

Alternative apportionment not appropriate when gross receipts arising from an incidental or occasional sale of assets used in the regular course of trade or business are excluded from the sales factor pursuant to 86 Ill. Adm. Code 100.3380(c)(2). (This is a GIL.)

January 11, 2022

Re: Petition for Alternative Apportionment
COMPANY
Tax Year Ended: DATE

Dear NAME:

This is in response to your petition 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 1200.120(b) and (c). For the reasons discussed below, your petition cannot be granted based on the information provided.

Your petition states as follows:

COMPANY and its subsidiaries that are members of its Illinois Unitary Business Group (“Taxpayer” or “COMPANY”) respectfully submit this Petition pursuant to 35 Ill. Comp. Stat. §5/304(f) and Ill. Admin. Code tit. 86, §§100.3380(a)(2), 100.3390 for use of an alternative method of apportionment from the apportionment provisions in Ill. Admin. Code tit. 86, §100.3380(c)(2). When applied to COMPANY for the tax period ended DATE, these apportionment provisions do not fairly represent COMPANY’S in-state business activity in light of COMPANY’S sale of the assets of its enterprise security division during this tax period. COMPANY submits this Petition to provide clear and convincing evidence of, and explanation for, why the Illinois apportionment provisions lead to a grossly distorted result with the COMPANY income attributed to Illinois out of all appropriate proportion to COMPANY’S business transacted in Illinois for this period. This Petition also includes a proposed alternative method of apportionment that would be used only for the tax period ended DATE and would clearly reflect COMPANY’S business activity in Illinois during this period. This Petition also explains why this alternative methodology is reasonable.

Your submission includes the following additional information pertinent to your petition for alternative apportionment:

I. FACTUAL BACKGROUND

COMPANY is the parent company of a multinational corporate group that is a trusted brand and leading provider of cyber safety solutions for consumers worldwide. COMPANY is a fiscal year taxpayer. The company's YEAR/YEAR fiscal year ended on DATE.

COMPANY'S business is built around the prevention, detection, and restoration of potential damages caused by cyber criminals. The need for COMPANY'S products is more critical than ever in today's increasingly digital world, as people transition to remote work environments, conduct virtual meetings, and engage in online gaming, streaming, shopping, telemedicine, and numerous other online transactions and activities on a daily basis. With each new digital interaction comes increased risk for consumers as cyber criminals look to take advantage of this accelerating trend.

COMPANY stands between today's cyber criminals and consumers, helping secure the devices, identities, online privacy, and home and family needs of nearly ## million consumers globally.

COMPANY was originally incorporated in YEAR as CORPORATION. From incorporation through the present day, COMPANY has been headquartered in STATE.

Prior to DATE, in addition to its consumer division, COMPANY (then CORPORATION) also conducted an enterprise security business, providing cyber security products, services, and solutions to more than ##### organizations in the private and public sectors. By DATE, COMPANY had operations in ## countries. Its annual federal taxable income attributable to company operations was typically between \$\$\$ million and \$\$\$\$ million.

On DATE, COMPANY and its subsidiaries sold substantially all of the assets of their global enterprise security business to BUSINESS for \$\$\$.\$ billion. At the same time, the company changed its name from CORPORATION to COMPANY. The assets sold on DATE included all enterprise security business products and related intellectual property, such as patents, trademarks, domain names, IP addresses, technology, code, database, algorithms, customer lists, trade secrets, all customer/partner/reseller/distributor agreements, all license agreements for technology, leases, options, permits, licenses, and registrations. The

assets also included fixed assets related to the enterprise security business. These assets, including the developed technologies, were developed outside of Illinois and were marketed and sold to a business (BUSINESS) incorporated and headquartered outside of Illinois. No aspect of the sale was negotiated within Illinois.

The allocation of the \$\$. billion purchase price to the assets sold by COMPANY subject to U.S. tax was as follows:

| | <u>Gross Receipts</u> |
|---|-----------------------|
| Intangible Assets & Goodwill | \$\$\$\$\$\$\$\$\$\$ |
| Tangible Assets (PPE, Prepaid Expenses, Other Current Assets & Inventories) | \$\$\$\$\$\$\$\$\$\$ |
| Total: | \$\$\$\$\$\$\$\$\$\$ |

Approximately ##% of the gross receipts allocated to intangible assets and goodwill are attributable to COMPANY'S developed technologies and related assets including patents, processes, and knowhow. The residual - approximately ##% of the gross receipts allocated to intellectual property and goodwill - are attributable to goodwill. Additionally, \$\$\$\$\$\$ of the gross receipts allocated to intellectual property and goodwill were attributable to customer contracts.

