carpathian"	Interest	$41,342,897	$40,113,564
"CTIC"	Interest	$808,304	$986,062
"Great Barrier Supply Co."	Interest	$677,669	$1,147,891
"Crunchmunch"	Gain from Put Option	0	$372,114
Miscellaneous	Interest	$20,980	$77,647
Totals		$42,849,850	$42,697,278

Stip. ¶¶ 61, 63.

37. "CII" paid salaries and wages of $7,619.59 during the year ended June 30, 1996. Stip. ¶ 62.

38. “CII” paid total salaries and wages of $4,832.68 during tax year ending June 30,1997. Stip. ¶ 65.

39. “CII” was included in “Carpathian’s” consolidated federal income tax return for the years at issue. Stip. ¶ 66.

40. “CII” did not conduct business in Illinois during the years at issue. Stip. ¶ 71.

41. On September 17, 1991, “Carpathian” incorporated “Einstein” in Delaware as a wholly owned subsidiary corporation to act as a vehicle for intercompany financing and to hold other intangibles including stock of various affiliates. Stip. ¶¶ 70 -72.

42. “Einstein” maintained its corporate headquarters and commercial domicile in Delaware. Stip. ¶¶ 73-74.

43. “Carpathian” formed “Einstein” with an initial $5,000 capital contribution. Stip. ¶ 75.

44. Subsequently, “Carpathian” made additional capital contributions to “Einstein”. Stip. ¶ 77.

45. On December 17, 1991, “Einstein” and “Carpathian” executed a revolving promissory note (the “Einstein” Note”) under which “Carpathian” was authorized to borrow up to $300 million from “Einstein”. Stip. ¶ 78.

46. During the years at issue, “Einstein” made 24 loans to “Carpathian” pursuant to the revolving promissory note ranging from $1.1 million to $1.5 million. Stip. ¶ 79.

47. During the years at issue, “John Doe”, “Richard Roe” and “Jane Seymour” were directors of “Einstein”. Stip. ¶ 80.

48. During the years at issue, the following individuals were corporate officers of “Einstein”: “Lance LaRue”, President; “Randolph Hearst”, Vice President; “Richard Roe”, Secretary and Treasurer; “Josh Gimple”, Assistant Secretary and Assistant

Treasurer; "Darnell Casey", Assistant Secretary (effective August 15, 1996); and "William Patterson", Assistant Treasurer (effective August 15, 1996). Stip. ¶ 81.

49. During the years at issue, "Einstein" had thirteen employees. Stip. ¶ 82.

50. The officers and employees of "Einstein" conducted the daily activities of "Einstein". Stip. ¶ 83.

51. "Einstein" maintained its bank accounts at "First Bank" in Wilmington, Delaware. Stip. ¶ 84.

52. "Einstein" did not conduct business in Illinois during the years at issue. Stip. ¶ 93.

53. "Carpathian" timely made all principal and interest payments that were required under the "Einstein" Note. Stip. ¶ 85.

54. During the years ended June 30, 1996 and June 30, 1997, "Einstein" paid "Carpathian" dividends of $1,000,000 and $5,000,000, respectively. Stip. ¶ 88.

55. "Cyclotron, Inc." ("Cyclotron") is a wholly owned subsidiary of "Carpathian". Stip. ¶ 86.

56. "Cyclotron" was engaged in the business of manufacturing ceramic cores for jet engines, decorative ornaments, and handles for knives during the years at issue. Stip. ¶ 92.

57. On October 4, 1994, "Einstein" and "Cyclotron" executed a promissory note ("Cyclotron" Note-I") under which "Cyclotron" borrowed $300,000 from "Einstein". Stip. ¶ 89.

58. On October 11, 1994, "Einstein" and "Cyclotron" executed a revolving promissory note ("Cyclotron" Note-II") under which "Cyclotron" borrowed $1,200,000 from "Einstein". Stip. ¶ 90.

59. “Cyclotron” timely made all principal and interest payments that were required under the notes with “Einstein”. Stip. ¶ 91.

