IT 10-0007-GIL 03/10/2010 CREDIT – REPLACEMENT TAX INVESTMENT

> General Information Letter: A taxpayer that is not primarily engaged in retailing, in manufacturing or in mining of coal or fluorite may not claim the replacement tax investment credit on property that is used in one of those activities.

March 10, 2010

Dear:

This is in response to your letter received January 28, 2010 regarding the Illinois replacement tax investment credit. The nature of your letter and the information provided require that we respond with a General Information Letter (GIL). A GIL is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), which may be accessed from the Department's web site at www.ILtax.com.

Your letter states as follows:

> We are tax professionals preparing the annual Illinois income tax returns for a fiscal year corporate client who has recently started a new manufacturing business in the state of Illinois. We are writing this letter to obtain clarification on whether or not the Illinois Replacement Tax Credit can be taken on assets placed in service by our client in the years 2008 and 2009 (since the credit that was set to expire has now been extended). The facts and circumstances are as follows:
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> 1. Previous to the year 2008, the Company's main activity was snow plowing services. During the year 2008, the Company started a completely new manufacturing activity. The manufacturing activity was set up as a distinct division with its own bank accounts and separate set of books and records.
> 2. The new manufacturing division purchased equipment to be used in the manufacturing of sectional snow plows. The equipment is to be used exclusively in the manufacturing division of the Company.
> 3. The manufacturing division of the Company is located in a different municipality in facilities that are distinct and separate from the Company's service division.
> 4. Since the division was a startup division in 2008, the Company did not have a large amount of sales. Since the service division of the Company is quite profitable, the gross receipts from the service operations of the Company is well over 50% of the total gross receipts of the Company. Consequently, based on the gross receipts test used by Illinois to determine if the Company would qualify for the credit, the Company would not be considered to be primarily engaged in manufacturing and thus would not qualify for the credit.
> 5. Our belief is that the manufacturing division of the Company is primarily engaged in manufacturing and the credit should be allowed on the equipment purchased by that division and used exclusively in the manufacturing process. We believe that if it was the intent of P.A. 88-141 (see enclosed) to relax the requirements for claiming the RTC, the gross receipts test should be applied to each division separately, not to the Company as a whole; otherwise it would appear that the Company would not qualify for the credit. Prior to P.A. 88-141, it appears the Company would qualify for the RTC, albeit it could only be taken on assets used exclusively in the actual manufacturing operations, and not on supporting assets.
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> We need to have clarification on whether or not in the above mentioned situation we still need to use the overall gross receipts test to determine if the Company is primarily engaged in manufacturing activities, or can the test be made by division, in which case the equipment

> purchased by the manufacturing division would be the only assets that would qualify for the credit. Since there is a completely separate set of books and records, we believe that only the sales from the manufacturing division should be used in determining whether that division of the Company is primarily engaged in manufacturing. We know that if the division was set up as a separate corporation, the Company would be qualified to take the credit. However, for name recognition purposes and because it was thought that the credit was set to expire, a separate corporation was not set up.
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> We believe that the intent of the Illinois Replacement Tax Investment Credit is to encourage the start up of new manufacturing businesses that will provide jobs for Illinois residents. Since P.A. 88-141 was meant to relax the requirements for claiming the RTC, we don't believe that a Company that sets up a separate manufacturing division within an existing corporation should be denied the credit based on the overall gross receipts of the Company. We believe that to be true to the intent of the credit, the two divisions of the Company should stand alone when determining whether or not the credit can be taken on the assets purchased by the manufacturing division.
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> We are therefore respectively requesting that you please review the above facts and circumstances and provide us with your determination as to whether or not the Company can take the credit on the equipment that was purchased by the manufacturing division. As mentioned above, separate books and records are maintained by the manufacturing division of the Company to support the purchase made and used exclusively by that division.

