

Petition to include property and payroll apportionment factors in sales factor calculation cannot be granted merely because the alternative method reaches a different apportionment percentage than the required statutory formula.

March 10, 2025

NAME
COMPANY1
ADDRESS

EMAIL

Re: Petition for Alternative Apportionment
COMPANY2
FEIN: XX-XXXXXXX
Tax Years Ended: YEAR1, YEAR2, YEAR3

Dear :

This is in response to your October 15, 2024, petition on behalf of COMPANY2, to use an alternative method of allocation or apportionment effective for tax years ending YEAR1, YEAR2, and YEAR3. The nature of your request and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy, and is not binding on the Department. See 2 Ill. Adm. Code Section 1200.120(b) and (c), which may be found on the Department's website at <https://tax.illinois.gov/>. For the reasons discussed below, your petition cannot be granted based on the information provided.

Your petition states as follows:

COMPANY2 ("Petitioner") has authorized COMPANY1 to represent it before the State of Illinois with respect to its Illinois Corporation Income and Replacement Tax paid to the Illinois Department of Revenue ("Department"). A Power of Attorney authorizing COMPANY1 to act on behalf of the COMPANY2 as its representative is enclosed.

Petitioner respectfully submits the enclosed Petition for Alternative Allocation or Apportionment ("Petition") in accordance with Ill. Admin. Code tit. 86ILAC8100.3390. Petitioner respectfully requests an alternative apportionment method to fairly represent the market for its goods, services, and other sources of business income in Illinois and proposes two potential remedies to resolve. Amended Corporation Income and Replacement Tax Returns (Form IL-1120-X) are included in attachments.

In accordance with Ill. Admin. Code tit. 86ILAC§100.3390, copies of the Petition are filed with:

Illinois Department of Revenue
Post Office Box 19016
Springfield, Illinois 62794-9016

Illinois Department of Revenue
Legal Services Bureau/Income Tax
101 W. Jefferson Street
Springfield, Illinois 62702

If you have any questions regarding this filing, please contact the undersigned at the above address or by telephone PHONE, NAME at PHONE or NAME at PHONE.

I. INTRODUCTION AND ALTERNATIVE APPORTIONMENT REQUEST

COMPANY2 files this petition for relief from standard apportionment provisions (“Petition”) on the basis that the statutory apportionment provisions do not fairly represent the market for COMPANY2’s goods, services, or other sources of business income in Illinois pursuant to Ill. Admin. Code tit. 86, §§ 100.3380(a)(1), 100.3390, and 35ILCS5/304(f). COMPANY2 submits this Petition to the Illinois Department of Revenue (“Department”) for tax years ending YEAR1; YEAR2; and YEAR3. COMPANY2 reserves the right to amend and supplement this Petition.

As grounds for this Petition, COMPANY2 sets forth the following facts and analysis of pertinent facts, judicial, statutory, and administrative authority, and analysis. Unless otherwise specified, “35ILCS5/” refers to Illinois Code, Chapter 35 Revenue, Illinois Income Tax Act and “86ILAC100” refers to Illinois Administrative Code, Title 86 Revenue, Part 100 Income Tax.

86 Ill. Adm. Code §100.3390(a) provides that when the standard provisions do not fairly represent the market for the taxpayer’s goods, services, or other sources of business income, that taxpayer may petition to use other reasonable methods including but not limited to separate accounting, the exclusion of any one or more of the factors, the inclusion of one or more additional factors which fairly represent the person’s business activity in Illinois, or the employment of any other method to effectuate an equitable allocation and apportionment of the person’s income.

Further, 86 Ill. Adm. Code §100.3390(c) provides a departure from the required apportionment method is allowed only when those methods do not accurately and fairly reflect the market in Illinois. 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.

Illinois's single-sales factor method, as applied to COMPANY2, 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 or the taxpayer's market in Illinois. According to the U.S. Supreme Court, "the enterprise of a corporation which manufactures and sells its manufactured product is ordinarily a unitary business and all the factors in that enterprise are essential to the realization of profits".¹

In COMPANY2's case, the single-sales factor with throwback sales does not fairly represent the market for its goods, services, and other sources of business income in Illinois. Instead, Illinois's single-sales factor method as applied to COMPANY2 results in an unreasonable and arbitrary tax outcome because it does not fairly reflect COMPANY2's in-state business activities, as it does not include a property or payroll representation, on which the throwback methodology rests. As such, the standard formula does not fairly reflect COMPANY2's business activities or market in the state resulting in gross distortion; therefore, COMPANY2's income for Illinois tax purposes should be apportioned using an alternative method.