60. “Carpathian” entered into a Taiwanese joint venture with “Whassup Lucy” to operate “Whassup Kay-Lo Specialty Steel Corporation” (“Whassup Kay-Lo”), and in August 1993 “Einstein” invested approximately $44,530,000 in “Whassup Kay-Lo”. Stip. ¶¶ 94, 97.

61. “Carpathian” provided technical assistance to “Whassup Kay-Lo’s” Yensui plant. Stip. ¶ 98.

62. On March 19, 1996, “Einstein” exercised a put option to sell a portion of its investment in “Whassup Kay-Lo” for $25,267,216. Stip. ¶ 99.

63. “Einstein” recognized a gain of $2,623,438 for the tax year ended June 30, 1996, on the exercise of a put option with respect to its investment in the “Whassup Kay-Lo” joint venture. Stip. ¶ 107.

64. During year ended June 30, 1996, prior to the exercise of its put option, “Einstein” owned 19% of “Whassup Kay-Lo.” Stip. ¶ 95.

65. During year ended June 30, 1997, “Einstein” owned 5% of “Whassup Kay-Lo”. Stip. ¶ 96.

66. During the years ended June 30, 1996 and June 30, 1997, “Einstein” earned the following income:

Payer	Type of Income	Amount 1996	Amount 1997
"Carpathian"	Interest	$15,390,234	$17,775,379
"Whassup"	Interest	$14,488	0
Miscellaneous	Interest	$5,633	0
"Whassup Kay-Lo"	Gain from Put Option	$2,623,435	0
Other	Interest	0	$6,865
Totals		$18,033,790	$17,782,244

Stip. ¶¶ 103, 105.

67. "Einstein" employed substantially all of its available capital in investments and extensions of credit to "Carpathian" and its subsidiaries and affiliates. Stip. ¶ 101.

68. "Einstein" was not registered with the SEC as an "investment company" pursuant to the Investment Company Act of 1940 during the years at issue. Stip. ¶ 102.

69. "Einstein" paid salaries and wages of $7,363.41 for the year ended June 30, 1996, and $4,446.13 for the year ended June 30, 1997. Stip. ¶¶ 104, 106.

70. "Carpathian" timely filed forms IL-1120 on a combined basis with its subsidiaries for its years ended June 30, 1996 and June 30, 1997. Stip. ¶¶ 112, 115.

71. "Carpathian" did not include "CII" or "Einstein" in its unitary business group in the combined Illinois income tax returns it filed for the years ended June 30, 1996 and June 30, 1997. Stip. ¶¶ 117, 118.

72. On April 20, 2000, the Department issued a Notice of Deficiency to "Carpathian" assessing additional income tax of $499,045. Stip. ¶ 119.

Conclusions of Law:

"Carpathian" is a Delaware corporation that maintains its headquarters in "Someplace", Pennsylvania. (Stip. ¶ 1) "Carpathian" is primarily engaged in the business of the manufacture, fabrication and distribution of specialty metals. (Stip. ¶ 2)

"Carpathian" owns a number of wholly owned subsidiary corporations, including "CII" and "Einstein". (Stip. ¶ 14)

"Carpathian" incorporated "CII" in Delaware on October 13, 1989, to act as a vehicle for inter-company financing, to hold other intangibles, and to conduct other investment activities as directed. (Stip. ¶¶ 15-18) "Carpathian" provided the funds to capitalize "CII". During the years at issue, "CII" made 24 loans to "Carpathian" each one of which was for between $3.2 million and $7.5 million. (Stip. ¶¶ 19-24) "Carpathian" made payments of principal and interest on these loans in a timely fashion as required by the promissory notes evidencing the loans. (Stip. ¶ 30)

"Great Barrier" borrowed $8,862,688 from "CII" on November 9, 1995 and $1,060,000 on January 29, 1996. Both transactions were evidenced by promissory notes. (Stip. ¶¶ 34,35) On March 24, 1997, these two notes were consolidated into a revolving credit promissory note with a credit limit of $50,000,000. (Stip. ¶ 37) "Great Barrier" made payments of principal and interest timely as required by these promissory notes. (Stip. ¶ 38)

