

ILLINOIS REGISTER  
DEPARTMENT OF REVENUE  
NOTICE OF PROPOSED AMENDMENTS

- 1) Heading of the Part: Income Tax
- 2) Code Citation: 86 Ill. Adm. Code 100
- 3) 

<u>Section Numbers:</u>	<u>Proposed Actions:</u>
100.3380	Amendment
100.3390	Amendment
- 4) Statutory Authority: 35 ILCS 5/304(f)
- 5) A Complete Description of the Subjects and Issues Involved: This rulemaking amends Sections 100.3380 and 100.3390 to reflect Public Act 98-478, which IITA Section 304(f) to provide that an alternative formula for apportioning business income to Illinois could be allowed or required if the statutory formula did not fairly represent the market for the taxpayer's goods and services in Illinois (rather than the extent of the taxpayer's business activities in Illinois under prior law) and to reflect current Department of Revenue policies.
- 6) Published studies or reports and sources of underlying data used to compose this rulemaking: None
- 7) Will this rulemaking replace any emergency rulemaking currently in effect? No
- 8) Does this rulemaking contain an automatic repeal date? No
- 9) Does this rulemaking contain incorporations by reference? No
- 10) Are there any other proposed rulemakings pending on this Part? No.
- 11) Statement of Statewide Policy Objective: This rulemaking does not create a State mandate, nor does it modify any existing State mandates.
- 12) Time, Place and Manner in which interested persons may comment on this rulemaking: Persons who wish to submit comments on this rulemaking may submit them in writing by no later than 45 days after publication of this Notice to:  
  
Brian Stocker  
Staff Attorney  
Illinois Department of Revenue  
Legal Services Office  
101 West Jefferson  
Springfield, Illinois 62796  
  
(217) 782-2844
- 13) Initial Regulatory Flexibility Analysis:

- A) Types of small businesses, small municipalities and not-for-profit corporations affected: This provides guidance for small businesses that are required to use an apportionment formula to determine the amount of their business income that is taxable by Illinois.
  - B) Reporting, bookkeeping or other procedures required for compliance: None
  - C) Types of professional skills necessary for compliance: None
- 14) Regulatory Agenda on which this rulemaking was summarized: June 2016

The full text of the Proposed Amendments begins on the next page:

### **Section 100.3380 Special Rules (IITA Section 304)**

a) Determining Business Activity or Market Within Illinois

1) Petition

IITA Section 304(f) provides that *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 do not, 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 require, in respect of all or any part of the person's business activity, if reasonable:*

- A) *Separate accounting;*
- B) *The exclusion of any one or more factors;*
- C) *The inclusion of one or more additional factors which will fairly represent the person's business activities or market in this State; or*
- D) *The employment of any other method to effectuate an equitable allocation and apportionment of the person's business income.*

2) Director's Determination

The Director has determined that, in the instances described in this Section, the apportionment provisions provided in subsections (a) through (e) and (h) of IITA Section 304 do not fairly represent the extent of a person's business activity or market within Illinois. For tax years beginning on or after the effective date of a rulemaking amending this Section to prescribe a specific method of apportioning business income, all nonresident taxpayers are directed to apportion their business income employing that method in order to properly apportion their business income to Illinois. Taxpayers whose business activity or market within Illinois is not fairly represented by a method prescribed in this Section and who do not want to use that method for a tax year beginning after the effective date of the rulemaking adopting that method must file a petition under Section 100.3390 requesting permission to use an alternative method of apportionment. For tax years beginning prior to the effective date of the rulemaking adopting a method of

apportioning business income, the Department will not require a taxpayer to adopt that method; provided, however, if any taxpayer has used that method for any of those tax years such tax year, the taxpayer must continue to use that method for that tax year. Moreover, a taxpayer may file a petition under Section 100.3390 to use a method of apportionment prescribed in this Section for any open tax year beginning prior to the effective date of the rulemaking adopting that method, and that such petition shall be granted in the absence of facts showing that that such method will not fairly represent the extent of a person's business activity or market in Illinois.

b) Property Factor. The following special rules are established in respect to the property factor in IITA Section 304(a)(1):

- 1) If the subrents taken into account in determining the net annual rental rate under Section 100.3350(c) produce a negative or clearly inaccurate value for any item of property, another method that will properly reflect the value of rented property may be required by the Director or requested by the person. In no case however shall the value be less than an amount that bears the same ratio to the annual rental rate paid by the person for the property as the fair market value of that portion of the property used by the person bears to the total fair market value of the rented property.

Example: A corporation rents a 10-story building at an annual rental rate of \$1,000,000. The corporation occupies two stories and sublets eight stories for \$1,000,000 a year. The net annual rental rate of the taxpayer must not be less than two-tenths of the corporation annual rental rate for the entire year, or \$200,000.