<u>RULING</u>

Section 201(e) of the Illinois Income Tax Act ("IITA" ; 35 ILCS 5/201(e)) allows a credit against the personal property tax replacement income tax for investment in qualified property. The IITA defines qualified property as follows:

> The term "qualified property" means property which:
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> (A) is tangible, whether new or used, including buildings and structural components of buildings and signs that are real property, but not including land or improvements to real property that are not a structural component of a building such as landscaping, sewer lines, local access roads, fencing, parking lots, and other appurtenances;
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> (B) is depreciable pursuant to Section 167 of the Internal Revenue Code, except that "3-year property" as defined in Section 168(c)(2)(A) of that Code is not eligible for the credit provided by this subsection (e);
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> (C) is acquired by purchase as defined in Section 179(d) of the Internal Revenue Code;
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> (D) is used in Illinois by a taxpayer who is primarily engaged in manufacturing, or in mining coal or fluorite, or in retailing, or was placed in service on or after July 1, 2006 in a River Edge Redevelopment Zone established pursuant to the River Edge Redevelopment Zone Act; and
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> (E) has not previously been used in Illinois in such a manner and by such a person as would qualify for the credit provided by this subsection (e) or subsection (f).

As indicated in paragraph (D) above, unless the property is placed in service in a River Edge Redevelopment Zone, in order for property to constitute qualified property it must be "used in Illinois by a taxpayer who is primarily engaged in manufacturing, or in mining coal or fluorite, or in retailing." The determination of a whether a taxpayer is primarily engaged in one of these activities must take into account all of the business operations in which the taxpayer engages, and is not applied on a division basis. This is made clear in Department Regulations Section 100.2101(f), which states:

> To qualify for the credit, property must be used in Illinois by a taxpayer who is primarily engaged in manufacturing, or in mining coal or fluorite, or in retailing. It is not required that the property be used exclusively in manufacturing, mining of coal or fluorite or in retailing. So long as the taxpayer is primarily, more than 50%, engaged in one of these operations, all qualified property is eligible for the credit, even if the property is not actually used in an exempt manufacturing, coal or fluorite mining or retailing process. The taxpayer must engage primarily in one or more of the operations. In other words, a taxpayer that is engaged 30% of the time in retailing and 40% of the time in manufacturing will qualify for the credit, because the taxpayer is engaged primarily in one or more of the operations. In determining whether a taxpayer is primarily engaged in an activity the Department will look to the gross receipts of the taxpayer received in the ordinary course of business by that taxpayer. For example, if more than 50% of the taxpayer's gross receipts are from manufacturing, the taxpayer is primarily engaged in manufacturing, or if more than 50% of the gross receipts are from retailing, the taxpayer is primarily engaged in retailing.
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> EXAMPLE 2: Corporation B operates a hotel. 80% of the gross receipts of Corporation B are from the renting of rooms, 5% of the gross receipts are from the operation of a gift shop in the hotel and the remaining 15% of the gross receipts are from the operation of a restaurant and lounge in the hotel. The renting of rooms is not retailing. Therefore, Corporation B is ineligible for the credit because it is not engaged primarily in retailing, even though it does, through the operation of the gift shop, restaurant and lounge, engage in some retailing activities.

In this case, Company does not qualify for the credit under IITA Section 201(e) because it is not primarily engaged in manufacturing, or in mining coal or fluorite, or in retailing. Even though Company does engage in some manufacturing activities, well over 50% of its gross receipts are from sales of service. Therefore, Company is not primarily engaged in manufacturing and its property is not qualified property under IITA Section 201(e).

You are correct that prior to P.A. 88-141, Company's property would have qualified for the credit. Your letter requests that the Department allow the credit as it applied before P.A. 88-141. However, P.A. 88-141 changed the definition of qualified property so that property may qualify for the credit even though it is not used in manufacturing, mining, or retailing, provided it is used in Illinois by a taxpayer primarily engaged in one of these activities. In other words, the focus of the credit was shifted from the use of the property to the primary business of the taxpayer purchasing the property. After P.A. 88-141, a taxpayer primarily engaged in manufacturing, for example, may claim the credit not only for property actually used in the manufacturing process, but for other property as well. On the other hand, a taxpayer not primarily engaged in manufacturing is not eligible for the credit, even with respect to property actually used in a manufacturing activity.

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 have questions regarding this GIL you may contact Legal Services at (217) 782-7055. If you have further questions related to Illinois income tax laws, visit our website at www.revenue.state.il.us or contact the Department's Taxpayer Information Division at (217) 782-3336.

Sincerely,

Brian L. Stocker
Staff Attorney (Income Tax)