On December 8, 1995, "CII" executed a $1.2 million revolving promissory note with "Dynamo Solar Simplex, Inc." ("DSSI"), a company in which "Carpathian" owned a one-third interest. (Stip. ¶ 43) DSSI was engaged in the business of distributing computer equipment and providing computer-related services during the years at issue. (Stip. ¶ 45) "DSSI" made timely payments of principal and interest. (Stip. ¶ 44)

On April 14, 1992, "CII" acquired 100% of the stock of "CTIC", a corporation formed under the laws of the United States Virgin Islands. (Stip. ¶ 49) On April 30, 1992, "CII" acquired 100% of the stock of "Carpathian Tools (Canada) Ltd.", a

corporation formed under the laws of Canada. (Stip. ¶ 50) Between June 26, 1990 and December 4, 1996, "CII" acquired a 1% equity interest in ten companies. Each one of these companies was incorporated in a different foreign country, except for two that were incorporated in Mexico. (Stip. ¶¶ 47,48, 51-58) One of these companies, "Carpathian" Tools (Taiwan) Ltd." was engaged in the business of providing technical consultation and market information services during the years at issue. (Stip. ¶ 57)

"CII" employed substantially all of its capital in investments and extensions of credit to "Carpathian" and its subsidiary corporations. (Stip. ¶ 59) In excess of 98% of "CII's" income during the years at issue consisted of interest on Loans to "Carpathian" and "Carpathian" subsidiaries and affiliates. (Stip. ¶¶ 61-63)

"CII" was not registered with the Securities and Exchange Commission as an investment company pursuant to the Investment Company Act of 1940. (Stip. ¶ 60)

On September 17, 1991, "Carpathian" incorporated "Einstein" in Delaware with capitalization of $5,000 as a wholly owned subsidiary corporation to act as a vehicle for inter-company financing and to hold other intangibles including stock of various affiliates. Stip. ¶¶ 70 –72, 75. "Einstein" maintained its corporate headquarters and commercial domicile in Delaware. (Stip. ¶¶ 73, 74) Subsequently, "Carpathian" made additional capital contributions to "Einstein". (Stip. ¶ 77) On December 17, 1991, "Einstein" and "Carpathian" executed a revolving promissory note authorizing "Carpathian" to borrow up to $300 million from "Einstein" (Stip. ¶ 78) During the years at issue, "Einstein" made 24 loans to "Carpathian" under the revolving promissory note ranging from $1.1 million to $1.5 million. (Stip. ¶ 79) "Carpathian" timely made all principal and interest payments that were required by the "Einstein" promissory note.

(Stip. ¶ 85) The officers and employees of "Einstein" conducted its daily business activities. (Stip. ¶ 83) "Einstein" maintained its bank accounts at "First Bank" in Wilmington, Delaware. (Stip. ¶ 84)

During the years at issue, "Einstein" employed substantially all of its available capital in investments and extensions of credit to "Carpathian" and its subsidiary corporations. (Stip. ¶¶ 89-99, 101) Substantially all of "Einstein"'s income was derived from loans to "Carpathian" and its affiliates during the years at issue. (Stip. ¶¶ 103, 105)

"Einstein" was not registered with the SEC as an "investment company" pursuant to the Investment Company Act of 1940 during the years at issue. (Stip. ¶ 102)

"Carpathian" and its subsidiary corporations filed Illinois income tax returns on a combined basis as a unitary business group for each of the years at issue, but "CII" and "Einstein" were not included in those returns. (Stip. ¶¶ 117, 118) The issue in this matter is whether "CII" and "Einstein" were financial organizations, within the meaning of Section 1501(a)(8), that were properly excluded from "Carpathian's" combined returns.

Section 304(e) of the Act requires unitary business groups of corporations to file combined income tax returns. The term "unitary business group" is defined, in relevant part, in Section 1501(a)(27) of the Act as follows:

> The term "unitary business group" means a group of persons related through common ownership whose business activities are integrated with, dependent upon and contribute to each other.. . . In no event, however, will any unitary business group include members which are ordinarily required to apportion business income under different subsections of Section 304 . . ..
> 35 ILCS 5/1501(a)(27).

