IT 08-0005-GIL 01/29/2008 ALTERNATIVE APPORTIONMENT

> General Information Letter: Petition for alternative apportionment was not granted because petitioner appeared to have misunderstood the statutory method for apportioning income flowed through from a partnership.

January 29, 2008

Dear:

This is in response to your letter dated December 31, 2007 in which you request permission to use an alternative method of allocation or apportionment. Department of Revenue ("Department") regulations require that the Department issue only two types of letter rulings, Private Letter Rulings ("PLRs") and General Information Letters ("GILs"). PLRs are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding against the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. GILs do not constitute statements of Department policy that apply, interpret or prescribe the tax laws and are not binding against the Department. See 2 Ill. Adm. Code 100.1200(b) and (c).

Although a ruling granting an alternative allocation or apportionment has been requested, because the petition fails to sustain the burden of proof required under 86 Ill. Adm. Code 100.3390 the Department must respond by GIL denying the petition.

In your letter you have stated as follows:

> I am writing to request the use of an alternative apportionment formula for the above referenced taxpayer. The entity invests in residential real estate properties in various states and receives K-1s to reflect activity. It has been determined that using the standard apportionment formula does not fairly represent the activity attributable to properties located within the state of Illinois as gross rents are not represented on the K-1s received from the various properties' returns. We are requesting the following alternative method; summarizing the activity from K-1s of property located within the state of Illinois and overriding the apportionment to reflect the correct income/losses generated from the Illinois activities.

RULING

Illinois Income Tax Regulations Section 100.3390 (86 Ill. Adm. Code 100.3390) allows a taxpayer to petition the Department for use of an alternative apportionment formula where the allocation and apportionment provisions of IITA Section 304(a) through (e) do not fairly represent the extent of the taxpayer's business activity in Illinois.

Regulations Section 100.3390(c) sets forth a taxpayer's burden of proof.

> Burden of Proof. 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 the 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 addition, Regulations Section 100.3390(d) states:

> A petition will be summarily rejected if its sole basis for support rests on the fact that an alternative method reaches a different apportionment percentage that the required statutory formula.

In this case, the petition states that "the standard apportionment formula does not fairly represent the activity attributable to properties located within the state of Illinois as gross rents are not represented on the K-1s received from the various properties' returns." It is inferred from the above statement that the income-generating properties in this case are held by either partnerships or S corporations, and that the income the subject of your petition is COMPANY's distributive share items. Unless COMPANY is engaged in a unitary business with the partnership or S corporation that holds the property, the apportionment of its distributive share income is prescribed under either Illinois Income Tax Act Section 305 or Section 308. 35 ILCS 5/305, 5/308. Section 305 states in pertinent part:

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

Section 308 states:

> (a) Allocation of Subchapter S corporation business income by shareholders other than residents. The respective shares of shareholders other than residents in so much of the business income of the Subchapter S corporation as is allocated or apportioned to this State in the hands of the Subchapter S corporation shall be taken into account by such shareholder pro rata in accordance with the requirements of Section 1366 of the Internal Revenue Code for the Subchapter S corporation's taxable year and allocated to this State.
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> (b) Allocation of Subchapter S corporation nonbusiness income by shareholders other than residents. The respective share of shareholders other than residents in the items of

> Subchapter S corporation income and deduction not taken into account in computing the business income of the Subchapter S corporation shall be taken into account by such shareholders pro rata in accordance with the requirements of Section 1366 of the Internal Revenue Code for the corporation's taxable year, and allocated as if such items had been paid, incurred, or accrued directly to such shareholders in their separate capacities.

As these sections indicate, the distributive share of a partnership's or S corporation's business income is apportioned to Illinois by the partner or shareholder to the extent that such income is apportioned to Illinois in the hands of the partnership or S corporation. Accordingly, unless COMPANY is engaged in a unitary business with the partnership or S corporation owning the income-producing property, COMPANY does not compute an apportionment formula for such income using the gross rents of the partnership or S corporation. Compare 86 Ill. Adm. Code 100.3380(d). Instead, COMPANY should include in its business income apportionable to Illinois its distributive share of income that is apportioned to Illinois by the partnership or S corporation.

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. If you wish to obtain a PLR which will bind the Department, please submit a request conforming to the requirements of 2 Ill. Adm. Code 100.1200 and 86 Ill. Adm. Code 100.3390.

Sincerely,

Brian L. Stocker
Associate Counsel (Income Tax)