II. FACTS

Summary of Company Operations

COMPANY2 provides enabling technologies for industrial growth markets that require advanced technology and high reliability. These markets include aerospace and defense, factory automation, air and water quality environmental monitoring, electronics design and development, oceanographic research, deepwater oil and gas exploration and production, medical imaging, and pharmaceutical research.

COMPANY2's products include digital imaging sensors, cameras and systems within the visible, infrared and X-ray spectra, monitoring and control instrumentation for marine and environmental applications, harsh environment interconnects, electronic test and measurement equipment, aircraft information management systems, and defense electronics and satellite

¹ Hans Rees' Sons, Inc. v. State of North Carolina ex rel. Maxwell, 283 U.S. 123 (1931).

communication subsystems. COMPANY2 also supplies engineered systems for defense, space, environmental and energy applications.

COMPANY2 also differentiates itself from many of its direct competitors by having a customer- and Company-sponsored applied research center that augments its product development expertise.

COMPANY2 has four business segments, which are broadly discussed below:

- 1) Digital Imaging;
- 2) Instrumentation;
- 3) Aerospace and Defense Electronics; and
- 4) Engineered Systems

1) Digital Imaging:

The Digital Imaging segment includes high-performance sensors, cameras, and systems, within the visible, infrared, ultraviolet and X-ray spectra for use in industrial, scientific, government, space, defense, security, medical and other applications. COMPANY2 also produces and provides manufacturing services for micro electromechanical systems (“MEMS”) and high-performance, high-reliability semiconductors including analog-to-digital and digital-to-analog converters, as well as unmanned aerial and ground systems. This segment also includes its customer- and Company-sponsored applied research center.

2) Instrumentation:

The Instrumentation segment provides monitoring and control instruments for marine, environmental, industrial, and other applications, and electronic test and measurement equipment. This segment also provides power and communications connectivity devices for distributed instrumentation systems and sensor networks deployed in mission critical, harsh environments.

3) Aerospace and Defense Electronics:

The Aerospace and Defense Electronics segment provides sophisticated electronic components and subsystems, data acquisition and communications components and equipment, harsh environment interconnects, general aviation batteries and other components for a variety of commercial and defense applications that require high performance and high reliability. Such applications include aircraft, radar, electronic countermeasures, weapon systems, space, wireless and satellite communications and terminals and test equipment.

4) Engineered Systems:

The Engineered Systems segment provides innovative systems engineering, integration and advanced technology development, and complex manufacturing solutions for defense, space, environmental and energy applications. This segment also designs and manufactures electrochemical energy systems and manufactures specialty electronics for demanding military applications.²

In summary, COMPANY2 is a manufacturer comprising several companies operating in four primary segments.

Summary of Illinois Operations

COMPANY2 operates multiple companies that fall within the four business segments discussed above. Several of these companies report sales to Illinois, including, but not limited to: SUBSIDIARIES.

Two of these companies have manufacturing facilities located in Illinois, which produce and sell tangible personal products (“TPP”), resulting in Illinois throwback sales reported in the sales apportionment. These two companies are SUBSIDIARIES.

- 1) SUBSIDIARY serves defense, space and commercial sectors worldwide. It offers a comprehensive portfolio of highly engineered solutions that meet the most demanding requirements in the harshest environments. Manufacturing both custom and off-the-shelf product offerings, its diverse product lines meet emerging needs for key applications for avionics, energetics, electronic warfare, missiles, radar, satcom, space, and test and measurement.³

SUBSIDIARY includes several divisions⁴; however, only its SUBSIDIARY division has facilities and payroll located in Illinois. Thus, all of SUBSIDIARY’s Illinois throwback sales are made by SUBSIDIARY.

