IT-22-0002 04/12/2022 ADDITION MODIFICATIONS – OTHER RULINGS

> Taxpayer who claimed bonus depreciation addition and subtraction modifications under IITA Sections 203(b)(2)(E-10) and (T) must add back the aggregate amount of subtraction modifications claimed on the property in the taxable year of an IRC Section 368(a)(1)(D) corporate reorganization. (This is a PLR.)

April 12, 2022

Re: Request for Private Letter Ruling
CORPORATION, FEIN: ##-#######
Tax Year Ended: YEAR

Dear NAME:

This is in response to your letter dated January 13, 2022, in which you request a Private Letter Ruling ("PLR") on behalf of CORPORATION. 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 on 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. The review of your request for a PLR indicates that all information described in paragraphs 1 through 8 of subsection (b) of 2 Ill. Admin. Code 1200.110 is contained in your request. This PLR will bind the Department only with respect to CORPORATION. Issuance of this PLR is conditioned upon the understanding that CORPORATION and/or any related taxpayer(s) is not currently under audit or involved in litigation concerning the issues that are the subject of this ruling request.

The facts and analysis as you have presented states as follows:

> CORPORATION ("CORPORATION" or the "taxpayer") hereby submits this request for a private letter ruling pursuant to 2 Ill. Admin. Code § 1200.110. We request that the Department delete the following confidential information from any publicly disclosed version of this letter or published ruling: any names of entities, officers, or employees; any FEINs or other identifying numbers; and any references to the nature of the businesses conducted by CORPORATION.
>
> The required representations and the relevant facts for this private letter ruling are set forth below, and the specific ruling request is detailed afterwards. If you have any questions, please don't hesitate to contact me by phone at ###-###-#### or by email at E-MAIL.
>
> REPRESENTATIONS
> The taxpayer requests a private letter ruling relating to its Illinois corporate income tax return for the tax year ending MONTH DAY YEAR. There are

currently no audits or litigation pending concerning tax year YEAR or matters at issue in the private letter ruling request. To the best of the taxpayer's knowledge, the Department has not previously ruled on the same or a similar issue for the taxpayer or a predecessor, nor has the taxpayer previously submitted the same or similar issue to the Department and withdrawn it after a letter ruling was requested.

FACTS

CORPORATION, a STATE corporation, is a publicly traded utility services holding company engaged in the generation, delivery, and marketing of electricity and natural gas through various subsidiaries. Headquartered in CITY, STATE, CORPORATION is the common parent of an affiliated group of U.S. corporations that files a consolidated U.S. federal income tax return. CORPORATION uses the accrual method of accounting and an accounting period ending on MONTH DAY for purposes of filing its U.S. federal income tax returns, as well as for maintaining its accounting books. CORPORATION files an Illinois combined return with its unitary subsidiaries.

CORPORATION is engaged in two key business lines: the competitive power generation and marketing of electricity and gas (the "Controlled Business") and the regulated transmission and distribution of electricity and natural gas (the "Distributing Business"). Certain subsidiaries of CORPORATION also provide a variety of support services to other CORPORATION subsidiaries, including legal, human resources, financial, information technology, and supply management services.

The Controlled Business is conducted through COMPANY ("COMPANY"), a STATE limited liability company and wholly-owned subsidiary of CORPORATION. COMPANY is currently, and has been since its inception, classified as a disregarded entity for U.S. federal income tax purposes.

The Distributing Business consists of the purchase and regulated retail sale of electricity and natural gas and the provision of distribution and transmission services to retail customers. The Distributing Business is operated through six utilities engaged in the purchase and regulated sale of electricity and natural gas.

The Separation

CORPORATION intends to pursue a tax-free spin-off (the "Separation") of its Controlled Business. To effectuate the Separation, CORPORATION has formed a new, wholly-and-directly-owned subsidiary corporation, SUBSIDIARY ("Controlled"), a STATE corporation. Controlled is a member of CORPORATION'S Illinois unitary group and will be included in CORPORATION'S YEAR Illinois combined return.

In furtherance of the Separation, CORPORATION will transfer its 100% membership interest in COMPANY to Controlled (the “Contribution”). Immediately thereafter, CORPORATION will then distribute to its shareholders, on a pro rata basis, all of the issued and outstanding shares of Controlled owned by CORPORATION (the “Distribution”). If applicable, cash may be distributed in lieu of fractional shares. The Contribution and Distribution are both expected to occur on the same day on MONTH DAY YEAR.