The federal taxable income attributable to the U.S. assets sold was \$\$\$\$\$\$\$\$\$\$, calculated as follows:

| | <u>Gross Receipts</u> | <u>Basis</u> | <u>Federal Taxable Income</u> |
|------------------------------|-----------------------|----------------------|-----------------------------------|
| Intangible Assets & Goodwill | \$\$\$\$\$\$\$\$\$\$ | \$\$\$\$\$\$\$\$\$\$ | \$\$\$\$\$\$\$\$\$\$ |
| Tangible Assets | \$\$\$\$\$\$\$\$\$\$ | \$\$\$\$\$\$\$\$\$\$ | \$\$\$\$\$\$\$\$\$\$ |
| Total: | | | \$\$\$\$\$\$\$\$\$\$ |

Only \$\$\$\$\$\$\$\$\$\$ of this taxable income is attributable to depreciation recapture.

In addition to this \$\$\$\$ billion taxable income, COMPANY will also report federal taxable income from an accelerated royalty required to be recognized pursuant to I.R.C. §367(d) as a result of the sale of the enterprise security business. In YEAR, COMPANY transferred various foreign patents and other items of foreign intangible property (collectively

“Transferred Foreign IP”) to two foreign subsidiaries. For six years following the YEAR transaction - which was the useful life of the Transferred Foreign IP - I.R.C. §367(d) required COMPANY to recognize as ordinary income a deemed payment equal to an arm’s length royalty charge for use of the Transferred Foreign IP. Because COMPANY disposed of the Transferred Foreign IP during this six year period as part of the sale of its enterprise security business, I.R.C. §367(d) and Treas. Reg. §1.367(d)-1 T(f)(l) require COMPANY to recognize in the year of the sale of its enterprise security business sale (i.e. the tax period ended DATE) gain equal to the sum of: (1) the difference between the fair market value of the Transferred Foreign IP and its former basis on the property (\$\$\$\$\$\$\$\$\$) and (2) a deemed payment equal to an arm’s length royalty charge for use of the Transferred Foreign IP for the part of the taxable year that the Transferred Foreign IP was held by COMPANY’S subsidiaries prior to sale (\$\$\$\$\$\$\$\$\$). Both components of this gain exclusively relate to foreign intangible assets. For the tax year ended DATE, the amount of gain that COMPANY must recognize pursuant to I.R.C. §367(d) is \$\$\$\$\$\$\$\$\$ which is reported as an accelerated royalty for federal tax purposes.

II. COMPANY’S ILLINOIS CORPORATION INCOME TAX RETURN FOR THE TAX PERIOD ENDED DATE

On DATE, prior to the submission of this Petition, COMPANY filed its Form IL-1120, Corporation Income and Replacement Tax Return for the tax period ended DATE (“Illinois Original Return”).

The starting point for the calculation of COMPANY’S taxable income in Illinois is its federal taxable income reported on its federal Form 1120, Line 30. For the taxable period at issue, COMPANY reported \$\$\$\$\$\$\$\$\$ of federal taxable income on Form 1120, Line 30.

After accounting for the specific addition and subtraction modifications in Illinois law, COMPANY is reporting Unitary Business Group’s Apportionable Income of \$\$\$\$\$\$\$\$\$, subject to Illinois’ income tax. COMPANY is not reporting any non-apportionable income.

The supermajority of this Unitary Business Group Income -- \$\$\$\$\$\$\$\$\$ or ##% -- is exclusively attributable to the gain from the sale of the enterprise security business’ intangible assets and goodwill and the I.R.C. §367(d) income inclusion.

The apportionment ratio COMPANY used for its Illinois Original Return reflects Illinois’ single sales factor formula.

COMPANY'S apportionment factor (for the Unitary Business Group) for the tax period ended DATE is #.####% calculated as:

$$\frac{\text{[$$$$$$$$ (Illinois Receipts of COMPANY)} \\ \text{divided by} \\ \text{$$$$$$$$} \\ \text{(Total Receipts of all members of the} \\ \text{COMPANY Unitary Business Group)]}}{\text{}}\end{math>$$

\$\$\$\$\$\$\$\$ divided by \$\$\$\$\$\$\$\$\$ equals #.####%.

Notably, the sales factor denominator does not include any of the gross receipts (or gain) attributable to the sale of the enterprise security intangible assets and goodwill. Ill. Admin. Code tit. 86, §100.3380(c)(2). The sales factor denominator also does not include any of the gross receipts (or gain) attributable to the I.R.C. §367(d) income inclusion or the sale of the tangible personal property that was part of the enterprise security business. 35 Ill. Comp. Stat. §5/304(a)(3)(B-2).