SUBSIDIARY is an industry leader in providing advanced cable assemblies and interconnect products around the globe and has a long and proud heritage serving domestic and overseas defense, space

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and telecom markets since YEAR.⁵ SUBSIDIARY is principally located within Illinois.⁶

In Illinois, SUBSIDIARY's activities include manufacturing facilities and employees involved in the manufacturing process. Sales are made from these Illinois manufacturing facilities to third parties in Illinois and elsewhere.

- 2) SUBSIDIARY is a leading manufacturer of advanced oscilloscopes, protocol analyzers, and other test instruments that verify performance, validate compliance, and debug complex electronic systems quickly and thoroughly. SUBSIDIARY has focused on incorporating powerful tools into innovative products that enhance PRODUCT. Faster PRODUCT enables users to rapidly find and fix defects in complex electronic systems, dramatically improving time-to-market for a wide variety of applications and end markets.⁷

SUBSIDIARY is comprised of different divisions. Its SUBSIDIARY division has facilities and payroll located in Illinois. All SUBSIDIARY's Illinois throwback sales are made by SUBSIDIARY.

SUBSIDIARY is a market leader in PRODUCTS as well as test tools for other digital video technologies.⁸

In Illinois, SUBSIDIARY's activities include manufacturing facilities and employees involved in the manufacturing process. Sales are made from these Illinois manufacturing facilities to third parties in Illinois and elsewhere.

In summary, COMPANY's activities and operations in Illinois are primarily manufacturing and selling TPP, with SUBSIDIARIES being the only entities with throwback sales to Illinois.

III. PETITION FOR ALTERNATIVE ALLOCATION OR APPORTIONMENT

The current single-sales factor operates unreasonably and arbitrarily to apportion income to Illinois out of all proportion to COMPANY2's market in

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WEBLINK

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Illinois. This results in significant gross distortion of COMPANY2's true economic activity and market within Illinois and results in the taxation of extraterritorial values.

Illinois's standard apportionment factor includes throwback sales, which represent sales of TPP shipped from Illinois to purchasers in another jurisdiction where the taxpayer is not taxable.

The inclusion of throwback sales within the Illinois standard apportionment factor does not fairly represent COMPANY2's market within Illinois as these sales represent another market outside Illinois. The inclusion of these throwback sales grossly distorts COMPANY2's true market within Illinois.

The following tables summarize COMPANY2's Combined Group's Illinois and Everywhere Sales, including Illinois sales with and without throwback.⁹

Table 1. Tax Year Ending	YEAR1	YEAR2	YEAR3
Illinois Sales without Throwback	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
Illinois Throwback Sales	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
Illinois Sales with Throwback	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
Everywhere Sales	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$

The Sales Factor based on Illinois sales with throwback (reported apportionment factor):

Table 2. Tax Year Ending	YEAR1	YEAR2	YEAR3	Average
Illinois Sales with Throwback	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	
Everywhere Sales	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	
Illinois Sales Factor	%%%%%%%%	%%%%%%%%	%%%%%%%%	%%%%%%%% %

The Sales Factor based on Illinois sales without throwback:

Table 3. Tax Year Ending	YEAR1	YEAR2	YEAR3	Average
Illinois Sales without Throwback	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	
Everywhere Sales	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	
Illinois Sales Factor without TB	%%%%%%%%	%%%%%%%%	%%%%%%%%	%%%%%%%%

⁹ Refer to Exhibit I for detailed breakout of Property, Payroll, and Sales per entity.

In comparing the Sales Factor with Throwback to Without Throwback, it is clear distortion is occurring. The table below shows the increase in sales due to throwback:

Table 4. Tax Year Ending	YEAR1	YEAR2	YEAR3	Average
Illinois Sales Factor with Throwback	%%%%%%%%	%%%%%%%%	%%%%%%%%	%%%%%%%%
Illinois Sales Factor without Throwback	%%%%%%%%	%%%%%%%%	%%%%%%%%	%%%%%%%%
Percentage Increase in Sales due to TB	%%%%%%%%	%%%%%%%%	%%%%%%%%	%%%%%%%%

This is further exemplified by the following tables showing the difference between COMPANY2's in-state market (Illinois) sales versus the inclusion of out-of-market throwback sales:

