

General Information Letter: The Northwest Ordinance does not require or allow the subtraction of income attributable to transportation on the Great Lakes from base income.

July 10, 2009

Dear:

This is in response to your letter dated November 25, 2008 that has been forwarded to the Legal Division for a response. Your letter states the following:

We are responding to your notice dated November 18, 2008 (copy enclosed), with regards to the above-referenced corporation income and replacement tax return. Your notice indicates that you have eliminated our Other subtractions (Schedule M, Line 23) for “net maritime revenues outside state jurisdiction” because this is not an acceptable subtraction. We disagree with your change for the reasons explained below.

Our affiliated companies COMPANY1, COMPANY2, and COMPANY3 are engaged in the business of maritime freight transportation by ship on the waters of the Great Lakes. This activity began on MONTH DAY, 2004, as a result of a corporate acquisition. COMPANY1 also was engaged before and after that date in the business of transporting freight by rail.

The companies determine their maritime shipping revenues and expenses by separate accounting in their books and records. The amount of the subtractions by COMPANY1 and by COMPANY2 for “net maritime revenues outside state jurisdiction” represents these affiliates’ net revenues over expenses derived from maritime shipping on the waters of the Great Lakes. The return also includes an addition by COMPANY3 for “net maritime loss outside state jurisdiction,” which represents the excess of expenses over revenues derived by this affiliate from maritime shipping on the waters of the Great Lakes. In addition, the movement of freight by ship on the Great Lakes has been excluded from the determination of the revenue-mile apportionment factors reported on Part IV, Schedule UB, of the return.

Jurisdiction by the state of Illinois to tax navigation on the Great Lakes is precluded by the acts of Congress which authorized the establishment of the state. In an enabling act of April 18, 1818, Congress authorized the people of the Illinois territory to form a constitution and state government, “...Provided, That the same, whenever formed, shall be republican, and not repugnant to the ordinance of the thirteenth of July, seventeen hundred and eighty-seven, between the original states and the people and states of the territory north-west of the river Ohio ...” (3 U.S. Statutes at Large p. 428) The referenced ordinance, the so-called Northwest Ordinance, made provisions for the government of the said territory, including that which would become the state of Illinois. The ordinance declared in part: “...That the following articles shall be considered as articles of compact between the original states and the people and states in the said territory, and forever remain unalterable, unless by common consent, to wit: ... [Article 4] ... The navigable waters leading into the Mississippi and St. Lawrence, and the carrying places between the same shall be common highways, and forever free, as well to the inhabitants of the said territory, as to the citizens of the United States, and those of any other states that may be admitted into the confederacy, without any tax, impost or duty therefore. [Article 5] ... [S]uch state shall be admitted by its delegates into the Congress of the United States, on an equal footing with the original states in all respects whatever; and shall be at liberty to form a permanent constitution and state government; Provided the constitution and

government so to be formed, shall be republican, and in conformity to the principles contained in these articles..." (Continental Congress, Ordinance of July 13, 1787, emphasis added)

The Great Lakes, being encompassed by "the navigable waters leading into the Mississippi and St. Lawrence," must therefore remain free from taxation, and the state of Illinois is not authorized to levy a tax on income earned from navigation on the Great Lakes. (See *United States Steel Corporation v. Commissioner of Taxation*, 840 Minnesota Board of Tax Appeals, December 28, 1964, for an equivalent finding with respect to the state of Minnesota.)

I have also attached copies of our BANK EFT payment confirmations and a copy of the first 3 pages of our 2006 IL return, which shows the amount of the overpayment credited from 2006 to 2007. The sum of these payments is \$7,593,233 (as per our filed 2007 IL return) whereas your notice shows payments of \$7,592,430. This is a difference of \$803. Please provide us with an explanation as to what this \$803 difference is.