Application of this regulatory apportionment ratio (#.####%) to COMPANY'S \$\$\$\$\$\$\$\$\$ of Unitary Business Group's Apportionable Income results in a calculation of Illinois' Taxable Share of Unitary Business Group's Apportionable Income of \$\$\$\$\$\$\$\$\$ (Line 34).

III. ALTERNATIVE APPORTIONMENT PETITION FRAMEWORK

Illinois law provides a mechanism for taxpayers to request the use of an alternative method of apportionment when its regulatory apportionment rules are not reasonably adapted to approximate the net income derived from business carried on within Illinois and do not fairly represent the extent of the taxpayer's business activity in state.

With respect to the corporation income tax, 35 Ill. Comp. Stat. §5/304(f) provides:

If the normal allocation and apportionment provisions do not 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 a petition, 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 that will fairly represent the person's business activities or market in Illinois;

- (4) the use of any other method to create an equitable allocation and apportionment of the taxpayer's business income.

35 Ill. Comp. Stat. §5/304(f).

The use of Illinois' alternative apportionment statute and regulation is authorized when the application of any of the Special Rules in Ill. Admin. Code tit. 86, §100.3380 - including the incidental or occasional sale rule in Ill. Admin. Code tit. 86, §100.3380(c)(2) - do not fairly represent a taxpayer's business activity or market within Illinois.

Requests for alternative apportionment under this provision are subject to the rules in Ill. Admin. Code tit. 86, §100.3390. There are several procedural rules for alternative apportionment relief in this regulation.

First, the party petitioning for an alternative apportionment must prove that the statutory formula results in the taxation of extraterritorial values or operates unreasonably and arbitrarily in attributing to Illinois a percentage of income that is out of all proportion to the business transacted in Illinois using clear and convincing evidence. Ill. Admin. Code tit. 86, §100.3390(c).

Second, the petitioner must prove that the proposed alternative apportionment method fairly and accurately apportions income to Illinois. *Id.* The regulation does not explain how a petitioner may do so, perhaps because "[a]llocating income among various taxing jurisdictions bears some resemblance ... to slicing a shadow." *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 192 (1983).

Third, the petition must be timely filed. A petition is timely if it is filed at least 120 days prior to the original tax returns due date, if it is filed as an attachment to a timely amended return, or if it is filed as part of a timely protest or petition to the Illinois Independent Tax Tribunal. Ill. Admin. Code tit. 86, §100.3390(e).

A taxpayer's request for alternative apportionment will not be granted solely because it arrives at a different apportionment percentage than the statutory or special rule formula. Ill. Admin. Code tit. 86, §100.3380(c).

IV. THE REGULATORY APPORTIONMENT PROVISIONS DO NOT FAIRLY REPRESENT COMPANY'S ILLINOIS BUSINESS ACTIVITY

For the tax period ended DATE, Illinois' regulatory apportionment provisions do not fairly represent the extent of COMPANY'S in-state business activity. As explained below, the regulatory provisions do not provide factor representation for any receipts attributable to over ##% of

COMPANY'S apportionable income for this period. Because nearly all of the receipts attributable to this taxable income are not sales within Illinois, the lack of factor representation results in the apportionment of income to Illinois that far exceeds COMPANY'S business activity in Illinois for the period.

A tax based on an inherently arbitrary method of apportionment cannot stand. *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 121 (1920); *Bass, Ratcliff & Gretton, Ltd. v. State Tax Commission*, 266 U.S. 271, 283 (1924). An apportionment method is inherently arbitrary if there is a lack of correspondence between the income included in a taxpayer's apportionable income and the factors that are used to apportion such income. See *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 169 (1983) (stating that "the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated.") This lack of correspondence between a taxpayer's apportionable income and the factors used to apportion such income is commonly referred to as a lack of "factor representation." Hellerstein, Hellerstein & Swain, *State Taxation* ¶ 9.15[1] (Thomson Reuters/Tax & Accounting, 3rd ed. 2001, with updates through May 2020) (online version accessed on Checkpoint (www.checkpoint.riag.com) on June 26, 2020) (emphasis added).

Illinois case law reflects this rule. In *Miami Corp. v. Dep't of Revenue*, 571 N.E.2d 800, 805 (Ill. App. 1991), a taxpayer's most profitable operation was its oil and gas reserves located in Louisiana, generating more than 80% of its total income. Illinois' then three-factor formula did not reflect the oil and gas reserves, as they were intangible property rights. The court held that the formula did not fairly represent the taxpayer's business activity and allowed the taxpayer to utilize a separate accounting apportionment method.