Table 5. Tax Year Ending	YEAR1	YEAR2	YEAR3	Average
Illinois Throwback Sales	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	
Illinois Sales with Throwback	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	
Percentage of Throwback Sales Included in Original Illinois Sales	%%%%%%%%	%%%%%%%%	%%%%%%%%	%%%%%%%%
Illinois Sales without Throwback	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	
Illinois Throwback Sales	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	
Percentage of Throwback Sales of the True Market Illinois Sales	%%%%%%%%	%%%%%%%%	%%%%%%%%	%%%%%%%%

One single-entity basis, the distortion is even more apparent. The following tables summarize SUBSIDIARIES's Illinois and Everywhere Sales, including Illinois sales with and without throwback.¹⁰

Table 6. Tax Year Ending:	YEAR1	YEAR2	YEAR3
SUBSIDIARY			
Illinois Sales without Throwback	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
Illinois Throwback Sales	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
Illinois Sales with Throwback	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
SUBSIDIARY			
Illinois Sales without Throwback	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$

¹⁰ Refer to Exhibit I for detailed breakout of Property, Payroll, and Sales per entity.

Illinois Throwback Sales	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
Illinois Sales with Throwback	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$

In comparing the Sales Factor with Throwback to Without Throwback, it is clear distortion is occurring. The tables below show the percentage increase in sales due to throwback:

Table 7. Tax Year Ending	YEAR1	YEAR2	YEAR3	Average
SUBSIDIARY				
Illinois Sales without Throwback	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	
Everywhere Sales	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	
Illinois Sales Factor without TB	%%%%%%%%	%%%%%%%%	%%%%%%%%	
Illinois Sales with Throwback	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	
Everywhere Sales	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	
Illinois Sales Factor with TB	%%%%%%%%	%%%%%%%%	%%%%%%%%	
Illinois Sales Factor without TB	%%%%%%%%	%%%%%%%%	%%%%%%%%	
Illinois Sales Factor with TB	%%%%%%%%	%%%%%%%%	%%%%%%%%	
Percentage Increase in Sales Factor due to Throwback	%%%%%%%%	%%%%%%%%	%%%%%%%%	%%%%%%%%
SUBSIDIARY				
Illinois Sales without Throwback	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	
Everywhere Sales	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	
Illinois Sales Factor without TB	%%%%%%%%	%%%%%%%%	%%%%%%%%	
Illinois Sales with Throwback	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	
Everywhere Sales	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	
Illinois Sales Factor with TB	%%%%%%%%	%%%%%%%%	%%%%%%%%	
Illinois Sales Factor without TB	%%%%%%%%	%%%%%%%%	%%%%%%%%	
Illinois Sales Factor with TB	%%%%%%%%	%%%%%%%%	%%%%%%%%	
Percentage Increase in Sales Factor due to Throwback	%%%%%%%%	%%%%%%%%	%%%%%%%%	%%%%%%%%

As evidenced in the tables above, COMPANY2's throwback sales result in distortion in its Illinois in-state market. On average, COMPANY2 as a whole sees %%%%%%%%% increase, SUBSIDIARY %%%%%%%%% increase, and

SUBSIDIARY % increase in the sales factor due to throwback sales.

COMPANY2 respectfully requests an alternative apportionment method to fairly represent the market for its goods, services, and other sources of business income in Illinois and proposes either of the following:

Remedy #1 – Three-Factor Apportionment (Equally Weighted Property, Payroll, and Sales)

COMPANY2’s first remedy proposes the inclusion of additional factors; specifically, property and payroll factors in apportioning business income utilizing three equally weighted factors comprising property, payroll, and sales (with throwback sales).

The property and payroll factors within Illinois are crucial components to COMPANY2’s economic activities within Illinois. The property factor measures the amount of capital located within Illinois and used to produce income. The payroll factor provides a measure of all varied types of activities carried on by COMPANY2’s employees to produce income. The combination of these factors along with COMPANY2’s sales represent necessary components to ascertain the true economic activity and market within Illinois.