- 2) If property owned by others is used by the person at no charge or rented by the person for a nominal rate, the net annual rental rate for the property shall be determined on the basis of a reasonable market rental rate for that such property.

c) Sales Factor. The following special rules are established in respect to the sales factor in IITA Section 304(a)(3):

- 1) For taxable years ending on or before December 31, 2008, in ~~the~~ the case of sales in which neither the origin nor the destination of the sale is within this State, and the person is taxable in neither the state of origin nor the state of destination, the sale will be attributed to this State (and included in the numerator of the sales factor) if the person's activities in this State in connection with the sales are not protected by the provisions of P.L. 86-272, 15 USC 381-385. Although P.L. 86-272, by its terms covers only sales of tangible personal property, its rules regarding a state's power to impose a net income tax, for purposes of this special rule, will be applied whether the sale is of tangible or intangible property. This subparagraph shall not apply in taxable years ending on or after December 31, 2008, because attributing the sale to this State is not required by IITA Section 304(a)(3) and does not fairly represent the market for the person's goods, services, or other sources of business income in this State.

Example: A corporation's salesman operates out of an office in Illinois. He regularly calls on customers both within and without Illinois. Orders are approved by him and transmitted to the corporation's headquarters in State A. If the property

sold by the salesman is shipped from a state in which the corporation is not taxable to a purchaser in a state in which the corporation is not taxable, the sale is attributable to Illinois.

- 2) When gross receipts arise from an incidental or occasional sale of assets used in the regular course of the person's trade or business, ~~those such~~ gross receipts shall be excluded from the sales factor. For example, gross receipts from the sale of a factory or plant will be excluded. Gross receipts from the sale of stock in a subsidiary will also be excluded. Exclusion of these gross receipts from the sales factor is appropriate for several reasons, more than one of which may apply to a particular sale, including:
  - A) incidental or occasional sales are not made in the market for the person's goods, services, or other ordinary sources of business income;
  - B) to the extent that gains realized on the sale of assets used in a taxpayer's business are comprised of recapture of depreciation deductions, the economic income of the taxpayer was understated in the years in which those deductions were taken and the recapture gains that reflect a correction of that understatement should be allocated using a method approximating the factors that were used in apportioning the deductions. If the business otherwise remains unchanged, including the gross receipts from the sale in the sales factor numerator of the state in which the assets were located would allocate a disproportionate amount of the recapture gains to that state compared to how the deductions being recaptured were allocated;
  - C) to the extent the gain on the sale is attributable to goodwill or similar intangibles representing the value of customer relationships, including the gross receipts from the sale in the sales factor will not reflect the market for the taxpayer's goods, services, or other ordinary sources of business income to the extent the sourcing of the receipts from that sale differs from the sales factor computed without regard to that sale; and
  - D) in the case of sales of assets that are made in connection with a partial or complete withdrawal from the market in the state in which the assets are located, including the gross receipts from those sales in the sales factor would increase the business income apportioned to that state when the taxpayer's market in that state has decreased.
- 3) When the income producing activity ~~in respect to~~ relevant to the sourcing of business income from intangible personal property can be readily identified, ~~that such~~ income is included in the denominator of the sales factor and, if the income producing activity occurs in this State, in the numerator of the sales factor as well. For example, with respect to taxable years ending before December 31, 2008, usually the income producing activity can be readily identified in respect to interest income received on deferred payments on sales of tangible property (see Section 100.3370(a)(1)(A)).
- 4) When business income from intangible property is sourced according to the income producing activity, and the income cannot readily be attributed to any income producing activity of the person, the income cannot be assigned to the

numerator of the sales factor for any state and shall be excluded from the denominator of the sales factor. The following provisions illustrate this concept:

- A) Subpart F (26 USC 951-964) income is passive income generated by the mere holding of an intangible. For taxable years ending on or after December 31, 1995, subpart F income is excluded from the sales factor under IITA Section 304(a)(3)(D). For prior taxable years, there is a rebuttable presumption that subpart F income is not includable in either the numerator or the denominator of the sales factor. If a taxpayer wishes to include subpart F income in either the numerator or the denominator of the sales factor, the burden of proof is on the taxpayer to identify the income producing activities and to situs those activities within a particular state, or
  - B) When business income in the form of dividends received on stock during taxable years ending before December 31, 1995, or interest received on bonds, debentures or government securities results from the mere holding of intangible personal property by the person, those dividends and interest shall be excluded from the denominator of the sales factor.
- 5) In the case of sales in the regular course of business of ~~business~~-intangibles (including, by means of example, without limitation, patents, copyrights, bonds, stocks and other securities), gross receipts shall be disregarded and only the net gain (loss) shall be included in the sales factor, provided that, for taxable years ending on or after December 31, 2008, only net gains shall be included in the sales factor for sales sourced under Section 304(a)(3)(C-5)(iii).

EXAMPLE: In 1990, Corporation A, a calendar year taxpayer, sells stock with an adjusted basis of \$98,000,000 for \$100,000,000, realizing a federal net capital gain of \$2,000,000. Only the net capital gain of \$2,000,000 is reflected in A's sales factor for the taxable year ending December 31, 1990.

