

Apportionment of separate businesses under 86 Ill. Adm. Code Section 100.3010(b) does not require petition for alternative apportionment. (This is a GIL.)

March 17, 2025

NAME
COMPANY1
ADDRESS1
EMAIL

Re: Petition for Alternative Apportionment
COMPANY2
FEIN: #####
Tax Year Ended: YEAR1

Dear NAME:

This is in response to your February 7, 2025, petition on behalf of COMPANY2 to use an alternative method of allocation or apportionment effective for tax year ending YEAR1 and subsequent tax years. 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.

Your petition for the YEAR1 tax year ended states as follows:

Request

The taxpayer would like to request the use of separate accounting as an alternative apportionment method to report Illinois taxable income/loss on Illinois Partnership Tax Return (Form IL-1065) for tax period YEAR1 and after for COMPANY2 (taxpayer). Pursuant to 86ILAC100.3390(a)(1) the use of separate accounting will more clearly reflect the taxable income/loss attributable to Illinois.

Background

COMPANY2 was formed in STATE1 DATE1 At this time the taxpayer owned one office building in CITY1, STATE1. The next year (YEAR2) the taxpayer purchased NUMBER1 additional office buildings including one in STATE2. As time went by the taxpayer grew and expanded the rental activities to other states. In YEAR3 the taxpayer owned NUMBER2 total office buildings in STATE1, STATE2, STATE3, and STATE4. The taxpayer's primary line of business has been rental real estate until YEAR4. In YEAR4 the taxpayer

purchased a hotel in STATE2 with rental real estate remaining the primary activity.

The first (and only) building purchased in Illinois was on DATE2 located at ADDRESS2 in CITY2.

In YEAR5, the taxpayer started a separate trade or business of providing business loans. At this time the taxpayer owned NUMBER3 office buildings in STATE1, STATE2, STATE4, Illinois, and STATE5; a lending business in STATE1; and a hotel in STATE2.

In YEAR6 the taxpayer acquired a large oil and gas business in STATE2. This business has been producing a significant amount of income in STATE2 and has considerably increased the taxpayer's gross revenue and taxable income. In YEAR7 the taxpayer acquired a new oil and gas business in STATE1 which also produces a significant amount of gross revenue and taxable income.

The taxpayer sold their hotel in STATE2 in YEAR7 and has a significant gain from this sale. Current business operations include owning and leasing NUMBER4 office buildings in various states, a lending business in STATE1, and oil and gas ventures in STATE2 and STATE1.

Illinois Standard Apportionment Law

Illinois uses the single sales factor apportionment formulas as provided in 86ILAC100.3500(b)(2). This method calculates percentage of sales in Illinois by taking total sales in Illinois (numerator) over total sales everywhere (denominator). The calculated percentage is used to multiply the Federal taxable income/loss adjusted for Illinois applicable items to get Illinois taxable income/loss.

YEAR6 Sales Formula results:

- In YEAR6 gross receipts in Illinois were \$\$\$ from the rental of real estate located in Illinois
- Total receipts from all activities everywhere were \$\$\$
- This results in an apportionment factor for Illinois of %%%
- The federal taxable income for YEAR6 for all activities was \$\$\$
- Illinois taxable income was \$\$\$ (YEAR6)

YEAR8 Sales Formula results:

- In YEAR8 gross receipts in Illinois were \$\$\$ from the rental of real estate located in Illinois
- Total receipts from all activities everywhere were \$\$\$
- This results in an apportionment factor for Illinois of %%%
- The federal taxable income for YEAR8 for all activities was \$\$\$
- Illinois taxable income was \$\$\$ (YEAR8)

YEAR7 Sales Formula results:

- In YEAR7 gross receipts in Illinois were \$\$\$ from the rental of real estate located in Illinois
- Total receipts from all activities everywhere estimated \$\$\$
- This results in an apportionment factor for Illinois of %%%
- The federal taxable income for YEAR7 for all activities was \$\$\$ (excluding the Excess Business Interest – Other Deduction)
- Illinois taxable income using the standard apportionment was \$\$\$ (YEAR7)

The taxpayer has used the standard apportionment method since the initial purchase of an Illinois property in YEARS

Fair Apportionment Under Due Process and Commerce Clause, U.S. Constitution

The U.S. Supreme Court has held that a state must apply its tax on interstate commerce by fairly determining the apportionment or allocation formula and not discriminate against interstate commerce. An apportionment formula is fair under both the Due Process Clause and Commerce Clause if it satisfies the standards of both the internal and external consistency tests.