Thus, "Carpathian" and its subsidiary corporations, being related through common ownership, were required to be included in the same unitary group. The only subsidiaries that could be excluded were subsidiaries that were required to apportion their income using a different apportionment formula than the one used by the other members of the group. If "CII" and "Einstein" were financial organizations as described in Section 1501(a)(8), they were required to use an apportionment formula that was different from the formula used by the rest of the members of the unitary business group and were properly excluded from "Carpathian's" combined income tax returns for the years at issue. I have concluded that "CII" and "Einstein" were not financial organizations as described in Section 1501(a)(8), so they were improperly excluded from the "Carpathian's" combined income tax returns.

For the years at issue, Section 304(a) of the Act set forth the general rule for apportionment of business income by a non-resident unitary business group such as "Carpathian". This rule required nonresident taxpayers to apportion business income by a three-factor formula consisting of the average of the taxpayer's payroll, property and sales in Illinois as a ratio of its total payroll, property and sales, with the sales factor being double weighted.[2] 35 ILCS 5/304(a), General Telephone co. v. Johnson, 103 Ill.2d 363, 469 N.E.2d 1067 (1984). This three-factor formula is the formula properly used by "Carpathian" on its combined returns.

Section 304, subsection (c), prescribes a different apportionment formula for financial organizations. The apportionment formula prescribed for financial

organizations is a single factor formula in which the numerator is the organization's business income in Illinois and the denominator is the organization's total business income. 35 ILCS 5/304(c). The term "financial organization" is defined in Section 1501(a)(8), in relevant part, as follows:

> (A) The term "financial organization" means any bank, bank holding company, trust company, savings bank, industrial bank, land bank, safe deposit company, private banker, savings and loan association, building and loan association, credit union, currency exchange, cooperative bank, small loan company, sales finance company, **investment company**, or any person which is owned by a bank or bank holding company. For the purpose of this Section a "person" will include only those persons which a bank holding company may acquire and hold an interest in, directly or indirectly, under the provisions of the Bank Holding Company Act of 1956 (12 U.S.C. 1841, et seq.), except where interests in any person must be disposed of within certain required time limits under the Bank Holding Company Act of 1956. [emphasis added].
> 35 ILCS 5/1501(a)(8).

"Carpathian" incorrectly argues that "CII" and "Einstein" are investment companies, and, therefore, qualify as financial organizations that should be excluded from "Carpathian's" combined income tax returns for the years at issue.

The term "investment company" is not defined in the IITA. However, the question of what is required to qualify a company as an investment company was addressed by the court in Automatic Data Processing, Inc., et al. v. Dept. of Revenue, 313 Ill.App.3d 433, 729 N.E.2d 897 (1st Dist. 2000), app. den. 191 Ill.2d 525, 738 N.E.2d 924. The facts in that case are similar to those in this case.

---

[2] Section 304(a) was amended by P.A. 84-1382, approved September 14, 1986, to double weight the sales factor effective for taxable years ending on or after January 1, 1987

Automatic Data Processing ("ADP") was a Delaware corporation engaged in the business of providing various services including payroll processing, payroll tax filing, and benefit information. 313 Ill.App.3d at 436. ADP's headquarters were in New Jersey, but it had a number of service divisions that operated in Illinois. The business was successful, and it found itself holding large amounts of cash from time to time. *Id*. For a time its treasury department managed the money, but then it decided to form a network of wholly owned Delaware subsidiary corporations to invest these funds. *Id*. The subsidiaries were capitalized by ADP and they earned interest by loaning substantial sums back to ADP. *Id*.

ADP asserted that the subsidiaries were investment companies within the meaning of Section 1501(a)(8), and, therefore, financial organizations under the statute, so they could not be included in the combined Illinois income tax returns that ADP filed in Illinois. The court first referred to the rule of statutory construction that requires that, "In the absence of a definition, the term 'investment company' should be accorded its ordinarily understood meaning. [citation omitted]" Automatic Data Processing, Inc., 313 Ill.App.3d at 443. The court noted that the parties disagreed on the commonly understood meaning of the term. On that issue, the Department argued that the term is a widely understood term of art that is statutorily defined. *Id*. The statutory definitions referred to by the Department are in the statutes that regulate the types of entities referred to in Section 1501(a)(8). The Department maintained that since those statutes defined the listed entities, it was not necessary for the legislature to define them again in the Act. *Id*.