For the tax period ended DATE, COMPANY reports \$\$\$\$\$\$\$\$\$\$ of apportionable income subject to Illinois' income tax. The supermajority (indeed nearly all) of this apportionable income -- \$\$\$\$\$\$\$\$\$\$ or ##% -- results from the sale of the enterprise security intangible assets and goodwill and an I.R.C. §367(d) income inclusion. Pursuant to Illinois' Special Rule for incidental or occasional sales in Ill. Admin. Code tit. 86, §100.3380(c)(2) none of that \$\$\$\$\$\$\$\$\$\$ is included in COMPANY'S regulatory sales factor. Its exclusion means that the sales factor used to apportion \$\$ billion of income for the tax period is based on the receipts corresponding to less than \$\$\$ million of that taxable income.

The lack of factor representation caused by the occasional sales rule far exceeds the absence of factor representation at issue in *Miami Corp.*, which required the use of an alternative method of apportionment. In

Miami Corp. 80% of the taxpayer's income lacked factor representation thus requiring use of Illinois' alternative apportionment statute. Here, there is no factor representation for ##% of COMPANY'S income.

For the following reasons, COMPANY'S sale of its enterprise security business created a specific and unusual situation for which Illinois' regulatory apportionment methods do not fairly represent the extent of COMPANY'S in-state business activity.

First, the magnitude of the disposition transaction by itself is unusual, unique, and nonrecurring. A \$\$\$ billion asset sale transaction is not only very unique among the universe of commercial disposition transactions, but the deal was the first of its kind for COMPANY and cannot be replicated by COMPANY given the nature of the company's remaining business operations.

Second, the amount of taxable income attributable to the transaction (\$\$ billion) relative to COMPANY'S taxable income from its ordinary business operations (typically between \$\$\$\$ million and \$\$\$\$ million, and only \$\$\$ million during this tax period) also makes the transaction unusual, unique, and non-recurring, especially for an on-going enterprise such as COMPANY. COMPANY is not aware of any other corporate asset transaction by any taxpayer that resulted in such a lopsided income presentation on any state's tax return.

Third, because the taxable income that is attributable to the sale of enterprise security assets dwarfs COMPANY'S other taxable income for the period, the lack of factor representation for the receipts from the sale of the enterprise security assets gives rise to incongruous results under Illinois law. It makes no sense for Illinois (or any other state) to seek to apportion \$.\$\$ billion of apportionable group income using the gross receipts attributable to only \$\$\$ million of that taxable income. As noted by the Supreme court in *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 169 (1983), "the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated." With respect to COMPANY for the tax period ended DATE, Illinois' regulatory apportionment formula does not actually reflect a reasonable sense of how COMPANY generated income during this period and does not fairly represent the extent of COMPANY'S business activity in Illinois for this one tax period.

In summary, this is a limited and specific case. It is an unusual fact situation that is unique and nonrecurring and results in the drastic overstatement of COMPANY'S business activity in Illinois for the tax period ended DATE because the regulatory allocation and apportionment

provisions are not reasonably adapted to approximate the COMPANY'S net income from business carried on within Illinois during this tax period.

As demonstrated below, the absence of factor representation for ##% of COMPANY'S apportionable income causes the Illinois' regulatory apportionment rules to not fairly represent COMPANY'S business activity within Illinois by a factor of ###%.

V. SALES FACTOR REPRESENTATION ANALYSIS WOULD FAIRLY AND ACCURATELY APPORTION INCOME TO ILLINOIS

The table below identifies the differences between application of the regulatory apportionment rules and an apportionment ratio that includes factor representation for the \$\$\$\$\$\$\$\$\$\$ of COMPANY'S taxable income from the sale of the intangible assets, goodwill, and I.R.C. §367(d) income that were recognized on the sale of the enterprise security assets.

| Table 1 | | | |
|---------------------------------------|---------------------------------|--|-------------------|
| | Regulatory Apportionment | Apportionment with Factor Representation for the Intangible Assets, Goodwill & 367(d) Income | Difference |
| Sales Factor Numerator | \$\$\$\$\$\$\$\$\$ | \$\$\$\$\$\$\$\$\$ | |
| Sales Factor Denominator | \$\$\$\$\$\$\$\$\$\$\$\$\$ | \$\$\$\$\$\$\$\$\$\$\$\$\$ (\$\$\$\$\$\$\$\$\$\$\$\$\$ + \$\$\$\$\$\$\$\$\$\$\$\$\$\$ + \$\$\$\$\$\$\$\$\$\$\$\$\$\$) | |
| Sales Factor | #.###% | #.###% | ###% |
| Apportionable Income | \$\$\$\$\$\$\$\$\$\$\$\$\$ | \$\$\$\$\$\$\$\$\$\$\$\$\$ | - |
| Income Apportioned to Illinois | \$\$\$\$\$\$\$\$\$ | \$\$\$\$\$\$\$\$\$ | ###% |