- 6) Hedging Transactions
- A) A "hedging transaction" is a transaction entered into by a taxpayer in the normal course of business primarily to manage interest rate risk or the risk of price or currency fluctuations. (See 26 USC 475(c)(3), 1221(b)(2)(A) and 1256(e)(2).) The purpose of the sales factor in IITA Section 304(a) is to apportion the business income of a taxpayer conducting an interstate business to this State based on this State's relative share of the marketplace for the goods and services sold by the taxpayer in the course of its business. Gains and losses on hedging transactions entered into to manage the risks associated with the acquisition of resources by a taxpayer (for example, price fluctuations in commodities consumed in the taxpayer's business) do not reflect the market for the taxpayer's goods and services and, therefore, should be excluded from the sales factor. Gains and losses on hedging transactions entered into to manage risks associated with the gross income the taxpayer expects from its sales of goods and services (for example, the effect of foreign currency fluctuations on the dollar amount of gross income the taxpayer will receive from sales to a particular foreign country) are best accounted for in the sales factor as adjustments to the gross receipts from the transactions whose risks are being hedged. Gains and losses on hedging transactions that manage

risks associated with both acquisitions and sales of the taxpayer (for example, electricity futures bought or sold by a taxpayer engaged in the business of buying and selling electrical power), or that otherwise cannot be associated with a particular transaction or class of transactions in the computation of the sales factor, should be excluded from the sales factor. Federal income tax law provides a framework for identifying gains and losses from hedging transactions to the transactions or class of transactions being hedged and for keeping records necessary to support the identifications. The federal practice should be followed for State purposes.

- B) General Rule. Except as provided in subsection (c)(6)(C), any income, gain or loss from a transaction properly identified as a hedge under 26 USC 1221(b)(2)(A), 475(c)(3) or 1256(e)(2) is excluded from the numerator and denominator of the sales factor.
- C) Special Rule. With respect to any hedging transaction described in subsection (c)(6)(B) as to which identification requirements of subsection (c)(6)(D) are satisfied, any income, gain or loss from the hedging transaction shall be included in the denominator of the sales factor if the gross receipts from the hedged item are included in the denominator. That income, gain or loss shall be included in the numerator of the sales factor if the gross receipts from the hedged item are included in the numerator of the sales factor, and shall be excluded from the numerator of the sales factor if the gross receipts from the hedged item are excluded from the numerator of the sales factor. If the hedging transaction relates to an identified group of hedged items, the income, gain or loss from the hedging transaction is included in the numerator of the sales factor in the same proportion that the gross receipts from the group of hedged items are included in the numerator of the sales factor.
- D) Identification Required. The identification requirements of this subsection (c)(6)(D) are met if the taxpayer's books and records clearly identify a hedging transaction as managing risk relating to a particular item or items of gross receipts, including anticipated items of gross receipts, that must be included in the sales factor. The identification must be made at the time and in the manner required under 26 USC 475(c)(3), 26 CFR 1.1221-2(f) and (g), or 26 CFR 1.1256(e)-1 and the taxpayer's books and records include the information necessary to apply subsection (c)(6)(C).
- E) This subsection (c)(6) does not apply to any hedging transaction that, for federal income tax purposes, is integrated with the hedged item, such as under 26 CFR 1.988-5 or 1.1275-6. In addition, for purposes of this subsection (c)(6):
  - i) a transaction entered into by one member of a federal consolidated group identified as a hedge against a risk of another member of the federal consolidated group under the "single-entity approach" in 26 CFR 1.1221-2(e)(1) is not a hedging transaction if the two members of the federal consolidated group are not members of the same unitary business group, because the transaction is not hedging

against a risk faced by the taxpayer entering into the transaction;  
and

- ii) a transaction entered into by one member of a unitary business group with another member of the unitary business group is not a hedging transaction, because the risk remains within the group, except in the case of a transaction identified under 26 CFR 1.1221-2(f) or (g) as a hedging transaction between two member of a unitary business group who are also members of a federal consolidated group that has made the "separate entity election" in 26 CFR 1.1221-2(e)(2) with regard to hedging transactions.

F) **EXAMPLES:** The provisions of this subsection (c)(6) may be illustrated by the following examples:

