

General Information Letter: Petition for alternative apportionment contained insufficient information for the Department to grant the petition.

December 9, 2010

Dear:

This is in response to your letter dated October 7, 2010, in which you request permission to source sales without regard to the "throwout" rule in Section 304(a)(3)(C-5)(iv) of the Illinois Income Tax Act (the "IITA"; 35 ILCS 101 *et seq.*), pursuant to Section 304(f) of the IITA. The nature of your letter 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 86 Ill. Adm. Code 1200.120(b) and (c), which may be found on the Department's web site at www.revenue.state.il.us. For the reasons discussed below, your petition cannot be granted at this time.

In your letter you have stated the following:

IITA Section 304(a)(3) provides that if sales are not claimed in another state they will be attributed to Illinois. This method doesn't represent fairly the extent of the partnership operations and we hereby petition under IITA Section 304(f) for an alternative method of apportionment.

The partnership operates in many states across the United States; many of which do not have any filing requirements for partnerships. The operations of the LLC are to perform exams and other procedures for bank customers of their borrowers' collateral, including, but not limited to, accounts receivable and inventory. Illinois accounts for roughly 25% of the taxpayer's revenue from these exams. The collateral exams are conducted in Illinois and various other states and allocating 100% of taxpayer's income would not fairly represent the extent of their business activity in the state.

We are allocating all payroll and property factors to the state of Illinois because the administrative functions of the LLC are conducted in Illinois, but propose that we only allocate revenues derived from exam functions in Illinois be considered in the revenue apportionment calculation. Exam work performed in other states would be excluded from the Illinois apportionment calculation.

For the amended 2008 tax return, revenues apportioned to Illinois consisted of exam fees for exams performed in the state of Illinois which is less than the gross revenues derived from exams performed in all states. The Taxpayer's accounting system is set up to track sales by state and we request permission to use this method of apportionment with respect to exam fee revenues derived from work performed in the state of Illinois.

Response

Alternative Apportionment Petitions

Section 304(f) of the IITA provides:

If the allocation and apportionment provisions of subsections (a) through (e) and of subsection (h) do not fairly represent the extent of a person's business activity in this State, 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 factors;
- (3) The inclusion of one or more additional factors which will fairly represent the person's business activities 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 this provision are required to file a petition complying with the requirements of 86 Ill. Adm. Code Section 100.3390, which may be found on the Department's web site at [www. tax.illinois.gov](http://www.tax.illinois.gov).

86 Ill. Adm. Code Section 100.3390(c) provides:

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.

Sales Factor Throwout Rule

The so-called "throwout" rule is contained in Section 304(a)(3)(C-5)(iv) of the IITA, which provides that:

If the taxpayer is not taxable in the state in which the services are received, the sale must be excluded from both the numerator and the denominator of the sales factor.

Section 303(f) of the IITA provides that a person is "taxable in another state" if:

- (1) In that state he is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax;
or

(2) That state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does or does not.

For more detailed guidance, see 86 Ill. Adm. Code Section 100.3200.

In your petition, you appear to misconstrue these provisions as requiring exclusion from the sales factor of all "sales [that] are not claimed in another state" because other states "do not have any filing requirements for partnerships." This construction is contrary to Section 303(f)(2), which provides that a person may be "taxable in another state" even if that state does not actually impose a tax on that person.

Conclusion

Your petition contains no evidence that, assuming the taxpayers activities in other states are such that the other states have no jurisdiction to subject it to an income tax, application of the throwout rule would operate "unreasonably and arbitrarily in attributing to Illinois a percentage of income which is out of all proportion to the business transacted in this State." Accordingly, the petition cannot be granted at this time.

Please review your computation of the sales factor under Section 304(a)(3)(C-5) of the IITA, and see if application of the proper standard for determining whether the taxpayer is "taxable in another state" will not eliminate some or all of the issues you raise about the statutory apportionment factor.

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. Although your letter was dated October 7, 2010, the envelope was postmarked October 20, 2010. A petition filed on October 20, 2010, will allow a taxpayer to use the requested method on original returns due on or after February 17, 2011, if granted. Earlier years, including particularly the 2008 tax year for which you have already filed an amended return, can be dealt with if and when this petition is granted.

As stated above, this is a general information letter which 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 still believe that your petition should be granted, please supplement the petition in accordance with the provisions of 86 Ill. Adm. Code Section 100.3390. If you have any questions, you may contact me at (217) 524-3951.

Sincerely,

Paul S. Caselton
Deputy General Counsel -- Income Tax