In MONTH YEAR, CORPORATION submitted a private letter ruling (“PLR”) request to the Internal Revenue Service (the “Service”) requesting a ruling that the Contribution followed by the Distribution will qualify as a tax-free reorganization under sections 355 and 368(a)(1)(D) of the Internal Revenue Code of 1986, as amended, and related regulations. On MONTH DAY YEAR, the Service ruled that the Contribution together with the Distribution will be a tax-free reorganization, as requested by CORPORATION.

Depreciation Related to COMPANY’S Assets
As noted previously COMPANY is a wholly-owned subsidiary of CORPORATION. COMPANY is currently, and has been since its inception, classified as a disregarded entity for U.S. federal income tax purposes and for Illinois income tax purposes. As a result, the assets owned by COMPANY are treated as being owned directly by COMPANY and depreciation deductions taken with respect to COMPANY’S assets have been reported at CORPORATION.

Since the enactment of bonus depreciation under Internal Revenue Code §168(k), CORPORATION has taken bonus depreciation deductions on its federal income tax returns for eligible assets. As required under Illinois law, CORPORATION has reported addition and subtraction modifications with respect to these assets, as required under 35 ILCS 5/203(b)(2)(E-10) and (b)(2)(T).

RULING REQUESTED
The taxpayer requests a ruling on whether it will be required to make the depreciation adjustments required under 35 ILCS 5/203(b)(2)(E-11) and (b)(2)(U) as a result of the Contribution and subsequent Distribution?

Supporting Authority
35 ILCS 5/203

Contrary Authority
None.

Illinois begins the computation of Illinois taxable income with federal taxable income. 35 ILCS 5/203(e). A corporation's federal taxable income is then subject to addition and subtraction modifications to arrive at base income. 35 ILCS 5/203(b). For taxable years 2001 and thereafter, a taxpayer that claims a bonus depreciation deduction under Internal Revenue Code Section 168(k) on its federal tax return for the taxable year is required to add back the amount of such deduction on its Illinois tax return for the taxable year. 35 ILCS 5/203(b)(2)(E-10). The taxpayer is then permitted to take an annual deduction, pursuant to specified formulas, on its Illinois tax return to recover a portion of the bonus depreciation that it was required to add back. 35 ILCS 5/203(b)(2)(T). Illinois law also contains specific addition and subtraction modifications that are required when a taxpayer transfers property that was the subject of the bonus depreciation modifications under 35 ILCS 5/203(b)(2)(E-10) and (T).

35 ILCS 5/203(b)(2)(E-11) provides for the following addition modification:

> If the taxpayer sells, transfers, abandons, or otherwise disposes of property for which the taxpayer was required in any taxable year to make an addition modification under subparagraph (E-10), then an amount equal to the aggregate amount of the deductions taken in all taxable years under subparagraph (T) with respect to that property.

35 ILCS 5/203(b)(2)(U) provides for the following subtraction modification:

> If the taxpayer sells, transfers, abandons, or otherwise disposes of property for which the taxpayer was required in any taxable year to make an addition modification under subparagraph (E-10), then an amount equal to that addition modification.

For tax years 2001 and thereafter, CORPORATION reported the addition modification required under 35 ILCS 5/203(b)(2)(E-10) and the subtraction modification required under 35 ILCS 5/203(b)(2)(T) on its Illinois tax returns with respect to COMPANY'S assets on which federal bonus depreciation has been claimed (because COMPANY is a disregarded entity for federal and state income tax purposes). On MONTH DAY YEAR, CORPORATION will transfer its membership interest in COMPANY to its unitary subsidiary Controlled (i.e., the Contribution). For federal and state income tax purposes, this will be treated as a transfer of COMPANY'S assets to Controlled. The Contribution will be followed by the Distribution on the same day. As noted previously, the Contribution and Distribution will be a tax-free reorganization for federal income tax purposes pursuant to Internal Revenue Code Sections 355 and 368(a)(1)(D).

Illinois law should follow the tax-free treatment of the Contribution and Distribution. There is no provision in Illinois law, however, that would preclude the application of the addition and subtraction modifications required under 35 ILCS 5/203(b)(2)(E-11) and (b)(2)(U) upon the occurrence of the Contribution and subsequent Distribution. These sections apply, without exception, "[i]f the taxpayer sells, transfers, abandons, or otherwise disposes of property" for which the taxpayer was required to make modifications in any taxable year under 35 ILCS 5/203(b)(2)(E-10) and (b)(2)(T).

The taxpayer accordingly requests that the Department issue a ruling affirming that CORPORATION will be required to make the addition and subtraction modifications required under 35 ILCS 5/203(b)(2)(E-11) and (b)(2)(U) on its Illinois income tax return for the tax year in which the Contribution and subsequent Distribution occur. At this time, CORPORATION anticipates this to occur in QUARTER YEAR.