- i) Taxpayer expects that, during its next production cycle, it will need 10 tons of commodity Y for its interstate manufacturing business. Commodity Y is a raw material used by Taxpayer in the manufacture of its inventory. In order to hedge against exposure to changes in the price of commodity Y, Taxpayer enters into a forward contract to purchase 10 tons of commodity Y. The forward contract is identified as a hedging transaction under IRC section 1221(b)(2)(A). Under subsection (c)(6)(B), any income, gain or loss recognized with respect to the forward contract is excluded from the numerator and denominator of the sales factor.
- ii) On January 1, 2008, Taxpayer owns 10 tons of commodity X, which it holds for sale in the ordinary course of business and expects to sell during its taxable year ending December 31, 2008. To hedge against price fluctuations in commodity X, on January 10, 2008, while Taxpayer still owns commodity X, it sells the equivalent of 10 tons of commodity X futures contracts on a futures exchange. Taxpayer expects to sell commodity X to customers in various states, including Illinois. The futures contract is identified as a hedging transaction under IRC section 1221(b)(2)(A), and Taxpayer properly identifies the futures contract as required under subsection (c)(6)(D) as hedging gross receipts from sales of commodity X. Under subsection (c)(6)(C), any gain or loss taken into account by Taxpayer during its taxable year with respect to the futures contract is included in the denominator of the sales factor, and is included in the numerator of the sales factor in the same proportion that gross receipts from actual sales of commodity X during the taxable year are included in the numerator of the sales factor. If a loss is recognized on the futures contract, the loss is treated as a reduction (but not below zero) of the gross receipts from the sale of commodity X in computing the sales factor.
- iii) Taxpayer is a corporation on the accrual method of accounting with the U.S. dollar as its functional currency. On January 1, 2008, Taxpayer acquires 1,500 British pounds (£) for \$2,250 (£1 = \$1.50). The acquisition of £1,500 is properly identified by Taxpayer as a hedging transaction under IRC section 1221(b)(2)(A). On February

5, 2008, when the spot rate is £1 = \$1.55, Taxpayer purchases inventory from its supplier by paying £1,500. Accordingly, Taxpayer recognizes \$75 exchange gain for federal income tax purposes upon disposition of the British pounds. The \$75 exchange gain is excluded from both the numerator and denominator of the sales factor under subsection (c)(6)(B).

- iv) Taxpayer is a calendar year corporation with the U.S. dollar as its functional currency. Based on past experience, Taxpayer anticipates making 2009 first quarter sales to customers in New Zealand of 100,000 New Zealand dollars (NZD). In order to hedge against currency fluctuations related to the anticipated first quarter sales, on December 31, 2008, Taxpayer enters into a forward contract to sell 100,000 NZD on March 31, 2009 for \$48,000. The forward contract is identified as a hedging transaction under 26 USC 1221(b)(2)(A), and the Taxpayer properly identifies the transaction as hedging its anticipated New Zealand sales in accordance with subsection (c)(6)(D). During the first quarter of its 2009 taxable year, Taxpayer makes sales to its New Zealand customers of 90,000 NZD. Under IITA Section 304(a), gross receipts from its New Zealand sales are included in the denominator of the Taxpayer's sales factor and are excluded from the numerator of the sales factor. Under subsection (c)(6)(C), any gain or loss recognized on the forward contract is included in the denominator of the Taxpayer's sales factor and is excluded from the numerator of the factor. This treatment is required even though the Taxpayer's sales to New Zealand customers were less than anticipated. Any loss recognized on the forward contract is treated as a reduction (but not below zero) of the gross receipts from sales to New Zealand customers that are included in the denominator of the sales factor.

## 7) Section 988 Transactions

- A) Section 988 Transactions. For sales factor purposes, foreign currency gain or loss that is computed under 26 USC 988, with respect to accrued interest income or expense, gain or loss on a debt instrument, a payable, a receivable or a forward contract payable in a foreign currency described in 26 CFR 1.988-1(a)(2) is treated as an adjustment to the income, expense, gain or loss. Accordingly, the foreign currency gain or loss is included in the numerator and denominator of the sales factor only to the extent that the income to which the foreign currency gain or loss relates is included in the numerator and denominator of the sales factor. Foreign currency gains and losses with respect to expense are excluded from the numerator and denominator of the sales factor.

EXAMPLES: The provisions of this subsection (c)(7)(A) may be illustrated by the following examples:

- i) Taxpayer is a corporation on the accrual method of accounting with the U.S. dollar as its functional currency. On January 1, 2008, Taxpayer converts \$13,000 to 10,000 British pounds (£) at the spot rate of £1 = \$1.30 and loans the £10,000 to Y for 3 years. The terms

of the loan provide that Y will make interest payments of £1,000 on December 31 of 2008, 2009 and 2010 and will repay Taxpayer's £10,000 principal on December 31, 2010. Based on average spot rates for 2008, 2009 and 2010 of £1 = \$1.32, £1 = \$1.37 and £1 = \$1.42, respectively, Taxpayer accrues interest income of \$1,320 for 2008, \$1,370 for 2009, and \$1,420 for 2010. Under IITA Section 304(a), the accrued interest income is included in the denominator of Taxpayer's sales factor, but is excluded from the numerator of its sales factor. Based on spot rates on December 31, 2008, December 31, 2009 and December 31, 2010 of £1 = \$1.35, £1 = \$1.40 and £1 = \$1.45, respectively, Taxpayer recognizes for federal income tax purposes exchange gain of \$30 upon receipt of the interest on December 31 of 2008, 2009 and 2010. In addition, Taxpayer recognizes, for federal income tax purposes, exchange gain of \$1,500 upon repayment of the loan principal on December 31, 2010. Under subsection (c)(7)(A), the \$30 of exchange gain recognized with respect to the accrued interest for 2008, 2009 and 2010 is included in the denominator of Taxpayer's sales factor and is excluded from the numerator of its sales factor. The \$1,500 of exchange gain with respect to the repayment of principal on December 31, 2010 is excluded from both the numerator and denominator of Taxpayer's sales factor because repayment of principal on a loan is not included in the sales factor.

