

Private Letter Ruling: A corporation that elects to be a bank holding company during a taxable year is a financial organization for the entire taxable year.

April 22, 2010

Dear:

This Private Letter Ruling is in response to your letter dated February 9, 2010, in which you requested a Private Letter Ruling on behalf of COMPANY1 (“COMPANY1”) and its subsidiaries. The Department issues two types of letter rulings. Private Letter Rulings (“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 on 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. Persons seeking PLRs must comply with the procedures for PLRs found in the Department’s regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter (“GIL”) is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at www.tax.illinois.gov to review regulations, letter rulings and other types of information relevant to your inquiry.

Review of your request disclosed that all the information described in paragraphs 1 through 8 of Section 1200.110 appears to be contained in your request. This Private Letter Ruling will bind the Department only with respect to the combined group that includes COMPANY1 for the issue or issues presented in this ruling, and is subject to the provisions of subsection (e) of Section 1200.110 governing expiration of Private Letter Rulings. Issuance of this ruling is conditioned upon the understanding that neither COMPANY1 nor a related taxpayer is currently under audit or involved in litigation concerning the issues that are the subject of this ruling request. The facts and analysis as you have presented them are as follows:

COMPANY2, as an authorized agent for COMPANY1 (“COMPANY1” or “taxpayer”) requests a Private Letter Ruling in accordance with 2 Ill. Adm. Code 1200.110 to the effect that COMPANY1 and its subsidiaries are entitled to file a single combined financial organization unitary return for its entire fiscal year beginning December 1, 2008 and ending November 30, 2009 in accordance with Illinois Income Tax Act (“IITA”) Section 1501(A)(8).

DISCLOSURES

In accordance with 2 Ill. Adm. Code 1200.110(b)(3), the subjects of this request are not being examined as part of an audit by the Illinois Department of Revenue (“Department”) and they are not pending in litigation in a case involving the taxpayer or a related taxpayer.

In accordance with 2 Ill. Adm. Code 1200.110(b)(4), to the best of the knowledge of both the taxpayer and the taxpayer’s representative, the Department has not previously ruled on the same or a similar issue for the taxpayer or a predecessor. In addition, the taxpayer and its representatives have not previously submitted the same or a similar issue to the Department and withdrawn it before a letter ruling was issued.

TAXPAYER

COMPANY1 for purposes of this request, includes itself and all of its subsidiaries included in its combined federal income tax return as outlined in the "Statement of Facts" section below. COMPANY1 is submitting this Private Letter Ruling request in accordance with 2 Ill. Adm. Code 1200.110(a)(3)(A)(i), which permits one ruling request by the designated agent of a group of taxpayers filing a combined federal income tax return.

TAX YEAR

This ruling is requested for the tax year ending November 30, 2009 ("the 2009 tax year").

STATEMENT OF FACTS

COMPANY1 is a publicly-traded holding company for one of the nation's premiere credit card and electronic payment services operations. COMPANY1 is organized under the laws of STATE, and is commercially domiciled in CITY, Illinois. COMPANY1 has two principal lines of business. First, it engages in credit card and other consumer lending and deposit taking through its wholly-owned depository institution subsidiary BANK1, a STATE state nonmember bank regulated by the Federal Deposit Insurance Corporation ("FDIC") and the STATE office of the State Banking Commissioner. Second, it provides payment network services through three payment networks: (1) the NETWORK1, through which cards issued by BANK1 and a number of third party banks are accepted at merchant locations; (2) the NETWORK2, an international charge card network; and (3) the NETWORK3, a U.S. automated teller machine and debit card network. On MONTH1 XX, 2008, COMPANY1 registered to become a bank holding company ("BHC") under the Bank Holding Company Act of 1956 ("BHC Act"). Section 5(a) of the BHC Act provides "within 180 days after becoming a bank holding company...each bank holding company shall register with the Board on forms prescribed by the Board." COMPANY1's intent to become a bank holding company was to receive funding from the Federal Trouble Asset Relief Program ("TARP").