The following table summarizes COMPANY2’s Illinois and Everywhere Property and Payroll.¹¹

Table 8. Tax Year	YEAR1	YEAR2	YEAR3	Average
Illinois Property	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	
Everywhere Property	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	
Illinois Property Factor	%%%%%%%%	%%%%%%%%	%%%%%%%%	%%%%%%%%
Illinois Payroll	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	
Everywhere Payroll	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	
Illinois Payroll Factor	%%%%%%%%	%%%%%%%%	%%%%%%%%	%%%%%%%%

¹¹ Refer to Exhibit I for detailed breakout of Property, Payroll, and Sales per entity.

Failure to include the property and payroll apportionment factors would **not** reflect COMPANY2's true market of income produced within Illinois.

The Illinois Apportionment Factor based on (Equally Weighted Property, Payroll, and Sales):

Table 9. Tax Year Ending	YEAR1	YEAR2	YEAR3	Average
Illinois Property Factor	%%%%%%%%%	%%%%%%%%%	%%%%%%%%%	%%%%%%%%%
Illinois Payroll Factor	%%%%%%%%%	%%%%%%%%%	%%%%%%%%%	%%%%%%%%%
Illinois Sales Factor with TB	%%%%%%%%%	%%%%%%%%%	%%%%%%%%%	%%%%%%%%%
Three Factor Apportionment	%%%%%%%%%	%%%%%%%%%	%%%%%%%%%	%%%%%%%%%

The table below shows the increase in originally reported sales factor over three factor apportionment:

Table 10. Tax Year Ending	YEAR1	YEAR2	YEAR3	Average
Illinois Three factor	%%%%%%%%%	%%%%%%%%%	%%%%%%%%%	%%%%%%%%%
Illinois Sales factor with TB	%%%%%%%%%	%%%%%%%%%	%%%%%%%%%	%%%%%%%%%
Percentage of Sales Factor Increase over Three Factor	%%%%%%%%%	%%%%%%%%%	%%%%%%%%%	%%%%%%%%%

If throwback sales are included to prevent the non-taxation of sales directed to states in which the taxpayer is not subject to tax, then property and payroll **must** be factored in as these are material requirements in producing those sales. The presence of substantial throwback sales operates as a quasi- property and payroll factor as the throwback is dependent upon these elements; therefore, it is reasonable to request that the property and payroll factors also be considered in determining the share of income attributable to Illinois.

Failing to do so results in significant gross distortion of COMPANY2's true economic activity and market within Illinois and results in the taxation of extraterritorial values. Therefore, the inclusion of property and payroll factors would result in a more equitable apportionment of COMPANY2's business income based on its true market within Illinois.

COMPANY2 encloses Amended Corporation Income and Replacement Tax Returns (Form IL-1120-X) and supporting schedules applying the proposed Three-Factor Apportionment in Exhibit II.

Remedy #2 – Single-Sales Factor Formula Without Throwback Sales

Alternatively, COMPANY2 proposes the removal of throwback sales from the standard apportionment factor in apportioning business income.

Based on the above, the inclusion of throwback sales as in-state sales results in gross distortion of COMPANY2's true market within Illinois and results in the taxation of extraterritorial values. As stated above, the purpose of throwback sales is to prevent the non-taxation of sales directed to states in which the taxpayer is not subject to tax. But this does not give license to apportion income out of all proportion to the activities in the state. Therefore, the removal of throwback sales would result in a more equitable apportionment of COMPANY2's business income based on its true market within Illinois.

COMPANY2 encloses Amended Corporation Income and Replacement Tax Returns (Form IL-1120-X) and supporting schedules applying the proposed Single-Sales Factor Formula Without Throwback Sales in Exhibit III.

IV. THE LAW

Illinois Statutory Apportionment/Distortion

Uniform Division of Income for Tax Purposes Act ("UDITPA")

UDITPA was approved by the National Commission on Uniform Laws as a Model Act in 1957. UDITPA Section 18 provides what equates to a pressure valve for statutory constitutionality. This provision provided for a variation when the statutory formula did not fairly reflect the extent of the taxpayer's business activity.

Although Illinois does not specifically adopt UDITPA, the State has generally incorporated its apportionment provisions, with certain exceptions, including the statutory shift to single-sales factor.