ADP asserted that these statutory definitions were too narrow and that broader dictionary definition was required.

For the definition of "investment company" the Department looked to the federal Investment Company Act of 1940. This statute sets forth the requirements for a company to be an investment company under that act, and it also sets forth a number of exceptions to the general definition that apply to companies that make investments, but that are excepted from the statutory definition of “investment company”.

The Investment Company Act of 1940, in pertinent part, provides that the term “investment company” means:

> any issuer which
>
> (1) is or holds itself out as being primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities;
>
> (2) is engaged or proposes to engage in the business of issuing face-amount certificates of the installment type, or has been engaged in such business and has any such certificate outstanding; or
>
> (3) is engaged or proposes to engage in the business of investing, reinvesting, owning, holding, or trading in securities, and owns or proposes to acquire investment securities having a value exceeding 40 per centum of the value of such issuer's total assets (exclusive of government securities and cash items) on an unconsolidated basis.
>
> 15 U.S.C. § 80a-3(a).

The statutory definition, however, does not end there. Sections 80a-3(b) and (c) of the Investment Company Act specifically detail the characteristics of those organizations which are excepted from the definition of an investment company. 15

U.S.C. §§ 80a-§§ 3(b)-(c).

Section 80a-3(b) of the Investment Company Act provides:

> (b) Notwithstanding subsection (a) of this section, none of the following persons is an investment company within the meaning of this subchapter:
>
> (1) Any issuer primarily engaged, directly or through a wholly owned subsidiary or subsidiaries, in a business or businesses other than that of investing, reinvesting, owning, holding, or trading in securities.
>
> (2) Any issuer which the Commission, upon application by such issuer, finds and declares to be primarily engaged in a business or businesses other than that of investing, reinvesting, owning, holding, or trading in securities either directly or (A) through majority-owned subsidiaries or (B) through controlled companies conducting similar types of businesses. The filing of an application under this paragraph in good faith by an issuer other than a registered investment company shall exempt the applicant for a period of sixty days from all provisions of this subchapter applicable to investment companies as such. For cause shown, the Commission by order may extend such period of exemption for an additional period or periods. Whenever the Commission, upon its own motion or upon application, finds that the circumstances which gave rise to the issuance of an order granting an application under this paragraph no longer exist, the Commission shall by order revoke such order.
>
> (3) Any issuer all the outstanding securities of which (other than short term paper and director's qualifying shares) are directly or indirectly owned by a company excepted from the definition of investment company by paragraph (1) or (2) of this subsection.
>
> 15 U.S.C. § 80a-3(b)

Subsection (c) of the statutory definition provides, in part:

> (c) Notwithstanding subsection (a) of this section, none of the following persons is an investment company within

the meaning of this subchapter:

> (1) Any issuer whose outstanding securities (other than short term paper) are beneficially owned by not more than one hundred persons and which is not making and does not presently propose to make a public offering of its securities. For purposes of this paragraph:
>
> > (A) Beneficial ownership by a company shall be deemed to be beneficial ownership by one person . . . .

15 U.S.C. § 80a-3(c)

One final requirement of the statute is that to be an investment company under the act, an entity must be registered with the SEC. 15 U.S.C. § 80a-7.

The court in Automatic Data Processing, Inc., noted that the ADP subsidiaries fell into one or more exceptions to the federal definition set forth in 15 U.S.C. § 80a-3, and they had not registered with the SEC. For those reasons, and others, the court affirmed the circuit court which upheld the Department' decision that the subsidiaries were not financial organizations under the statute.