ii) Taxpayer is a corporation on the accrual method of accounting with the U.S. dollar as its functional currency. On January 15, 2008, Taxpayer sells inventory for 10,000 Canadian dollars (C\$). The spot rate on January 15, 2008 is C\$1 = U.S. \$.55. Under IITA Section 304(a), \$5,500 in gross receipts from this sale is included in the denominator of Taxpayer's sales factor, and is excluded from the numerator of the sales factor. On February 23, 2008, when Taxpayer receives payment of the C\$10,000, the spot rate is C\$1 = U.S. \$.50. For federal income tax purposes, Taxpayer recognizes (\$500) of exchange loss upon receipt of C\$10,000 on February 23, 2008. Under subsection (c)(7)(A), the (\$500) exchange loss with respect to the January 15, 2008 sale is included in the denominator of the Taxpayer's sales factor and is excluded from the numerator of the sales factor. The exchange loss is reflected as a reduction of the denominator of the Taxpayer's sales factor.

B) Section 986(c)(1) Foreign Exchange Gain or Loss on Distributions of Previously Taxed Income. Foreign currency gain or loss recognized pursuant to 26 USC 986(c)(1) on distributions of amounts previously taxed to the recipient as subpart F income or as earnings of a qualified electing fund shall be excluded from both the numerator and denominator of the sales factor because those distributions are excluded from federal gross income and, therefore, from the sales factor.

d) Unitary Partners: Inclusion of shares of partnership unitary business income and factors in combined unitary business income and factors of partners.

- 1) IITA Section 304(e) provides that whenever *2 or more persons are engaged in a unitary business as described in IITA Section 1501(a)(27), a part of which is conducted in this State by one or more members of the group, the business income attributable to this State by any ~~such~~ member or members shall be apportioned by means of the combined apportionment method.* Because partnerships may be members of a unitary business group within the meaning of IITA Section 1501(a)(27), this provision requires a partnership to use combined apportionment when it is engaged in a unitary business with one or more of its partners. However, partners who are not engaged in a unitary business with the partnership are required to include their shares of the partnership's business income apportioned to Illinois in their Illinois net incomes under IITA Section 305(a), and those partners' business activities or share of the partnership's market in Illinois would not be represented fairly by their shares of partnership income computed by combining the business income and apportionment factors of the partnership with the business income and apportionment factors of its unitary partners.
- 2) Accordingly, except in a case in which substantially all of the interests in the partnership (other than a publicly-traded partnership under 26 USC section-7704 of the Internal Revenue Code) are owned or controlled by members of the same unitary business group, when the business activities of a partnership and any of its partners' business activities constitute a unitary business:

- A) The partner's distributive share of the business income and apportionment factors of the partnership shall be included in that partner's business income and apportionment factors. In determining the business income of the partnership, transactions between the unitary partner (or members of its unitary business group) and the partnership shall not be eliminated. However, all transactions between the unitary business group and the partnership shall be eliminated for purposes of computing the apportionment factors of the partner and of any other member of the unitary business group.

EXAMPLE: Partner and Partnership are engaged in a unitary business. Partner owns a 20% interest in Partnership. Partnership has \$10,000,000 in sales everywhere, \$3,000,000 of which are to Partner, and \$4,000,000 in Illinois sales, \$1,000,000 of which are to Partner. In computing its apportionment factor, Partner will include \$1,400,000 from Partnership in its everywhere sales (20% of Partnership's \$10,000,000 in everywhere sales, after eliminating the \$3,000,000 in sales to Partner) and \$600,000 from Partnership in its Illinois sales (20% of Partnership's \$4,000,000 in Illinois sales, after eliminating the \$1,000,000 in sales to Partner). Also, Partner must eliminate any sales it made to Partnership.

- B) If a partnership and one of its partners are engaged in a unitary business and the partnership is itself a partner in a second partnership:
  - i) If the partner is not engaged in a unitary business with the second partnership, the partner's share of the first partnership's share of the business income and apportionment factors of the second partnership shall not be included in the partner's business income and apportionment factors. Instead, the partner's share of the first

partnership's share of the base income apportioned to Illinois by the second partnership will be included in the partner's Illinois net income.

- ii) If the partner is engaged in a unitary business with the second partnership, the partner's share of the first partnership's share of the business income and apportionment factors of the second partnership shall be included in the partner's business income and apportionment factors.
- 3) This subsection (d) shall not apply to a partner's shares of business income and apportionment factors from any partnership that cannot be included in a unitary business group with that partner because:

- A) the partner and the partnership are required to apportion their business income using different apportionment formulas under IITA Section 304, and therefore cannot be members of a unitary business group under IITA Section 1501(a)(27); or
- B) the business activities of either the partner or the partnership outside the United States are equal to or greater than 80% of the total worldwide business activities of that partner or partnership, as determined under Section 1502(a)(27) of the IITA. In applying this 80-20 test to a taxpayer, no apportionment factors of any partnership shall be included in the apportionment factors of that taxpayer pursuant to this subsection (d).