Your request includes the following supplemental information submitted to the Department on March 22, 2022:

Pursuant to your request, CORPORATION hereby submits this supplement to its request for a private letter ruling pursuant to 2 Ill. Admin. Code § 1200.110, previously submitted on January 14, 2022. In this supplement we are providing a representation that the Distribution satisfies the Business Purpose requirement of Treasury Regulation 1.355-2(b).

REPRESENTATIONS

- The Distribution was motivated by non-tax business purposes.
- The Distribution was motivated, in whole or in part, by the following business purposes:

  The Separation will enhance the fit and focus of both Distributing and Controlled across several critical criteria including, but not limited to, management focus, competition for capital, capital structure, management and employee compensation, and acquisition currency.

RULING

Section 203(e)(1) of the Illinois Income Tax Act ("IITA", 35 ILCS 5/101 et seq.), provides that for purposes of Section 203 a taxpayer's gross income, adjusted gross income, or taxable income for the taxable year shall mean the amount of gross income, adjusted gross income or taxable income properly reportable for

federal income tax purposes for the taxable year under the provisions of the Internal Revenue Code ("IRC"). This provision, which couples the Illinois tax base to the federal tax base, is complimented by three other rules. First, IITA Section 401 provides that a taxpayer's taxable year under the IITA is generally the same as the taxpayer's taxable year for federal income tax purposes. Second, IITA Section 402 states that a taxpayer's method of accounting under the IITA is the same as the taxpayer's method of accounting for federal income tax purposes. Finally, IITA Section 403 requires each taxpayer to take into account on his or her Illinois income tax return items of income, deduction and exclusion in the same manner as reflected on the taxpayer's federal income tax return. Primarily as a result of these provisions, transactions that are deemed to occur for federal income tax purposes, and the tax consequences that result from those deemed transactions, likewise are deemed to occur and apply for purposes of the IITA. In addition, pursuant to IITA Sections 102 and 1501(a)(4), 86 Ill. Admin. Code Section 100.9750(b)(1) provides that any entity treated as a corporation for federal income tax purposes must be treated as a corporation for all purposes of the IITA, and that no entity (other than a cooperative) that is not treated as a corporation for federal income tax purposes may be treated as a corporation for purposes of the IITA.

Pursuant to Section 203(b) of the IITA, a corporation computes its base income by starting with its federal taxable income and making various addition and subtraction modifications. Section 203(h) of the IITA provides:

> Except as expressly provided by this Section there shall be no modifications or limitations on the amounts of income, gain, loss or deduction taken into account in determining gross income, adjusted gross income or taxable income for federal income tax purposes for the taxable year, or in the amount of such items entering into the computation of base income and net income under this Act for such taxable year, whether in respect of property values as of August 1, 1969 or otherwise.

Pursuant to Section 203(b)(2)(E-10) of the IITA, a corporation is required to add back to its federal taxable income:

> For taxable years 2001 and thereafter, an amount equal to the bonus depreciation deduction on the taxpayer's federal income tax return for the taxable year under subsection (k) of Section 168 of the Internal Revenue Code.

Pursuant to Section 203(b)(2)(T) of the IITA, a corporation is then allowed to subtract:

> For taxable years 2001 and thereafter, for the taxable year in which the bonus depreciation deduction is taken on the taxpayer's federal income tax return under subsection (k) of Section 168 of the Internal Revenue

Code and for each applicable taxable year thereafter, an amount equal to "x", where:

1) "y" equals the amount of the depreciation deduction taken for the taxable year on the taxpayer's federal income tax return on property for which the bonus depreciation deduction was taken in any year under subsection (k) of Section 168 of the Internal Revenue Code, but not including the bonus depreciation deduction;

2) for taxable years ending on or before December 31, 2005, "x" equals "y" multiplied by 30 and then divided by 70 (or "y" multiplied by 0.429);

3) for taxable years ending after December 31, 2005:

   i. for property on which a bonus depreciation deduction of 30% of the adjusted basis was taken, "x" equals "y" multiplied by 30 and then divided by 70 (or "y" multiplied by 0.429);

   ii. for property on which a bonus depreciation deduction of 50% of the adjusted basis was taken, "x" equals "y" multiplied by 1.0;

   iii. for property on which a bonus depreciation deduction of 100% of the adjusted basis was taken in a taxable year ending on or after December 31, 2021, "x" equals the depreciation deduction that would be allowed on that property if the taxpayer had made the election under Section 168(k)(7) of the Internal Revenue Code to not claim bonus depreciation on that property; and

   iv. for property on which a bonus depreciation deduction of a percentage other than 30%, 50% or 100% of the adjusted basis was taken in a taxable year ending on or after December 31, 2021, "x" equals "y" multiplied by 100 times the percentage bonus depreciation on the property (that is, 100(bonus%)) and then divided by 100 times 1 minus the percentage bonus depreciation on the property (that is, 100(1-bonus%)).

