

Petition for Alternative Apportionment not Timely

January 21, 2020

Re: Petition for Alternative Apportionment

Dear Xxxx:

This is in response to your request on behalf of the above-named taxpayer for permission to use an alternative method of allocation or apportionment. Department of Revenue ("Department") regulations require that the Department issue only two types of letter rulings, Private Letter Rulings ("PLRs") and General Information Letters ("GILs"). PLRs are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding against the Department, but only as to the taxpayer issued the ruling and only to the extent the facts recited in the PLR are correct and complete. GILs do not constitute statements of Department policy that apply, interpret or prescribe the tax laws and are not binding against the Department. See 2 Ill. Adm. Code 100.1200(b) and (c). For the reasons discussed below, your petition cannot be granted at this time.

Your letter states as follows:

Based on ILL Admin Code 86 Section 100.3380(a) TAXPAYER through its REPRESENTATIVE is hereby requesting that the Taxpayer be allowed to use an alternative apportionment method on its 2018 Illinois Form IL-1120-ST as the required standard methodology does not accurately reflect the Taxpayer's activity within the State of Illinois.

Background:

The Taxpayer operates several assembly and sequencing plants that manufactures parts for various automotive original equipment manufacturers throughout the country. The taxpayer has assembly and sequencing plants in STATE, STATE1, STATE2, STATE3, and STATE4.

In addition to the assembly and sequencing plants operated by the Taxpayer, the taxpayer also invests in and receives K-1's from the following three Limited Liability Companies:

- A) COMPANY – has a loan on a STATE2 facility owned by COMPANY1.
- B) COMPANY1 – invests in a partnership that operates a manufacturing facility located in STATE2.
- C) COMPANY2 – operates manufacturing facilities in STATE2, STATE3, STATE 5 and STATE6.

Discussion of relevant law:

Pursuant to Ill Admin Code 86 Section 100.3380(a) if the normal allocation and apportionment provisions do not, for taxable years ending before December 31, 2008, fairly represent the extent of a person's business activity in Illinois, or, for taxable years ending on or after December 31, 2008, fairly represent the market for the person's goods, services, or other sources of business income, the person can petition for or the Director may, without permission, permit or require:

- (1) Separate accounting

- (2) the exclusion of one or more factors from the formula
- (3) the inclusion of one or more additional factors
- (4) the use of any other method to create equitable allocation and apportionment of the taxpayer's business income.

The taxable income and gross receipts of the various entities listed above, including TAXPAYER's activities is as follows:

[Tabular Material Omitted]

The United States Supreme Court has previously outlined a four prong test to determine if the state tax regime violates the Commerce Clause of the United States Constitution. Per this test, a state's tax structure is constitutional when the tax is fairly apportioned. The court ruled that fair apportionment is one that meets both the "internally consistent" and "externally consistent" tests. The internal consistency test applies to the overall structure of the tax and how it would impact interstate commerce. This test does not apply to Group in this situation. The external consistency test looks to the economic impact of the tax. When an apportionment methodology is externally inconsistent the U.S. Constitution will require an alternative apportionment factor to be used to more accurately reflect the taxpayers instate activities. In Groups case the required inclusion of Enterprises and COMPANY2 in the tax base and apportionment factors violates the externally consistent test.

The Taxpayer is requesting separate accounting for COMPANY2 for when the taxpayer prepares their 20XX Illinois income tax return as the inclusion of this entity in the tax base does not fairly represent the taxpayer's activity within the State of Illinois under the externally consistent test. When the activity of COMPANY2 is:

1) Included in the Illinois tax base and apportionment factors on the 20XX Illinois IL-1120-ST tax is \$\$\$ (see "Exhibit A" attached)

2) Excluded from the Illinois tax base and apportionment factors as in their 20XX Illinois IL-1120-ST tax is \$\$\$ (see "Exhibit B" attached)

The inclusion of COMPANY2's taxable income when they have no nexus related activities in the state results in a nearly threefold increase in the Illinois tax which does not fairly represent the taxpayer's activity in Illinois. COMPANY2 is not unitary with any of the other entities listed above. In *Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell*, Comm'r of Revenue, 238 U.S. 123, 133 (1931) the United States Supreme Court ruled that North Carolina's apportionment methodology that resulted in a distortion of tax between 270% and 370% did not accurately reflect the company's activities within the State of North Carolina and an alternative method should be used.

Conclusion:

Per the above information we respectfully request that the Illinois Department of Taxation approve the taxpayers request to allow separate accounting when preparing their 20XX Illinois income tax returns. If you should have any additional information or need more information please do not hesitate to contact us directly as we have attached a signed power of attorney authorizing the department to communicate with our office.

**RULING**

Section 304(a) of the Illinois Income Tax Act ("IITA" 35 ILCS 5/304) provides that when a nonresident derives business income from Illinois and one or more other states, such income shall be apportioned to Illinois by multiplying the income by the taxpayer's apportionment factor. For taxable years ending on and after December 31, 1998, except in the case of an insurance company, financial organization, transportation company, or federally regulated exchange, the apportionment factor is equal to the sales factor. IITA Section 304(a)(3) defines the sale factor as a fraction, the numerator of which is the total sales of the person in Illinois during the taxable year, and the denominator of which is the total sales of the person everywhere during the taxable year.