Illinois Standard Apportionment

Taxpayers that have taxable income from business activity both in and outside Illinois must assign the income among the taxing states. A taxpayer

must assign business income to Illinois and other states using a standard apportionment formula.¹²

Business income is broadly defined for Illinois income tax purposes as all income that may be treated as apportionable business income under the U.S. Constitution.¹³ COMPANY2 reported all income as business income for tax years ending YEAR1; YEAR2; and YEAR3. Therefore, COMPANY2's sales are classified as business income subject to apportionment.

Corporations must use the single-sales factor apportionment formula for business income.¹⁴ The Illinois apportionment formula sales factor measures the ratio of a taxpayer's total sales in Illinois to its total sales everywhere during the tax year.¹⁵

Illinois follows the destination test for the sourcing of income from the sales of TPP. Taxpayers must source sales of TPP to Illinois if the taxpayer delivers or ships the property to a purchaser in the state. This applies to sales of TPP, regardless of the F.O.B. (free on board) point or other conditions of sale.¹⁶

Throwback sales are included in the apportionment factor. Sales of TPP are apportioned to Illinois if the property is:

- 1) delivered or shipped to a purchaser within this State regardless of the f.o.b. point or other conditions of sale; or
- 2) shipped from an office, store, warehouse, factory or other place of storage in this State and the taxpayer is not taxable in the state of the purchaser.¹⁷

Illinois Alternative Apportionment

Illinois provides for a petition for an alternative apportionment method if the standard allocation and apportionment provisions do not fairly represent the market for the taxpayer's goods, service, or other sources of the taxpayer's business income in the state.¹⁸

¹² 35ILCS5/304; 35ILCS5/1501; 86ILAC100.3010

¹³ 35ILCS5/304; 35ILCS5/1501(a)(1); 86ILAC100.3010(a)(2).

¹⁴ 35ILCS5/304(h).

¹⁵ 35ILCS5/304(a)(3)(A); 86ILAC100.3370.

¹⁶ 35ILCS5/304(a)(3)(B); 86ILAC100.3370(c)(1).

¹⁷ 35ILCS5/304(a)(3)(B); 86ILAC100.3370(c)(1)&(2).

¹⁸ 35ILCS5/304(f); 86ILAC100.3380(a); 86ILAC100.3390(a).

An alternative apportionment method may not be invoked 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.¹⁹

Illinois's alternative apportionment methods include:

- 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 taxpayer's market in Illinois; or
- 4) The employment of any other method that will result in an equitable allocation and apportionment of the taxpayer's business income.²⁰

The party seeking to use an alternative apportionment method carries the burden of proof.²¹ That party must show by clear and convincing evidence that the standard apportionment formula²² results in the taxation of extraterritorial values or operates unreasonably and arbitrarily to apportion income to Illinois out of all proportion to the taxpayer's market in the state.²³

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 the market for the taxpayer's goods, services, or other sources of business income in this State.²⁴

¹⁹ 86ILAC100.3390(c).

²⁰ 86ILAC100.3390(a)(1)-(4).

²¹ 86ILAC100.3390(c).

²² A higher standard has been applied such that party requesting deviation must prove by "clear and cogent evidence" that the income attributed to the State is the standard applied by the U.S. Supreme Court in *Container Corp. of America v. Franchise Tax Bd*, 463 U.S. 159, 180 (1983)). In its decision, the U.S. Supreme Court espoused three-factor formula apportionment as the "benchmark against which other apportionment formulas are judged. All prior cases involving the evaluation of distortion relate to tax years in which the state allowed property and payroll in the apportionment factor. Illinois's shift to sales-only factor is reflective of the State's interest to reflect only the market portion of the previously described "benchmark" of apportionability. As such, the higher evidentiary standard should not be applied in these circumstances: By its nature, the State distorts the results by excluding from the apportionment factor property and payroll. Furthermore, the clear and convincing standard has not been equally applied to taxpayers and the Illinois Department of Revenue alike. That is, the decisions in these cases provide a form of agency deference that had been applied post *Chevron* doctrine has now been overturned by the U.S. Supreme Court in *Loper Bright Enterprises v. Raimondo*, 603 U.S.__(2024).

²³ 86ILAC100.3390(c).

²⁴ *Id.*.