Internal consistency requires that if the formula were applied to every jurisdiction, it would result in no more than 100% of the taxpayer's unitary income being subject to tax. External consistency requires the apportionment factor, or factors must actually reflect the reasonable sense of how income is generated within the state.

Most states have adopted statutes imposing a standard apportionment methodology applicable to taxpayers that file a corporate income tax return, unless the taxpayer operates in a specialized industry (e.g. airlines), in which case a specialized apportionment methodology may be applicable. Because the standard apportionment methodology may not accurately reflect how income is attributable to a specific state for all taxpayers, state apportionment statutes typically provide that a taxpayer may request, or a

taxing authority may require, the use of an apportionment methodology deviating from the statutory methodology, or an “alternate methodology”.

Illinois Alternative Apportionment Law

Illinois provides that, if the allocation and apportionment provisions of IITA Section 304(a) through (e) do not fairly represent the extent of the person’s business activity in this State, or do not fairly represent the market for the person’s goods, services or other sources of business income, the person may petition the Director and request an alternative apportionment formula. The taxpayer respectfully requests the Illinois Director to grant permission to use the separate accounting method under 86ILAC100.3390(a)(1). The facts and circumstances of our request to follow.

Facts

The initial Illinois income tax return was filed for COMPANY2 in YEAR4. The taxpayer purchased one office building in Illinois in YEAR4 and at the time owned NUMBER5 total office buildings in various states. The apportionment percent in the initial year was %%% with an overall federal taxable loss. As the taxpayer has diversified its operations and expanded into oil and gas and financing activities outside of Illinois, the Illinois apportionment factor has become skewed and no longer a fair representation of the Illinois activities. Under the standard single sales factor, the taxpayer is subject to tax on more than 100% of its income/loss in violation of the internal consistency requirement.

Further, it does not meet the external consistency requirement as the single sales factor Illinois taxable loss is greater or equal to total Illinois sales. It distorts the Illinois source income as it does not allow for any of the Illinois business expenses or deductions as a consequence of apportioning all the income from the out of state activities of oil and gas productions and financing in STATE2, STATE1, and other states outside of Illinois. The taxpayer has a separate general ledger for each property/business venture and is able to track the income/losses attributable to each property in each separate state.

Support and Analysis

The taxpayer is providing support with this letter to demonstrate how the single sales factor apportionment method is not a fair representation for the business activity in Illinois.

The taxpayer's gross receipts in Illinois have increased slightly over the past YEARS but the income apportioned to the state has increased. The first set of support and analysis are listed in the bullet points below.

- Gross income comparison for tax years YEARS.
- The gross income for all YEARS is categorized into different types of businesses and different states.
- In YEARS, the total gross income everywhere increased from \$\$\$ to \$\$\$\$. In YEAR7 total gross income increased to \$\$\$.
- The large increase was due to the oil and gas sales in STATE2 when comparing YEARS, the oil and gas sales was \$\$\$ and YEAR8 was \$\$\$.
- Federal taxable income in YEAR6 was \$\$\$ and YEAR8 was \$\$\$\$. This increase is due to the oil and gas operations in STATE2. In YEAR7, federal taxable income was \$\$\$.

The second set of support and analysis are listed in the bullet points below.

- Included are income statements for the property located in Illinois for taxable years YEARS. The income statements accurately report the taxable loss for the Illinois rental property.
- For YEARS, if separate accounting method was used, Illinois would have had taxable losses of \$(\$\$\$) and \$(\$\$\$) respectively. The use of separate accounting accurately and fairly represents the taxpayer's business activity in Illinois.
- Separate accounting was used on the YEAR7 Form IL-1065 to report the taxable loss \$(\$\$\$). The return has not yet been amended.

Conclusion

COMPANY2 is primarily a rental real estate entity with properties located in NUMBER6 states. This has been its main source of income from YEARS. In YEAR6 the oil and gas venture acquired in STATE2 significantly increased overall income and profits. The income earned from the oil and gas activity has skewed Illinois taxable income when the single sales factor apportionment methodology is utilized. Due to the taxpayer effectively reporting profit and loss by each rental property located in each separate state and by separately reporting the oil and gas income from STATE2, financing activities from STATE1, and each line of business by states, the taxpayer can more accurately report the income/loss in Illinois using the separate accounting method.