In reviewing the table, it is important to note that (1) all of the I.R.C. §367(d) income was attributable to foreign intangible assets that had no nexus to Illinois whatsoever and (2) all of the developed technologies comprising the \$\$\$\$\$\$\$\$\$\$ of receipts were developed outside of Illinois, were marketed and sold to a business incorporated and headquartered outside of Illinois, and no aspect of the sale was negotiated within Illinois. As a result, with the exception of the two items noted below, most of the intangible asset and goodwill gross receipts and all of the I.R.C. §367(d) income to be included in COMPANY'S sales factor are properly included solely in COMPANY'S sales factor denominator for the tax period ended DATE.

The first item includable in COMPANY'S sales factor numerator (with factor representation) is the portion of the depreciation recapture

recognized on the sale of the intangible assets that approximates the amount of depreciation benefit that COMPANY received in Illinois in prior years. This amount is calculated by multiplying the total accumulated depreciation recapture from the sale of these assets (\$\$\$\$\$\$\$\$\$) by a factor equal to COMPANY'S Illinois regulatory sales factor for the period ended DATE (#.###%).

The second item includable in COMPANY'S sales factor numerator (with factor representation) is the approximate value of COMPANY'S Illinois customer contracts transferred with the sale of the enterprise business assets. This amount is calculated by multiplying the total valuation of the customer contracts (\$\$\$\$\$\$\$\$\$) by a factor equal to COMPANY'S Illinois regulatory sales factor for the period ended DATE (#.###%).

The table above compares application of the regulatory apportionment rules with factor representation for the developed intangible assets and the goodwill sold with COMPANY'S enterprise security assets and the related I.R.C. §367(d) income inclusion.

COMPANY recognizes, however, that because the value of transferred goodwill cannot always be readily assigned to a specific state, Illinois may take the position that COMPANY'S receipts from the sale of goodwill attributable to the sale of its enterprise security assets (which was determined to reflect ##% of the \$\$\$\$\$\$\$\$\$ value assigned to the intangible assets and goodwill) should never be afforded factor representation.

However, even if goodwill is properly excluded from COMPANY'S sales factor the failure of the regulatory apportionment rules to provide factor representation for the receipts attributable to the developed intangible assets (i.e., patents, knowhow, etc.) results in the clear distortion of COMPANY'S business activity in Illinois during the tax period ended DATE. Specifically, as reflected in the table below, failure to provide factor representation for the receipts attributable to the developed intangible assets (but not goodwill) and the I.R.C. §367(d) income inclusion still results in the overstatement of COMPANY'S income attributable to Illinois by ###%:

| Table 2 | | | |
|-----------------------------------|-----------------------------|---|------------|
| | Regulatory Apportionment | Apportionment with Factor Representation for the Developed Intangible Assets & 367(d) Income | Difference |
| Sales Factor Numerator | \$\$\$\$\$\$\$\$ | \$\$\$\$\$\$\$\$ | |
| Sales Factor Denominator | \$\$\$\$\$\$\$\$ | \$\$\$\$\$\$\$\$ (\$\$\$\$\$\$\$\$ + \$\$\$\$\$\$\$\$ * .# + \$\$\$\$\$\$\$\$) | |
| Sales Factor | #.####% | #.####% | ###% |
| Apportionable Income | \$\$\$\$\$\$\$\$ | \$\$\$\$\$\$\$\$ | - |
| Income Apportioned to Illinois | \$\$\$\$\$\$\$\$ | \$\$\$\$\$\$\$\$ | ###% |

VI. COMPANY'S PROPOSED ALTERNATIVE METHOD OF APPORTIONMENT

COMPANY respectfully petitions that for the tax period ended DATE - and for this period only - the company be permitted to deviate from the regulatory apportionment rules consistent with the second table above. As compared to regulatory apportionment, this method reflects four changes to the calculation of COMPANY'S sales factor:

1. COMPANY will include in its sales factor denominator the I.R.C. §367(d) income inclusion (\$\$\$\$\$\$\$\$). All of this income relates to foreign intangible property that has no nexus whatsoever to COMPANY'S business activity in Illinois. If this income is to be included in the COMPANY group's apportionable income, it must be afforded factor representation.
2. COMPANY will include in its sales factor denominator ##% of the gross receipts attributable to the sale of the intangible assets and goodwill received from sale of its enterprise security business (\$\$\$\$\$\$\$\$ * ##% = \$\$\$\$\$\$\$\$). This ##% amount reflects the amount allocated to the developed intangible assets (and not goodwill) that were sold with enterprise security assets.
3. COMPANY will include in the numerator of its sales factor the portion of the depreciation recapture recognized on the sale of the intangible assets that approximates the amount of depreciation benefit that COMPANY received in Illinois in prior years. This amount will be calculated by multiplying the total accumulated depreciation recapture from the sale of these assets (\$\$\$\$\$\$\$\$) by a factor equal to COMPANY'S Illinois regulatory sales factor for

the period ended DATE (#.####%). The amount of this numerator inclusion is \$\$\$\$\$\$.