In light of the above, the Great Lakes maritime shipping income is properly excluded from Illinois taxable income as an Other Subtraction. In addition, we feel that the payments shown on our return are correct. As such, we respectfully request that you adjust your records accordingly with respect to the above return and accept our return as filed.

According to the Department of Revenue ("Department") regulations, the Department may issue only two types of letter rulings: Private Letter Rulings ("PLR") and General Information Letters ("GIL"). The regulations explaining these two types of rulings issued by the Department can be found in 2 Ill.Adm.Code §1200, or on the website <http://www.tax.illinois.gov/LegallInformation/regs/part1200>.

Due to the nature of your inquiry and the information presented in your letter, we are required to respond with a GIL. GILs are designed to provide background information on specific topics. GILs, however, are not binding on the Department.

You use the Northwest Ordinance dated April 18, 1818 to support the subtraction of the "net maritime revenues outside state jurisdiction." The Ordinance states "[t]he navigable waters leading into the Mississippi and St. Lawrence, and the carrying places between the same, shall be common highways, and forever free, ... without any tax, impost, or duty therefore." In support of your position that Illinois is not authorized to levy a tax on income earned from navigation on the Great Lakes because of the language in the Northwest Ordinance, you cite the 1964 Minnesota Board of Tax Appeals Decision, *United States Steel Corporation v. Commissioner of Taxation*. In that case the Board held that to include income from business activities relating to navigation of the Great Lakes in the measure of a tax was objectionable because the "navigation clause, the terms of which have been **accepted by Minnesota and carried over into its Constitution**, prevent such a tax without the consent of Congress. There have been no court decisions allowing such navigation income to be taxed and no enactment by Congress similar to its action concerning the taxation of interstate commerce ..." (emphasis added). Article II, Section 3 of the Minnesota Constitution of 1857 reads as follows: "The propositions contained in the act of Congress entitled, 'An act to authorize the people of the Territory of Minnesota to form a constitution and state government, preparatory to their admission into the Union on equal footing with the original states,' are hereby **accepted, ratified and confirmed**, and shall remain irrevocable without the consent of the United States; ..." (emphasis added).

The distinguishing factor between Minnesota and Illinois is that Illinois has not “accepted, ratified and confirmed” the Northwest Ordinance in its Constitution or elsewhere. There has been no Illinois act of Congress to exempt from taxation business activities relating to the navigation of the Great Lakes. The applicability of the Northwest Ordinance has been addressed in other cases such as *American Barge Line Co. v. Koontz*, 136 W. Va 474, 68 W.E. 2d 56 (Supreme Court of Appeals, 1951):