Apportionment Constitutional Standard

The manner in which states tax individuals and businesses is constrained by constitutional provisions. In *Complete Auto Transit, Inc. v. Brady*, the U.S. Supreme Court outlines a four-part test for determining whether a tax is constitutional.²⁵ This four-part test requires that the taxpayer have substantial nexus with the state; that the tax has a relationship to the service provided in the state; that the tax not discriminate against interstate commerce; and that the tax be fairly apportioned. These tests have been further explained in subsequent case law. With regard to COMPANY2, the last three prongs are the most relevant. The second prong looks at the relationship between the tax and the benefits provided by the state. The Due Process Clause of the U.S. Constitution requires that the tax be “rationally related to ‘the values connected with the taxing State’.”²⁶

The third prong of the test requires that the tax not discriminate against interstate commerce. The Constitution gives the federal government the power to regulate commerce between the states. This has been interpreted by the courts to mean that states are not permitted to burden interstate commerce.

Finally, under the fourth prong, the tax must be fairly apportioned. The courts have focused heavily on the meaning of fairly apportioned since long before *Complete Auto*’s inclusion of the phrase in its test of constitutionality. The first broad judicial discussions of a fair apportionment began in 1920 with the tacit acknowledgement that a fair, if imperfect, methodology was required for states “faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders.”²⁷

Fair Apportionment

As early as the 1930’s, the results of an apportionment formula were overturned for not meeting this final prong in *Hans Rees’ Sons, Inc. v. North Carolina*.²⁸ That case established that an apportionment method is

²⁵ *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977).

²⁶ *Moorman Mfg. Co. v. Bair*, 437 U.S. 267 (1978) (quoting *Norfolk & Western R. Co. v. State Tax Comm’n*, 390 U.S. 317, 390 U.S. 325).

²⁷ *Underwood Typewriter Co. v. Chamberlain*, (1920) 254 U.S. 113, 120-121.

²⁸ *Hans Rees’ Sons, Inc. v. State of North Carolina ex rel. Maxwell*, 283 U.S. 123 (1931).

unconstitutional when it apportions income to a state “out of all appropriate proportion to the business transacted by the appellant in that State.”²⁹

The U.S. Supreme Court noted that providing sufficient evidence was of key importance, when it stated:

“Evidence which was found to be lacking in the Underwood and Bass cases is present here. These decisions are not authority for the conclusion that where a corporation manufactures in one State and sells in another, **the net profits of the entire transaction, as a unitary enterprise, may be attributed, regardless of evidence, to either State.**”³⁰ [Emphasis Added]

In that case, the taxpayer had made painstaking efforts to demonstrate that the profit that was being taxed resulted from activities and equipment in another state. “The petitioner also offered evidence to the effect that the income from the business was derived from three sources, to-wit: (1) buying profit; (2) manufacturing profit; (3) selling profit.”³¹ The Court described the results as more than 250 percent difference from the statutory formula.³² This demonstration of value and profit analysis seems to be persuasive evidence to show by clear and cogent evidence that the statutory factor results in apportionment of income out of all proportion to the income earned in a state.

V. ANALYSIS

As mentioned above, COMPANY2 reported all income as business income for tax years ending YEAR1; YEAR2; and YEAR3, and its sales are classified as business income subject to apportionment.

COMPANY2 has provided sufficient documentation to demonstrate the sales factor does not fairly reflect the market for its goods or services. The fair reflection of income from the sale of TPP requires the inclusion of property and payroll factors to accurately represent the market. Relying solely on a single-sales factor **with throwback sales** considers sales of goods to customers but also by the nature of throwback, includes, but does not recognize the payroll and property which is used in the origination jurisdiction to determine throwback; nor does it recognize all the necessary economic

²⁹ Id.

³⁰ Id. (Referencing Bass, Ratcliff & Gretton, Ltd. v State Tax Comm’n, 266 U.S. 271 (1924)).

³¹ Id.

³² Id.

activities and operations to derive sales of TPP, such as production, manufacturing, and distribution, among others.

COMPANY2's business activities in Illinois for SUBSIDIARIES are primarily property relating to manufacturing facilities, payroll in the form of salaries and wages to employees involved in the manufacturing process, and sales to third parties both within Illinois and from throwback sales. The throwback is determined by origin of the sales, **not**, the market for the sale. It is contradictory not to include the factors (payroll and property) in an apportionment factor which depends on both of these elements to determine throwback.