4. COMPANY will include in the numerator of its sales factor is the value of the customer contracts transferred with the sale of the enterprise business assets that approximates the value of the customer contracts in Illinois. This amount will be calculated by multiplying the total valuation of the customer contracts (\$\$\$\$\$\$) by a factor equal to COMPANY'S Illinois regulatory sales factor for the period ended DATE (#.####%). The amount of this numerator inclusion is \$\$\$\$\$\$.

This alternative method proposed by COMPANY is authorized by 35 Ill. Comp. Stat. §5/304(f).

Consistent with this alternative method, the components of COMPANY'S apportionment ratio and Illinois corporation income would be as follows:

| | Regulatory Apportionment | Apportionment with Factor Representation for the Developed Intangible Assets & 367(d) Income |
|---------------------------------------|--------------------------|--|
| Sales Factor Numerator | \$\$\$\$\$\$\$\$ | \$\$\$\$\$\$\$\$ |
| Sales Factor Denominator | \$\$\$\$\$\$\$\$ | $ \begin{aligned} & \$$$$$$$$$ \\ & (\$$$$$$$$$ + \$$$$$$$$$ * \# + \\ & \quad \$$$$$$$$$) \end{aligned} $ |
| Sales Factor | #.####% | #.####% |
| Apportionable Income | \$\$\$\$\$\$\$\$ | \$\$\$\$\$\$\$\$ |
| Income Apportioned to Illinois | \$\$\$\$\$\$\$\$ | \$\$\$\$\$\$\$\$ |

There are multiple reasons why the proposed alternative apportionment method fairly and accurately apportions income to Illinois.

First, this proposal provides factor representation for nearly all of COMPANY'S taxable income for the period. The only income that does not have factor representation is the income from the sale of goodwill attributable to the enterprise security assets. Providing factor representation to the goodwill would only decrease COMPANY'S Illinois apportionment percentage for the year.

Second, the proposal is consistent with the considerations listed in Ill. Admin. Code tit. 86, §100.3380(c)(2) to justify the incidental or occasional sale rule. According to the regulation, the "exclusion of gross receipts from the sales factor is appropriate for several reasons, more than one of which may apply to a particular sale, including:

- a) incidental or occasional sales are not made in the market for the person's goods, services or other ordinary sources of business income;
- b) to the extent that gains realized on the sale of assets used in a taxpayer's business are comprised of recapture of depreciation deductions, the economic income of the taxpayer was understated in the years in which those deductions were taken. The recapture gains that reflect a correction of that understatement should be allocated using a method approximating the factors that were used in apportioning the deductions. If the business otherwise remains unchanged, including the gross receipts from the sale in the sales factor numerator of the state in which the assets were located would allocate a disproportionate amount of the recapture gains to that state compared to how the deductions being recaptured were allocated;
- c) to the extent the gain on the sale is attributable to goodwill or similar intangibles representing the value of customer relationships, including the gross receipts from the sale in the sales factor shall not reflect the market for the taxpayer's goods, services or other ordinary sources of business income to the extent the sourcing of the receipts from that sale differs from the sales factor computed without regard to that sale; and
- d) in the case of sales of assets that are made in connection with a partial or complete withdrawal from the market in the state in which the assets are located, including the gross receipts from those sales in the sales factor would increase the business income apportioned to that state when the taxpayer's market in that state has decreased."

III. Admin. Code tit. 86, §100.3380(c)(2). The proposal reflects each of these four considerations.

With respect to the first consideration, the proposed alternative methodology reflects the reality that COMPANY'S primary source of taxable income for the year was from the sale of its enterprise security business and not its ordinary operations. In other words, the company's business operations were inverted for the period with occasional sales compromising ##% of the taxable income for the period. The concern with dilution presented in this first consideration is simply not present in this inverted scenario. With respect to the second consideration, the proposed alternative methodology sources to Illinois a percentage of the depreciation recapture and the value assigned to the customer contracts consistent with COMPANY'S sales factor for the period without regard to

the sale of the enterprise security business. With respect to the third consideration, the proposed alternative methodology does not include the receipts attributable to goodwill in either the numerator or the denominator of COMPANY'S Illinois apportionment factor. And with respect to the fourth consideration, the sale of the enterprise security assets will not have a material impact on COMPANY'S apportionment factor in the future years from its remaining consumer security business. COMPANY'S market in Illinois and in all the other states for its consumer security business is roughly the same as its market from the disposed of enterprise security business.