The facts in this case follow the same pattern as do the facts in Automatic Data Processing, Inc. "Carpathian" is a Delaware corporation as was ADP. "Carpathian" incorporated wholly owned Delaware subsidiary corporations to manage its cash, as did ADP. The "Carpathian" subsidiary corporations, "CII" and "Einstein", were capitalized by their parent as was the case with the ADP subsidiary corporations. "CII" and "Einstein" loaned substantial sums to their parent as did the ADP subsidiary corporations. The ADP subsidiaries performed treasury functions for their parent company. "CII" and

"Einstein" performed treasury functions for their parent company by loaning funds to it and by holding stock or equity interests in subsidiary corporations and affiliates.

Applying the tests relied on by the court in Automatic Data Processing, Inc., *supra*, to the facts of this case demands the same conclusion as the court in Automatic Data Processing, Inc. arrived at, *i.e.*, that neither "CII" nor "Einstein" are investment companies within the meaning of Section 1501(a)(8).

A plain reading of the relevant provisions of the Investment Company Act of 1940 establishes that "CII" and "Einstein" do not meet the statutory requirements to be an investment company under that act. They are clearly excepted from the definition of an investment company by §§ 80a-3(b)(3) and 80a-3(c)(1). Furthermore, they are not registered with the SEC as required by the 1940 act. 15 U.S.C. § 80a-7. Therefore, they are not investment companies as contemplated by Section 1501(a)(8).

"Carpathian" argues that "CII" and "Einstein" are "investment companies" under the plain meaning of that term as found in Webster's dictionary and Black's Law Dictionary, and that the legislature intended companies such as "CII" and "Einstein" to be qualified investment companies under Section 1501(a)(8). In making this argument, "Carpathian" ignores the court's rejection of the same argument in Automatic Data Processing, Inc., in favor of the Department's assertion that the term "investment company" is a statutorily defined term of art. 313 Ill.App.3d at 446, 729 N.E.2d at 908.

It is worth noting that at least one other state court has acknowledged that the term "investment company" is a term of art. In Bureau of Employment Security v. Hecker & Co., the Pennsylvania Supreme Court wrote:

> [t]he term "investment company" is a term of art and refers to companies, such as mutual fund companies, whose business is to make a profit by investing in other companies. It is so defined in the Investment Company Act, [footnote omitted] in the Pennsylvania Business Corporation Law, as well as in other Pennsylvania statutes. **In the absence of evidence to the contrary, we must assume that the legislature intended to use the term in this accepted business sense.** [emphasis added].
> 409 Pa. 117, 124, 185 A.2d 549, 553 (1962)

Similarly, when the Illinois general assembly used the term "investment company" in the IITA, it had recently defined the identical term in another Illinois statute. *See,* Ill. Rev. Stat. ch. 21, ¶ 64.2 ("An act to amend . . . the 'Cemetery Care Act'") (Laws 1967, p. 1189, eff. July 7, 1967) (*now codified at* 760 ILCS 100/2). In a 1967 amendment to the Cemetery Care Act, the legislature defined "investment company", in part, as a company "defined in and registered under the 'Investment Company Act of 1940' . . . ."[3] While the Cemetery Care Act is obviously not *in pari materia* with the IITA, the legislature's prior definition of the same term by specific reference to the definition in the Investment Company Act is strong evidence that the legislature accepted the Investment Company Act's definition as authoritative. Accordingly, it is reasonable to conclude that when the legislature enacted Section 1501(a)(8), it found it unnecessary to redefine the listed organizations because they already had well defined statutory meanings.

---

[3]. The applicable amendment to the Cemetery Act's definition section provided:

> "Investment Company" means any issuer (a) whose securities are purchasable only with care funds or trust funds, or both; and (b) which is an open and diversified management company as defined in and registered under the "Investment Company Act of 1940"; and (c) which has entered into an agreement with the Auditor containing such provisions as the Auditor by regulation reasonable requires for the proper administration of the Act. Ill. Rev. Stat. ch. 21, ¶ 64.2 (1967).

"Carpathian" argues further that to adopt the definition of investment company set forth in the Investment Company Act of 1940 would require reading into the IITA words that were not included by the legislature which is contrary to a fundamental rule of statutory construction.