TARP is a national program established as part of the Emergency Economic Stabilization Act of 2008 ("EESA") to help restore stability and liquidity to the U.S. financial system. Under EESA, the U.S. Treasury created the Capital Purchase Program ("CPP") under which it would purchase senior preferred stock and warrants in eligible institutions to increase cash flow of credit to businesses and consumers and to support the economy. The U.S. Treasury disbursed \$303.3 billion in TARP funds, a majority of which went to the CPP, the U.S. Treasury's primary vehicle under TARP for stabilizing financial markets. Only eligible institutions were able to participate in the CPP. An "eligible institution" included BHCs, financial holding companies, insured depository institutions and savings and loan holding companies that engaged solely or predominantly in activities that is permissible for financial holding companies under relevant law. COMPANY1 was not an "eligible institution" for purposes of the BHC Act prior to its registering to become a BHC.

Under BHC Act Section 4(f)(1), a company which controlled an institution which became a bank as a result of the enactment of the Competitive Equality Amendments of 1987 and was not a BHC on the day before the enactment of the above mentioned act, shall not be treated as a BHC solely by virtue of such company's control of such institution ("grandfathered status"). COMPANY1's ownership of BANK1 disqualifies it as a BHC since control of a bank does not constitute status as a BHC. On MONTH1 XX, 2008, COMAPNY1 surrendered the

grandfathered status under Section 4(f)(1) of the BHC Act by registering as a BHC under Section 5(a) of the BHC Act.

On MONTH1 X, 2008, COMPANY1 filed its application to become a BHC with the Federal Reserve. The application was tentatively approved by the Federal Reserve on MONTH1 XX, 2008. Preliminary TARP approval was given over the phone on MONTH3 XX, 2009 and later the preliminary approval was referenced in a letter dated MONTH4 XX, 2009.

Although COMPANY1's application was tentatively approved in MONTH1 by the Federal Reserve, its bank holding status did not become effective until MONTH2 XX, 2009. COMPANY1 required additional time to issue preferred stock and warrants to the U.S. Treasury, in return for CPP funding. On MONTH2 XX, 2009, COMPANY1 received approximately \$X.X billion in funds through the CPP.

Under Illinois law, a combined return is required to be filed by all members engaged in a unitary business. However, the definition of a unitary business group states "in no event, however, will any unitary business group include members which are ordinarily required to apportion business income under a different subsection of Section 304... If a unitary business group would include members that are ordinarily required to apportion business income under different subsections of Section 304, then for each subsection of Section 304 for which there are two or more members, there shall be a separate unitary business group composed of such members." IITA Section 1501(a)(27).

In the past, COMPANY1 was required to file two corporate Illinois income tax returns because certain members of its unitary business group were deemed financial organizations while other members of its unitary group were non-financial organizations. For the tax year ending November 30, 2007 COMPANY1's financial organizations included the following entities: COMPANY3, COMPANY4, BANK1, COMPANY5, COMPANY6 and BANK2 (hereafter referred to as "COMPANY1's financial organizations"). For the tax year ending November 30, 2007 COMPANY1's non-financial organizations included the following entities" COMPANY1, COMPANY7 COMPANY8, COMPANY9, COMPANY10, COMPANY11, COMPANY12, COMPANY13 and COMPANY14 (hereafter referred to as "COMPANY1's non-financial organizations").

After COMPANY1's conversion to a BHC, it will no longer be required to file two separate unitary corporate income tax returns in Illinois. Under Illinois law, a financial organization includes any person which is owned by a bank or BHC. IITA Section 1501(a)(8). COMPANY1's conversion to a BHC classifies all of its subsidiaries as financial organizations for Illinois income tax purposes.

RULING REQUESTED

1. For purposes of filing its fiscal year 2009 Illinois corporate income tax return (December 1, 2008 through November 30, 2009), can COMPANY1 file a unitary financial organization return for its entire fiscal year? We are unaware of any guidance that the Department has provided to an entity that converted to a BHC during the taxable year and the effect that said conversion has to the unitary group for the entire taxable year. COMPANY1 requests the Department to issue

a ruling that permits COMPANY1 to file one financial organization unitary return for all members of its combined group for the tax period December 1, 2008 through November 30, 2009.

DISCUSSION

IITA Section 1501(a)(8) defines a financial organization as “any bank, bank holding company, trust company, savings bank, industrial bank, land bank, safe deposit company, private banker, savings and loan association, building and loan association, credit union, currency exchange, cooperative bank, small loan company, sales finance company, investment company, or any person which is owned by a bank or bank holding company.” IITA Section 1501(a)(8) further defines a “person” as only those persons which a “bank holding company may acquire and hold an interest in, directly or indirectly, under the provisions of the Bank Holding Company Act of 1956 (12 U.S.C. 1841, et seq.), except where interests in any person must be disposed of within certain required time limits under the Bank Holding Company Act of 1956.” A “person” under the IITA is construed to mean and include an individual, a trust, estate, partnership, association, firm, company, corporation, limited liability company or fiduciary.”