Third, factor representation fairly and accurately apportions COMPANY'S income consistent with common sense, found in *Miami Corp.* The intangible assets and I.R.C. §367(d) gain generated ##% of COMPANY'S income. Including them in the sales factor would "reflect a reasonable sense of how income is generated." *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 169 (1983). This proposal provides factor representation for nearly all of COMPANY'S taxable income for the period, consistent with *Miami Corp.*

Fourth, factor representation would align the treatment of the sale of the enterprise security assets in Illinois with the 29 other jurisdictions. 27 other jurisdictions provide factor representation by statute or regulation. Two additional jurisdictions (STATE and STATE) have granted relief pursuant to their respective alternative apportionment statutes to provide factor representation to COMPANY identical to the proposal set forth in this petition. Related correspondence attached. As of this date, no state has denied a petition similar to this one.

VII. CONCLUSION

For all of the foregoing reasons, the Illinois Department of Revenue should grant this petition for alternative apportionment. Illinois' occasional sale rule does not fairly and accurately apportion COMPANY'S income, whereas the alternative methodology outlined above clearly would.

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. Section 304(a)(3) of the IITA defines the sales 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 100.3380(a)(2) states:

The Director has determined that, in the instances described in this Section, the apportionment provisions provided in IITA Section 304(a) through (e) and (h) do not fairly represent the extent of a person's business activity or market within Illinois. For tax years beginning on or after the effective date of a rulemaking amending this Section to prescribe a specific method of apportioning business income, all nonresident taxpayers shall apportion their business income employing that method in order to properly apportion their business income to Illinois. Taxpayers whose business activity or market within Illinois is not fairly represented by a method prescribed in this Section and who want to use another method for a tax year beginning after the effective date of the rulemaking adopting that method may obtain permission to use that other method by filing a petition under Section 100.3390. For tax years beginning prior to the

effective date of the rulemaking adopting a method of apportioning business income, the Department will not require a taxpayer to adopt that method; provided, however, if any taxpayer has used that method for any of those tax years, the taxpayer must continue to use that method for that tax year. Moreover, a taxpayer may file a petition under Section 100.3390 to use a method of apportionment prescribed in this Section for any open tax year beginning prior to the effective date of the rulemaking adopting that method, and that petition shall be granted in the absence of facts showing that that method will not fairly represent the extent of a person's business activity or market in Illinois.

Taxpayers who wish to use an alternative method of apportionment under these provisions are required to file a petition complying with the requirements of 86 Ill. Adm. Code Section 100.3390. Subsection (c) of that regulation provides:

A departure from the required apportionment method is allowed only when those methods do not accurately and fairly reflect business activity in Illinois (for taxable years ending before December 31, 2008) or market in Illinois (for taxable years ending on or after December 31, 2008). An alternative apportionment method may not be invoked, either by the Director or by a taxpayer, merely because it reaches a different apportionment percentage than the required statutory formula. However, if the application of the statutory formula will lead to a grossly distorted result in a particular case, a fair and accurate alternative method is appropriate. The party (the Director or the taxpayer) seeking to utilize an alternative apportionment method has the burden of going forward with the evidence and proving by clear and convincing evidence that the statutory formula results in the taxation of extraterritorial values or operates unreasonably and arbitrarily in attributing to Illinois a percentage of income that is out of all proportion to the business transacted in this State (for taxable years ending before December 31, 2008) or the market for the taxpayer's goods, services or other sources of business income in this State (for taxable years ending on or after December 31, 2008). In addition, the party seeking to use an alternative apportionment formula must go forward with the evidence and prove that the proposed alternative apportionment method fairly and accurately apportions income to Illinois based upon business activity in this State (for taxable years ending before December 31, 2008) or the market for the taxpayer's goods, services or other sources of business income in this State (for taxable years ending on or after December 31, 2008).