This argument is incorrect because at the time Section 1501(a)(8) was enacted, the term "investment company" was already a statutorily defined term of art so it was not necessary to define it again. In fact, this was true for most of the organizations listed in Section 1501(a)(8), so it was not necessary for the legislature to redefine them in the Act. For example, when the legislature enacted section 1501(a)(8) of the IITA, a "bank" had already been defined pursuant to the Illinois Banking Act, Ill. Rev. Stat. ch. 16½, ¶ 102 (1969), and pursuant to various federal banking acts, e.g., the National Banking Act, 12 U.S.C. § 21 *et seq.* (1969), and the Federal Deposit Insurance Corporation Act, 12 U.S.C. § 1813 (1969); a "bank holding company" had already been defined pursuant to the Illinois Bank Holding Company Act of 1957, Ill. Rev. Stat. ch. 16½, ¶ 72 (1969), and pursuant to the Bank Holding Company Act of 1956, 12 U.S.C. § 1841 *et seq.* (1969); a "trust company" had already been defined pursuant to the Illinois Banking Act, Ill. Rev. Stat. ch. 16½, ¶ 101 *et seq*. (1969)); and a "currency exchange" had already been defined pursuant to Illinois' Currency Exchange Act, Ill. Rev. Stat. ch. 16½, ¶ 31 *et seq*. (1969). Thus, as stated previously, when the legislature enacted section 1501(a)(8) of the IITA, the term "investment company" had already been defined in the Investment Company Act of 1940, so it had a common business meaning as a term of art and no additional language in the IITA was necessary.

"Carpathian's" argument regarding legislative intent also runs counter to the

theory of combined apportionment as enacted in Illinois. Combined apportionment combines the various entities that constitute a single business enterprise into a unitary group which is treated as a single taxpayer. Citizens Utilities Co. v. Dept. of Revenue, 111 Ill.2d 32, 39 488 N.E. 2d 984, 986 (1986). Combined reporting is much less subject to income manipulation between states than is separate accounting for multiple entities making up a single business enterprise. *Id*. Neither "CII" nor "Einstein" conducted any business in Illinois. Both of them conducted treasury functions for "Carpathian". If they were to be treated as financial organizations, none of their income would be taxable in Illinois because they did not conduct business in Illinois and they had no presence in Illinois. In addition, none of it is likely to be taxed in Delaware because corporations whose Delaware activities are limited to maintenance and management of their intangible investments, including distribution of income from those investments are exempt from Delaware's corporate income tax. Del. Code Ann. § 1902(b)(8). "Carpathian's" theory would let any multi-state corporation operating in Illinois incorporate its treasury function in Delaware and avoid paying any state income tax on its investment income. Such a result would undermine the purpose of combined apportionment. As the court held in Automatic Data Processing, Inc., it is not reasonable to conclude that such a construction would comport with legislative intent. 313 Ill.App.3d at 446, 729 N.E. 2d at 908.

"Carpathian's" last two arguments are: 1) that past interpretations of the Department with regard to the meaning of "investment company" have been inconsistent, so they should not be given any consideration; and 2) that Section 1501(a)(8) is

ambiguous, so it should be construed in favor of the taxpayer. "Carpathian" is basing its inconsistency argument on several letter rulings issued by the Department and regulations that were proposed but not adopted. Letter rulings are issued to individual taxpayers by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. Letter rulings are binding on the Department only as to the taxpayer who is the subject of the request for ruling. They have no weight as precedent. 86 Ill. Admin. Code § 1200.110(a); Container Corporation of America, Inc. v. Wagner, 293 Ill.App.3d 1089, 1096, 689 N.E.2d 259, 264 (1st Dist. 1997) (Private letter rulings have no precedential effect except where they clearly contain a policy of general applicability in which case they are instructive.)

To the extent that there may have been ambiguity in the statute or inconsistency in the Department's prior private letter rulings and proposed regulations in the past, those ambiguities have been eliminated by the court's decision in Automatic Data Processing, Inc., *supra*.

For all of the above reasons, I conclude that the taxpayer has failed to introduce evidence or argument sufficient to overcome the Department's prima facie case. Therefore, I recommend that the Notice of Deficiency be made final.

ENTER: April 5, 2002

_____

Administrative Law Judge