If the partnership is itself a partner in a second partnership, and one of its partners is engaged in a unitary business with the second partnership and is not prohibited from being a member of a unitary business group that includes the second partnership under subsection (d)(3)(A) or (B), that partner shall include in its business income and apportionment factors its share of the partnership's share of the second partnership's business income and apportionment factors.

- 4) If substantially all of the interests in a partnership (other than a publicly-traded partnership under [26 USC section 7704 of the Internal Revenue Code](#)) are owned or controlled by members of the same unitary business group as the partnership, the partnership shall be treated as a member of the unitary business group for all purposes, and, for purposes of applying IITA Section 305(a) to any nonresident partner who is not a member of the same unitary business group, the business income of the partnership apportioned to this State shall be determined using the combined apportionment method prescribed by IITA Section 304(e). For purposes of this subsection (d), substantially all of the interests in a partnership are owned or controlled by members of the same unitary business group if more than 90% of the federal taxable income of the partnership is allocable to one or more of the following persons:

- A) any member of the unitary business group;
- B) any person who would be a member of the unitary business group if not for the fact that 80% or more of that such person's business activities are conducted outside the United States;

- C) any person who would be a member of the unitary business group except for the fact that ~~that such~~ person and the partnership apportion their business incomes under different subsections of IITA Section 304; or
  - D) any person who would be disallowed a deduction for losses by paragraphs (b), (c), and (f)(1) of section 267 of the Internal Revenue Code by virtue of being related to any person described in subsections (d)(4)(A), (B) or (C) of this Section, as well as any partnership in which a person described in subsections (d)(4)(A), (B) or (C) is a partner.
- 5) EXAMPLE: Corporation A owns a 50% interest in P-1, a partnership. Corporation A and P-1 are engaged in a unitary business within the meaning of IITA Section 1501(a)(27). P-1 itself conducts no business activities in Illinois, and the Illinois numerator of its apportionment factor is zero. P-1 holds a 50% interest in P-2, a partnership doing business exclusively in Illinois. P-1 has \$1.4 million of taxable business income, not including any income from P-2. P-2 has base income of \$1 million, all of which is business income, and on a separate-entity basis, all of its business income would be apportioned to Illinois.

If Corporation A and P-2 are not members of the same unitary business group, Corporation A would compute its business income apportioned to Illinois by including \$700,000 (50% of \$1.4 million) of P-1's business income in Corporation A's business income, and 50% of P-1's apportionment factors in its apportionment factors. Corporation A also would include in its Illinois net income its 50% share of P-1's 50% share of the base of P-2 apportionable to Illinois, or \$250,000 (50% of 50% of \$1 million).

If Corporation A, P-1 and P-2 are members of the same unitary business group, P-1 will include 50% of P-2's business income and 50% of P-2's apportionment factors in its own business income and apportionment factors. Accordingly, P-1's business income will be \$1.9 million (the \$1.4 million it earned directly plus its 50% share of P-2's \$1 million in business income). Corporation A will then compute its business income apportioned to Illinois by including its 50% share of P-1's business income, or \$950,000 (50% of \$1.9 million) with its business income and its 50% share of P-1's apportionment factors (which will include P-1's share of P-2's apportionment factors) in its apportionment factors.

If Corporation A, P-1 and P-2 are unitary, but P-1 cannot be included in a unitary business group with Corporation A and P-2 because those entities apportion their business income under IITA Section 304(a) and P-1 is a financial organization that apportions its business income under IITA Section 304(c), Corporation A will include in its business income and apportionment factors its 50% share of P-1's 50% share of the business income and apportionment factors of P-2. Also, Corporation A's Illinois net income will include 50% of the business income of P-1 apportioned to Illinois by P-1 using its own apportionment factors. Because, in this example, P-1 is not doing business in Illinois, none of its business income will be included in Corporation A's Illinois net income.

- e) Apportionment of Business Income by Foreign Taxpayers.

- 1) Under 26 USCA 882, foreign corporations include only effectively-connected income in their federal taxable income. Foreign taxpayers may exclude other items of income from their federal taxable income if authorized under treaty, as provided in 26 USCA 894. Using a foreign taxpayer's worldwide apportionment factors to determine how much of its domestic business income should be apportioned to Illinois would not fairly represent that taxpayer's business activities or market within Illinois. Accordingly, a foreign taxpayer shall use only the apportionment factors related to its domestic business income when apportioning its business income to Illinois. Similarly, in determining whether 80% or more of a foreign taxpayer's total business activity is conducted outside the United States for purposes of IITA Section 1501(a)(27), that taxpayer must use only the apportionment factors related to the business income included in its federal taxable income (plus addition modifications), rather than use all of its worldwide factors.
- 2) Foreign Sales Corporations. Under 26 USC 921, "exempt foreign trade income" of a foreign sales corporation is treated as foreign source income excluded from gross income. "Exempt foreign trade income" is defined in 26 USC 923 to equal the sum of the amounts of income derived from various categories of transaction, with the income from each category multiplied by specific percentages. As a general rule, there is no systematic relationship between transactions qualifying for this treatment and any particular item of property or payroll of a foreign sales corporation. Accordingly, the provisions of subsection (e)(1) of this Section shall not apply to a foreign sales corporation and, in apportioning its business income and in determining whether 80% or more of its business activity is conducted outside the United States, a foreign sales corporation shall use all of its apportionment factors.