Department Regulations Section 100.3380(c)(2) states:

When gross receipts arise from an incidental or occasional sale of assets used in the regular course of the person's trade or business, those gross receipts shall be excluded from the sales factor. For example, gross receipts from the sale of a factory or plant shall be excluded. Gross receipts from an incidental or occasional sale of stock in a subsidiary shall also be excluded. Exclusion of these gross receipts from the sales factor is appropriate for several reasons, more than one of which may apply to a particular sale, including:

- A. incidental or occasional sales are not made in the market for the person's goods, services or other ordinary sources of business income;
- B. to the extent that gains realized on the sale of assets used in a taxpayer's business are comprised of recapture of depreciation deductions, the economic income of the taxpayer was understated in the years in which those deductions were taken. The recapture gains that reflect a correction of that understatement should be allocated using a method approximating the factors that were used in apportioning the deductions. If the business otherwise remains unchanged, including the gross receipts from the sale in the sales factor numerator of the state in which the assets were located would allocate a disproportionate amount of the recapture gains to that state compared to how the deductions being recaptured were allocated;
- C. to the extent the gain on the sale is attributable to goodwill or similar intangibles representing the value of customer relationships, including the gross receipts from the sale in the sales factor shall not reflect the market for the taxpayer's goods, services or other ordinary sources of business income to the extent the sourcing of the receipts from that sale differs from the sales factor computed without regard to that sale; and
- D. in the case of sales of assets that are made in connection with a partial or complete withdrawal from the market in the state in which the assets are located, including the gross receipts from those sales in the sales factor would increase the business income apportioned to that state when the taxpayer's market in that state has decreased.

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. Exclusion

of such receipts from the sales factor thereby prevents distortion of the sales factor that would otherwise occur.

Your petition indicates that on DATE COMPANY sold substantially all of the assets of their global enterprise security business, which included all enterprise security business products and related intellectual property, intangible assets such as goodwill, and other fixed assets related to the enterprise security business. You indicate that gross receipts from the sale of these assets is excluded from the sales factor under 86 Ill. Adm. Code Section 100.3380(c)(2) as an incidental or occasional sale of assets used in the regular course of COMPANY'S trade or business. In addition, you indicate COMPANY reported federal taxable income from an accelerated royalty required to be recognized pursuant to IRC Section 367(d) as a result of the sale of the enterprise security business. Your petition asserts that the failure to include such receipts in the denominator of the sales factor results in an amount of income apportioned to Illinois that does not fairly represent the market for COMPANY'S goods, services, or other sources of business income. The primary basis for this assertion is that the sale of the enterprise security business created a specific and unusual situation which Illinois' regulatory apportionment provisions do not provide factor representation for any receipts attributable to over ##% of COMPANY'S apportionable income for the period and this lack of factor representation results in the apportionment of income to Illinois which exceeds COMPANY'S business activity in Illinois because nearly all of the receipts attributable to this taxable income are not sales within Illinois, leading to a grossly distorted result.

As you have represented that the sale of the enterprise security business is an incidental or occasional sale of assets of COMPANY, and that no similar sale can be replicated by COMPANY given the nature of the company's remaining business operations, Department Regulations Section 100.3380(c)(2) properly applies in this case. Therefore, the gross receipts from such sale must be excluded from both the numerator and denominator of COMPANY'S sales factor.

The facts stated in your petition are not sufficient to satisfy the burden set forth in Ill. Adm. Code Section 100.3390(c). As indicated above, for taxable years ending on or after December 31, 2008, alternative apportionment under IITA Section 304(f) is appropriate in cases where the allocation and apportionment provisions under IITA Sections 304(a) through (e) do not fairly represent the market for the taxpayer's goods, services, or other sources of business income. In this case, your petition does not meet the regulatory requirement and cannot be granted at this time. Your request merely states that due to the regulatory exclusion of the receipts from the sale of the enterprise security business from COMPANY'S sales factor for tax year ended DATE, pursuant to 86 Ill. Adm. Code 100.3380(c)(2), an alternative apportionment formula would more accurately represent COMPANY'S market in Illinois. Your proposed alternative method of apportionment, which would reduce the sales factor by only #.####% (#.####% - #.####%), fails to demonstrate how the application of the statutory

method leads to a grossly distorted result. An alternative apportionment method may not be invoked, either by the Department or by a taxpayer, merely because it reaches a different apportionment percentage than the required statutory formula.

Section 304(f) relief is proper where the income allocated to the State by the otherwise applicable statutory formula is unfairly disproportionate to the business activity conducted in the State. There is nothing inherently distortive or unfair in excluding from the sales factor those receipts which arise from an incidental or occasional sale of assets used in the regular course of trade or business.

Accordingly, your petition for alternative apportionment for tax year ended DATE cannot be granted. However, if you have additional information related to this request that was not previously submitted, you may supplement your petition and we will reconsider your request. Please note that 86 Ill. Adm. Code Section 100.3390(e)(1) requires a petition to be filed at least 120 days prior to the due date (including extensions) for the first return for which permission is sought to use the alternative apportionment method.

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,

Jennifer Uhles
Associate Counsel (Income Tax)