The aggregate amount deducted under this subparagraph in all taxable years for any one piece of property may not exceed the amount of the bonus depreciation deduction taken on that property on the taxpayer's federal income tax return under subsection (k) of Section 168 of the

Internal Revenue Code. This subparagraph (T) is exempt from the provisions of Section 250.

In the case of a sale or other disposition of property with respect to which federal bonus depreciation deductions have been claimed, the IITA provides for both an addition and subtraction modification to federal taxable income. First, IITA Section 203(b)(2)(E-11) requires that the taxpayer make an addition modification equal to the aggregate amount of subtraction modifications taken in all taxable years with respect to the property under IITA Section 203(b)(2)(T). Second, IITA Section 203(b)(2)(U) allows a subtraction modification equal to the addition modification under IITA Section 203(b)(2)(E-10) previously claimed with respect to the property for the bonus depreciation. These two modifications reverse all the modifications made on the property prior to disposition, so that the amount of gain or loss recognized for federal income tax purposes on disposition reflects the correct gain or loss for Illinois purposes.

IRC Section 368(a)(1)(D) provides that the term "reorganization" means a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor, or one or more of its shareholders (including persons who were shareholders immediately before the transfer), or any combination thereof, is in control of the corporation to which the assets are transferred; but only if, in pursuance of the plan, stock or securities of the corporation to which the assets are transferred are distributed in a transaction which qualifies under IRC Section 354, 355, or 356. To qualify for IRC Section 368(a)(1)(D) tax deferral treatment, Treasury Regulation Section 1.368-1 provides that corporate reorganization must meet certain requirements such as continuity of business enterprise and valid business purpose.

IRC Section 355(a)(1) provides the general rule no gain or loss shall be recognized to (and no amount shall be includible in the income of) such shareholder or security holder on the receipt of stock or securities if a distributing corporation distributes to a shareholder, with respect to its stock, or distributes to a security holder, in exchange for its securities, solely stock or securities of a controlled corporation which it controls immediately before the distribution. Treasury Regulation Section 1.355-2(b) provides that IRC Section 355 applies to a transaction only if it is carried out for one or more corporate business purposes. A transaction is carried out for a corporate business purpose if it is motivated, in whole or substantial part, by one or more corporate business purposes.

Under the provisions of the IITA discussed above, where a corporate reorganization occurs for federal income tax purposes, it likewise is recognized for Illinois income tax purposes. Further, the transactions that are deemed to occur for federal purposes incident to the reorganization, and the tax consequences that result from those deemed transactions, are likewise deemed to occur, and apply for Illinois income tax purposes.

You represented in your ruling request letter the Internal Revenue Service (“IRS”) ruled the transactions you described will qualify as a “reorganization” within the meaning of IRC Section 368(a)(1)(D), and will qualify as tax-free transactions, federally. In their ruling, the IRS made no determination regarding whether the Distribution satisfied the business purpose requirement of Treasury Regulation 1.355-2(b). In your supplemental letter, you represented the Distribution satisfied the business purpose requirement of Treasury Regulation 1.355-2(b) and was motivated by non-tax business purposes.

IITA Sections 203(b)(2)(E-11) and (b)(2)(U) provide an addition and subtraction modification where property, with respect to bonus depreciation modifications have been required, is sold, transferred, abandoned, or otherwise disposed. Since a corporation that is reorganized under IRC Section 368(a)(1)(D) is deemed to have contributed all of its assets to the new corporation, the addition and subtraction modifications under IITA Section 203(b)(2)(E-11) and (b)(2)(U) apply. For the taxable year of its reorganization (i.e., Contribution and subsequent Distribution), CORPORATION must add back the aggregate amount of subtraction modifications claimed on property under IITA Section 203(b)(2)(T) and is permitted to subtract the amount of the addition modification claimed on property under IITA Section 203(b)(2)(E-10).

Except as provided herein, this ruling shall bind the Department for the taxable year ending MONTH DAY YEAR. The facts upon which this ruling is based are subject to review by the Department during the course of any audit, investigation or hearing and this ruling shall bind the Department only if the material facts as recited and incorporated in this ruling are correct and complete. This ruling shall bind the Department for the taxable year specified above, except as limited pursuant to 2 Ill. Admin. Code 1200.110(d) and (e). In addition, this ruling will cease to bind the Department if there is a pertinent change in statutory law, case law, rules or in the material facts recited in this ruling.

Sincerely,

Jennifer Uhles
Associate Counsel (Income Tax)