Section 304(f) of the IITA states:

If the allocation and apportionment provisions of subsections (a) through (e) and of subsection (h) do not, for taxable years ending before December 31, 2008, fairly represent the extent of a person's business activity in this State, or, for taxable years ending on or after December 31, 2008, fairly represent the market for the person's goods, services, or other sources of business income, the person may petition for, or the Director may, without a petition, permit or require, in respect of all or any part of the person's business activity, if reasonable:

- (1) Separate Accounting;
- (2) The exclusion of any one or more factors;
- (3) The inclusion of one or more additional factors which will fairly represent the person's business activities or market in this State; or
- (4) The employment of any other method to effectuate an equitable allocation and apportionment of the person's business income.

Department Regulations Section 100.3390 sets forth procedures for taxpayer petitions pursuant to IITA Section 304(f). Section 100.3390(e) describes timely filed petitions:

e) Timely Filed Petitions. A taxpayer petition for use of a separate accounting method or any other alternative apportionment method will not be considered by the Director unless that petition has been timely filed. A taxpayer who petitions the Director for an alternative apportionment formula does so subject to the Department's right to verify, by audit of the taxpayer's return and supporting books and records within the applicable statute of limitations, the facts submitted as the basis of the petition. A petition for alternative allocation or apportionment is timely filed if the petition is filed:

- 1) 120 days prior to the due date of the tax return (including extensions) for which permission to use an alternative method is sought. A taxpayer who does not petition more than 120 days prior to the due date of the original return must file the return and pay tax according to the statutorily approved allocation or apportionment method. If the petition is approved, the Department shall grant permission to use an alternative apportionment method in the form of a private letter ruling issued under 2 Ill. Adm. Code 1200.110.

- 2) as an attachment to a return amending an original return which was filed using the statutory allocation and apportionment rules. A taxpayer who has not filed a petition for alternative apportionment under subsection (e)(1), or whose subsection (e)(1) petition has been rejected, may thereafter file a petition with an amended return. The

explanations section of the amended return should state that the amended return includes a petition for alternative apportionment that should be referred to the Legal Services Bureau/Income Tax, and a copy of the amended return should be mailed to the Legal Services Bureau/Income Tax, at the address in subsection (d). If the amended return results in a claim for refund, the Department will consider the petition, along with any other issues raised in the claim for refund, pursuant to the procedures set forth at Section 100.9400.

3) as part of a protest, an action filed under the State Officers and Employees Money Disposition Act [30 ILCS 230] or a petition to the Illinois Independent Tax Tribunal regarding a notice of deficiency issued as a result of the audit of the taxpayer's return and supporting books and records; provided that the audit adjustments being protested result in the need for the petition for alternative apportionment. Alternative apportionment may not be raised in a protest, a court filing or a petition to the Illinois Independent Tax Tribunal regarding a notice of deficiency unless the taxpayer has requested in writing that the auditor allow the use of alternative apportionment and the request was denied, or the audit disallows an alternative method of apportionment used by the taxpayer on its return. The disallowance of the use of alternative apportionment in an audit may be reviewed by the Informal Conference Board.

Your petition for alternative apportionment is not timely under Regulations Section 100.3390(e)(1). Therefore, you must follow the petition procedures set forth in Section 100.3390(e)(2) or (e)(3).

However, please note that the information provided in your petition suggests that you have not correctly applied the apportionment provisions of Article 3 of the IITA. IITA Section 305 sets forth the method of apportionment of a nonresident partner with respect to such partner's distributive share of the income of a non-unitary partnership.

§ 305. Allocation of Partnership Income by partnerships and partners other than residents. (a) Allocation of partnership business income by partners other than residents. The respective shares of partners other than residents in so much of the business income of the partnership as is allocated or apportioned to this State in the possession of the partnership shall be taken into account by such partners pro rata in accordance with their respective distributive shares of such partnership income for the partnership's taxable year and allocated to this State.

(b) Allocation of partnership nonbusiness income by partners other than residents. The respective shares of partners other than residents in the items of partnership income and deduction not taken into account in computing the business income of a partnership shall be taken into account by such partners pro rata in accordance with their respective distributive shares of such partnership income for the partnership's taxable year, and allocated as if such items had been paid, incurred or accrued directly to such partners in their separate capacities.

(c) Allocation or apportionment of base income by partnership. Base income of a partnership shall be allocated or apportioned to this State pursuant to Article 3, in the same manner as it is allocated or apportioned for any other nonresident.

Your petition states that the taxpayer is not engaged in a unitary business with COMPANY2. Assuming that is true, then under Section 305(a) the taxpayer should include in its Illinois net income only its distributive share of the business income of COMPANY2 that is apportioned to Illinois in the

hands of COMPANY2 under IITA Section 305(c). The taxpayer should allocate its distributive share of any of the nonbusiness income of COMPANY2 under IITA Section 305(b).

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.

Sincerely,

Brian Stocker  
Associate Counsel (Income Tax)