(Source: Amended at 41 Ill. Reg. \_\_\_\_\_, effective \_\_\_\_\_)

### **Section 100.3390 Petitions for Alternative Allocation or Apportionment (IITA Section 304(f))**

- a) In general. IITA Section 304(f) provides that if the allocation and apportionment provisions of IITA Section 304(a) through (e) do not, for taxable years ending before December 31, 2008, fairly represent the extent of the person's business activity in this State, or do not, 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 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 of the factors;
  - 3) the inclusion of one or more additional factors which will fairly represent the person's business activity in this State; or
  - 4) the employment of any other method to effectuate an equitable allocation and apportionment of the person's income.
- b) The petition procedures provided in this Section are exclusive means by which a taxpayer may petition for an alternative apportionment formula. Any attempt to invoke an

alternative apportionment formula by a method or procedure other than as specified in this Section shall not be considered a valid petition under IITA Section 304(f). Pursuant to Section 304(f), the Director has sole and exclusive authority to grant a petition for an alternative apportionment formula.

- c) Burden of Proof. A departure from the required apportionment method is allowed only where ~~those such~~ 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 cogent~~ evidence that the statutory formula results in the taxation of extraterritorial values ~~or 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 (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).
- d) Filing Procedure. A petition for alternative apportionment must be clearly labeled "Petition for Alternative Allocation or Apportionment" and be supported by sufficient facts and information to allow the Director to determine whether the taxpayer has met the burden of proof required under subsection (b) ~~above~~. 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 than the required statutory formula. Petitions must be submitted to:

Illinois Department of Revenue  
Legal Services Bureau/Income Tax  
101 W. Jefferson Street  
Springfield IL ~~6270262794-9001~~

- e) Timely Filed Petitions. A taxpayer petition for use of a separate accounting method or any other alternative apportionment method will not be considered by the Director unless ~~that such~~ petition has been timely filed. A taxpayer who petitions the Director for an alternative apportionment formula does so subject to the Department's right to verify, by audit of the taxpayer's return and supporting books and records within the applicable statute of limitations, the facts submitted as the basis of the petition. A petition for alternative allocation or apportionment is timely filed if the petition is filed:
- 1) 120 days prior to the due date of the tax return (including extensions) for which permission to use ~~an such~~ alternative method is sought. A taxpayer who does not petition more than 120 days prior to the due date of the original return must file

the return and pay tax according to the statutorily approved allocation or apportionment method. If the petition is approved, the Department shall grant permission to use an alternative apportionment method in the form of a private letter ruling issued under 2 Ill. Adm. Code 1200.110.

- 2) as an attachment to a return amending an original return which was filed using the statutory allocation and apportionment rules. A taxpayer who has not filed a petition for alternative apportionment under subsection (e)(1) ~~above~~, or whose subsection (e)(1) petition has been rejected, may thereafter file ~~a such~~ petition with an amended return. The explanations section of the amended return should state that the amended return includes a petition for alternative apportionment that should be referred to the Legal Services Bureau/Income Tax, and a copy of the amended return should be mailed to the Legal Services Bureau/Income Tax, at the address in subsection (d) of this section. If the amended return results in a claim for refund, and the Department will consider the petition along with any other issues raised in the claim for refund pursuant to the procedures set forth at Section 100.9400 100.9110 of this Part.
- 3) as part of a protest or petition to the Illinois Independent Tax Tribunal regarding ~~to~~ a notice of deficiency issued as a result of the audit of the taxpayer's return and supporting books and records; provided that the audit adjustments being protested result in the need for the petition for alternative apportionment. Alternative apportionment may not be raised in a protest or petition to the Illinois Independent Tax Tribunal regarding a notice of deficiency unless (i) the taxpayer has requested in writing that the auditor allow the use of alternative apportionment and the request was denied or (ii) the audit disallows an alternative method of apportionment used by the taxpayer on its return. The disallowance of the use of alternative apportionment in an audit may be reviewed by the Informal Conference Board. ~~to a notice of deficiency if such petition could have been submitted under subsection (e)(1) or (e)(2) above (i.e., the petition for an alternative apportionment formula is not necessitated by the proposed adjustments made to the taxpayer's return during the course of the audit).~~