Historically, manufacturing contributions to business activities were traditionally reflected within the property and payroll factors. Hans Rees Sons reminded us that items manufactured in one state (reflected in the property factor) and sold into another (reflected in the sales factor) require evidence of income in one business activity or the other in order to establish unfair apportionment.

As evidenced in the tables above, the average percentage increase in sales due to throwback is %%% greater than without for COMPANY2 as a whole, %%% for SUBSIDIARY, and %%% for SUBSIDIARY. While in Hans Rees, the Court did not establish a specific percentage as a constitutional rule, the increased percentages above for COMPANY2 as a whole is close to the %%% noted in Hans Rees and the increased for SUBSIDIARIES vastly exceed this amount. The result is clearly shown as distortive for COMPANY2.

It should be understood that manufacturing activities are sufficiently qualitatively different than other types of activities, such as those from service companies, to allow for an inquiry as to whether distortion exists in fact. In COMPANY2's case, that difference is enhanced, as these two divisions operate as both manufacturers and distributors of their produced goods.

A sales-only apportionment factor with throwback sales does not reasonably approximate the market of a manufacturing business as the manner in which they generate income is qualitatively unique and requires commensurate factor reflection with the business apportionment. In this case we have shown the distortion created by including throwback sales in the factor without including the elements creating the throwback.

VI. CONCLUSION

Illinois law permits taxpayers to petition for the use of an alternative apportionment when the statutory apportionment calculation does not fairly reflect the market within the state. As illustrated above and in the attached exhibits, the single-sales factor apportionment formula as applied to COMPANY2 does fairly [sic] reflect the market activities as a result of their Illinois operations.

As a result, COMPANY2 requests either (1) the inclusion of the payroll and property factors with the sales factor in a three-factor, equally-weighted apportionment or (2) the removal of throwback sales from the single-sales apportionment factor to more accurately reflect how income is earned in the business and to remedy the distortion caused by the use of the standard apportionment method (single-sales factor with throwback). To the extent of tax years open under the statute of limitation, COMPANY2 requests a refund of tax determined to be overpaid with the requested remedy applied.

In summary and for the reasons outlined in its Petition, COMPANY2 requests and should be granted the use of an alternative apportionment formula that fairly reflects all of its economic activities and market in Illinois.

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 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 provides:

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.

Taxpayers who wish to use an alternative method of apportionment under IITA Section 304(f) 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).

Your petition indicates that the single-sales factor apportionment formula as applied to COMPANY2 does not fairly reflect the market activities as a result of their Illinois operations. You indicate that property and payroll apportionment factors must be included as these are material requirements in producing those sales. In addition, you indicate it is

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reasonable to request those factors to be considered in the determination of the share of income attributable to Illinois as failing to do so would result in a significant gross distortion of COMPANY2's true economic activity and market within Illinois. Alternatively, your petition proposes the removal of throwback sales from the standard apportionment formula would result in a more equitable apportionment as the inclusion of these sales results in gross distortion of COMPANY2's true market within Illinois.

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) and of subsection (h) 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 petition merely states that due to the statutory exclusion of the property and payroll apportionment factors, an evenly weighted three-factor formula consisting of property, payroll, and sales reaches a different apportionment percentage than the required statutory formula. The petition indicates that using an evenly weighted three-factor formula is expected to result in a smaller Illinois apportionment factor. 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. In addition, the alternative proposal to exclude throwback sales does not address the first problem you identify, which is the statutory apportionment formula's failure to reflect the taxpayer's activities in Illinois. To the contrary, to the extent the throwback rule reflects the taxpayer's activities in Illinois, excluding throwback sales will exacerbate this problem.

Accordingly, your petition for alternative apportionment for tax years ended YEAR1; YEAR2; and YEAR3 cannot be granted. However, if you have additional information related to this request that was not previously submitted, you may supplement your petition and the Department 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. In addition, each Private Letter Ruling request submitted to the Department for consideration must include certain information outlined in 2 Ill. Adm. Code Section 1200.110.

As stated above, this is a General Information Letter. A General Information Letter does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department.

Sincerely,

COMPANY2
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Jennifer Uhles
Associate Counsel (Income Tax)

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