Based on the facts, analysis and explanation presented the single sales factor apportionment is not a fair and accurate method that represents

COMPANY2's activity in Illinois. The single sales factor method does not accurately apportion the income to the state where the taxpayer's income-producing activities occur, i.e. accurately report the Illinois rental income from the properties located in Illinois. It results in the taxpayer paying tax in a state where there is not taxable income and appears to violate the Commerce Clause and Due Process Clause. Therefore, the taxpayer requests the use of an alternate apportionment methodology, the use of separate accounting method, to calculate Illinois taxable income/loss, Form IL-1065 for years ending YEAR1

To conclude, the taxpayer respectfully requests the Illinois Director to grant permission to use the separate accounting method under 86ILAC100.3390(a)(1).

I confirm that these statements are made under the penalties of perjury and to the best of my knowledge and belief are true, correct, and complete.

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.

IITA Section 304(f) 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 to 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. 86 Ill. Adm. Code Section 100.3390(c) provides:

A departure from the required apportionment method is allowed only where such methods do not accurately and fairly reflect business activity in Illinois. 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 cogent evidence that the statutory formula results in the taxation of extraterritorial values and operates unreasonably and arbitrarily in attributing to Illinois a percentage of income which is out of all proportion to the business transacted in this State. 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.

In applying IITA Section 304(a), 86 Ill. Adm. Code Sections 100.3010(b)(1) and (2) provide that when a taxpayer conducts two or more separate businesses, the business income of each such business must be separately apportioned:

A person may have more than one "trade or business". In such cases, it is necessary to determine the business income attributable to each separate trade or business. In the case of a person other than a resident, the income of each business is then apportioned by a formula that takes into consideration the instate and outstate factors relating to the trade or business the income of which is being apportioned.

Example: The person is a corporation with three operating divisions. One division is engaged in manufacturing aerospace items for the federal government. Another division is engaged in growing tobacco products. The

third division produces and distributes motion pictures for theaters and television. Each division operates independently; there is no strong central management. Each division operates in this State as well as in other states. In this case, it is fair to conclude that the corporation is engaged in three separate “trades or businesses”. Accordingly, the amount of business income attributable to the corporation’s trade or business activities in this State is determined by applying an apportionment formula to the business income of each business.

Your petition for alternative apportionment appears to be based on the position that the rental properties, the financing activities, and the oil and gas business are separate trades or businesses. Assuming that position is correct, then 86 Ill. Adm. Code Section 100.3010(b)(1) provides for the business income of each such trade or business to be apportioned separately. It is not necessary to file a petition for alternative apportionment in order to apply the provisions of 86 Ill. Adm. Code Section 100.3010(b)(1). (See also IT 17-0006-GIL.) This will likely produce either the result you are seeking in your petition or a result that you will not consider to be grossly distorted.

This letter does not constitute a determination that the separate activities described in your petition in fact constitute separate businesses. You must make that determination applying the rules set forth in 86 Ill. Adm. Code Section 100.3010(b)(3). If in applying those rules you determine that the operations constitute a single unitary business, then the income from each property must be combined and apportioned applying IITA Section 304(a) to the activities as a single business. In order to obtain an alternative apportionment ruling, you must satisfy the burden of proof set forth in 86 Ill. Adm. Code Section 100.3390(c).

Alternatively, if the businesses are unitary, you have not presented evidence sufficient to allow the Department to grant your request. In order to make a determination under IITA Section 304(f) as to whether or not the apportionment provisions of subsections (a) through (e) and of subsection (h) reflect the market for the person’s goods, services, or other sources of business income, it is necessary that the taxpayer first determine its apportionment under such sections. If the apportionment under such sections does not fairly reflect the taxpayer’s market, then an alternative apportionment method may be permitted. Your request does not indicate whether the taxpayer has determined its apportionment under IITA Section 304 for the tax year ended YEAR1. Your request contains no information relative to the market for the taxpayer’s goods and services, nor does it contain information by which a determination can be made as to whether the apportionment resulting under IITA Section 304 fails to fairly reflect that market. Your request contains no evidence that the statutory apportionment formula for tax year ended YEAR1 does not fairly

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represent the extent of the taxpayer's business activities in Illinois or that the proposed alternative method of separate accounting does produce a reasonable result. Further, your petition includes sales formula information for tax years ended YEARS, reflecting a consistent Illinois apportionment factor with total gross income increasing for each tax year, but your petition fails to include sales formula information for tax year ended YEAR1.

The facts stated in your petition are not sufficient to satisfy the burden set forth in 86 Ill. Adm. Code Section 100.3390(c). 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. Because your request merely states that separate accounting for the taxpayer's Illinois income more accurately reflects its Illinois activity, your petition for alternative apportionment does not meet the regulatory requirement and cannot be granted at this time.

Accordingly, your petition for alternative apportionment for tax year ended YEAR1 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,

Jennifer Uhles
Associate Counsel

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