f) Consideration of Petitions

- 1) After consideration of a petition for alternative apportionment under subsections (e)(1) or (e)(2) ~~above~~, the Director will issue a ruling letter advising the taxpayer that the petition has been accepted, partially accepted or rejected.
- 2) If the petition is partially accepted (i.e., where the Director finds that the taxpayer has established that apportionment relief is warranted but disagrees with the taxpayer's proposed alternative apportionment method) the Director shall so notify the taxpayer of the reasons for rejecting the proposed alternative apportionment formula. The taxpayer may then submit a modified alternative apportionment formula for the Director's approval, or protest the Director's rejection of the proposed alternative apportionment formula by requesting an administrative hearing on the matter.
- 3) If a taxpayer's petition is rejected in its entirety, the Director will state the reasons for the rejection of the petition.

g) Appeal Procedures. A denial of a petition for alternative apportionment which petition was submitted under subsections (e)(1) or (e)(2) ~~above~~ is not a final administrative decision and may be protested as provided herein. If the petition is submitted prior to the filing of the original return under subsection (e)(1) ~~above~~, and is denied, the taxpayer must file and pay tax using the statutory formula. A taxpayer who has filed using the statutory formula after denial of a petition for alternative apportionment may file an amended return claiming a refund based upon the original petition. Additional information in support of the taxpayer's petition for alternative apportionment may be submitted for the Director's reconsideration at that time. If the claim for refund is denied, the taxpayer may file a protest pursuant to IITA Section 910 and request an administrative hearing, or file a petition with the Illinois Independent Tax Tribunal, solely on the issue of alternative apportionment or in addition to other issues raised in the claim for refund.

h) Bifurcated Administrative Hearings

1) The taxpayer will have waived the right to raise alternative apportionment as an issue in the administrative hearing or before the Illinois Independent Tax Tribunal if taxpayer has not complied with procedures set forth in this Section.

2) Where a protest to a notice of deficiency or a claim denial raises the issue of alternative apportionment in addition to other issues, the administrative hearing shall proceed in two distinct phases.

A) All issues other than the petition for alternative apportionment, which have properly been raised in the protest to the notice of deficiency or claim denial, shall be considered first. The ALJ shall conduct the hearing and the taxpayer shall present its case. The ALJ shall not accept any evidence with regard to alternative apportionment until the taxpayer and the Department have rested their case with regard to all other issues raised in the protest to the notice of deficiency or claim denial.

B) When the taxpayer and the Department have rested with regard to all other issues raised in the protest of the notice of deficiency or claim denial, the ALJ shall conduct the hearing and the taxpayer shall present its case in support of its petition for alternative apportionment. Evidence allowed into the record with regard to all other issues raised in the protest of the notice of deficiency or claim denial shall be deemed to be allowed into the record with regard to the protest to the Director's denial of alternative apportionment and need not be resubmitted. However, on any issue as to which evidence has already been allowed with regard to the protest of the notice of deficiency or claim denial, the ALJ shall allow submission of additional evidence on the issue of alternative apportionment.

C) In ~~those such~~ bifurcated hearings, the ALJ shall issue a two-part recommendation to the Director. The first part of the recommendation shall address all other issues raised in the protest of the notice of deficiency or claim denial and the second part of the recommendation shall be a determination of whether the taxpayer has met its burden of proof under subsection (b) ~~above~~.

3) Proceedings before the Illinois Independent Tax Tribunal shall be conducted according to the rules of the Illinois Independent Tax Tribunal.

i) Director's Decision after Administrative Hearing

- 1) The Director will consider the ALJ's recommendation. If the Director agrees that the taxpayer has met his burden of proof under subsection (b) ~~above~~ and that the formula proposed by the taxpayer and recommended by the ALJ fairly and accurately apportions income to Illinois based upon the taxpayer's business activity in this State, the Director will accept the recommendation of the ALJ and it will become final.
- 2) If the Director, after considering the ALJ's decision, agrees that the taxpayer has met its burden of proof under subsection (b) ~~above~~, but finds that the proposed alternative apportionment formula does not fairly and accurately apportion income to Illinois based upon the taxpayer's business activity in this State, the Director's decision will so state and will provide an appropriate alternative apportionment formula. The Director's decision will be final for purpose of administrative review.
- 3) If the Director finds that the taxpayer has not established 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 or the market in this State and also finds that the taxpayer's proposed alternative apportionment formula is not permissible, the Director shall issue his decision so stating. The taxpayer may seek ~~seed~~ administrative review of this final decision of the Director. If the court finds that the taxpayer has met the burden of proof under subsection (b) that an alternative apportionment formula is warranted but agrees with the Director that the alternative apportionment formula proposed by the taxpayer does not fairly and accurately reflect the taxpayer's business activities in this State, and the case is remanded to the Department, the Director shall provide an appropriate alternative apportionment formula. The designation of a formula by the Director is a final administrative decision of the Department subject to administrative review by the court.

(Source: Amended at 41 Ill. Reg. \_\_\_\_\_, effective \_\_\_\_\_)