The next question relates to the applicability of the **Northwest Ordinance** of 1787. It has been repeatedly stated that after the admission of a state into the Union such ordinance is no longer of any force. The ordinance of 1787 ‘was itself superseded by the adoption of the Constitution of the United States, which placed all the State of the Union upon a perfect equality, which they would not be if the Ordinance continued to be in force after its adoption.’ *Strader v. Graham*, 10 Howard 82, 13 L.Ed. 337. In the case of *Escanaba & L. M. Transp. Co. V. Chicago*, 107 U.S. 678, 688, 2 S.Ct. 185, 193, 27 L.Ed. 442, the Supreme Court of the United States used the following language: ‘The ordinance was passed July 13, 1787, one year and nearly eight months before the Constitution took effect; and although it appears to have been treated afterwards as in force in the territory, except as modified by Congress, and by the act of May 7, 1800, c. 41, creating the Territory of Indiana, and by the act of Feb. 3, 1809, c. 13, creating the Territory of Illinois, the rights and privileges granted by the ordinance are expressly secured to the inhabitants of those Territories; and although the act of April 18, 1818, c. 67, enabling the people of Illinois Territory to form a constitution and State government, and the resolution of Congress of Dec. 3, 1818, declaring the admission of the State into the Union, refer to the principles of the ordinance according to which the constitution was to be formed, ***its provisions could not control the authority and powers of the State after her admission.*** [Emphasis supplied] Whatever the limitation upon her powers as a government whilst in a territorial condition, whether from the ordinance of 1787 or the legislation of Congress, it ceased to have any operative force, except as voluntarily adopted by her, after she became a State of the Union. **On her admission she at once became entitled to and possessed of all the rights of dominion and sovereignty which belonged to the original States.** She was admitted, and could be admitted, only on the same footing with them. The language of the resolution admitting her is ‘on an equal footing with the original States *in all respects whatever.*’ 3 Stat. 536. Equality of constitutional right and power is the condition of all the States of the Union, old and new. Illinois, therefore, as was well observed by counsel, could afterwards exercise the same power over rivers within her limits that Delaware exercised over Black Bird Creek, and Pennsylvania over the Schuylkill River. *Pollard's Lessee v. Hagan*, 3 How. 212, 11 L.Ed. 565; *Permoli v. First Municipality*, 3 How. 589, 11 L.Ed. 739; *Strader v. Graham*, 10 How. 82, 13 L.Ed. 337.’ See *Sands v. Manistee River Imp. Co.*, 123 U.S. 288, 8 S.Ct. 113, 31 L.Ed. 149; *Huse v. Glover*, 119 U.S. 543, 7 S.Ct. 313, 30 L.Ed. 487; *city of Cincinnati v. Louisville & Nash. R. R. Co.*, 223 U.S. 390, 32 S.Ct. 267, 56 L.Ed. 481; *Hawkins v. Bleakly*, 245 U.S. 210, 37 S.Ct. 255, 61 L.Ed. 678. In the case of *Economy Light & Power Co. v. United States*, 256 U.S. 113, at page 120, 41 S.Ct. 409, at page 412, 65 L.Ed. 847, Mr. Justice Pitney used the following language: ‘To the extent that it pertained to internal affairs, the Ordinance of 1787-notwithstanding its contractual form-was no more than a regulation of territory belonging to the United States, and was superseded by the admission of the state of Illinois into the Union ‘on an equal footing with the original states in all respects whatever.’ In the *Economy Light Co.* case, referring to previous cases on the subject of the **Northwest Ordinance**, the opinion goes on to state: ‘**Those cases simply hold, in effect, that a state formed out of a part of the Northwest Territory has the same power to regulate navigable waters within its borders that is possessed by other states of the**

Union; that is to say, until Congress intervenes, the power of the state, locally exerted, is plenary * * *.'

Emphasis in bold added. As described in the cases above, the Northwest Ordinance is not binding, and has nothing to do with the current Illinois tax laws.

Section 203(b)(1) of the Illinois Income Tax Act ("IITA"; 35 ILCS 5/101 et seq.) provides that the computation of a corporation's net income subject to Illinois tax begins with the corporation's federal taxable income. Various addition and subtraction modifications are then made under Section 203(b)(2) of the IITA, and the resulting base income is allocated and apportioned among the states. Section 203(h) 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.

Section 203 contains no provision allowing a subtraction for "net maritime revenues outside state jurisdiction." Accordingly, the subtraction claimed on the 2007 return cannot be allowed.

Your letter mentions that "the movement of freight by ship on the Great Lakes has been excluded from the determination of the revenue-mile apportionment factors reported on Part IV, Schedule UB, of the return." Since the revenue miles on the Great Lakes are not included in the Illinois apportionment factor, the miles at issue are already excluded from Illinois taxable income. As a result, you are not being taxed in Illinois on those "excluded" miles.

The final issue concerns the \$803 difference you mention at the end of your letter. I have been told by our business processing unit that the Illinois Department of Revenue records have been corrected to show the same amounts as the documentation you provided us.

As stated above, this is a general information letter which does not constitute a statement of policy that either applies, interprets or prescribes tax law. It is not binding on the Department. Should you have additional questions, please do not hesitate to contact our office.

Sincerely,

Heidi Scott
Staff Attorney -- Income Tax