The same definition of a “financial organization” is also incorporated in 86 Ill. Adm. Code 100.9710(g) which states the term “financial organization” under the IITA includes any person that is owned by a bank (within the meaning of subsection (d)(1) of this Section or subsection (e) of this Section) or by a bank holding company (within the meaning of subsection (f) of this Section).

After COMPANY’s conversion to a BHC, all of COMPANY1’s subsidiaries are deemed financial organizations and are included in a financial organization unitary corporate income tax return. There is however, a lack of guidance as to the filing requirements when an entity converts into a BHC during its taxable year and the effect that said election has on the non-financial organization entities.

The Department has provided guidance in various general information letters and private letter rulings with regards to short period returns. For example, in Illinois Private Letter Ruling No. IT 87-0276, the Department rule that corporate subsidiaries acquired in an acquisition were permitted to file one 12 month Illinois return encompassing the fragmented federal periods which together comprise only one 12 month period. The corporate subsidiaries filed federal income tax returns in consolidation with its parent corporation. Subsequently, another entity acquired 83% of the corporate subsidiaries, which resulted in a fragmented federal income tax year. The business activities of the corporate subsidiaries remained unchanged and the ability to file a single Illinois tax return would eliminate the superfluous paperwork. The letter discusses the application of IITA Section 401, stating the taxable year of a person shall be the same as the taxable year of such person for federal income tax purposes. The Department ruled that usually an Illinois return is required for each taxable year, including short taxable years. However, the Department has interpreted IITA Section 401 to permit the taxpayer to file one 12 month Illinois encompassing the fragmented federal periods which together comprise one 12 month period. See also PLR IT 87-0003 and General Information Letter IT 01-0034-GIL.

Unlike these rulings, COMPANY1's tax year is unchanged from its conversion to a BHC and COMPANY1 will be required to file a full year federal consolidated tax return for the fiscal year ending November 30, 2009. Under 86 Ill. Adm. Code 5270(f), the Department addresses the computation of combined income for part year members of a unitary group. This regulation provides for the situation when a corporation becomes a member of a unitary business group after the beginning of the combined return year or ceases to be a member of the unitary business group during the combined return year.

86 Ill. Adm. Code 5270(f) does not address the situation where a corporation becomes a BHC during the year and how said treatment affects the unitary group. This regulation's focus is on companies leaving or entering a unitary group. This regulation is silent on the statutory preference that is placed on a BHC. IITA Section 1501(a)(8) clearly states that "any person" that is owned by a BHC is treated as a financial organization, but is silent about when a subsidiary of a bank holding company will be treated as a financial organization.

The Internal Revenue Service has looked to the status of a taxpayer as of the last day of the taxpayer's taxable year to determine the classification of a taxpayer for filing purposes. In the case of marital status, the determination of whether an individual is married is made as of the close of the individual's taxable year. See Internal Revenue Code Section 7703(a)(1). Illinois has incorporated the marital status as determined for federal income tax purposes in IITA Section 502(c).

There is no question that COMPANY1 is a BHC on the last day of its taxable year ending November 30, 2009. COMPANY1 had requested and received tentative approval from the Federal Reserve Board to be a BHC on MONTH1 XX, 2008, only XX days after the start of its fiscal year. As a practical matter, no accounting reports were prepared as of the conversion date (MONTH2 XX, 2009). Apportionment data for the three and a half month period does not exist. As discussed, COMPANY1 will be preparing a single federal consolidated return for its entire fiscal year and all of its subsidiaries will be included in the same federal return.

COMPANY1's financial and nonfinancial groups have been unitary since 1986 and had filed as one unitary financial group up until approximately 1991 when an organization structural change required COMPANY1 to file two unitary groups, one financial and one nonfinancial. The prior filings have been audited by the Department and said filing methods have been sustained. There has been no material change in the operation of any entity due to the conversion of COMPANY1 to a BHC.

Providing full year income and apportionment data in a single financial organization Illinois unitary return will fairly reflect COMPANY1 and its subsidiaries' income and tax due the State of Illinois. COMPANY1 requests that the Department permit the filing of one 12 month period beginning December 1, 2008 and ending November 30, 2009.

RULING

IITA Section 1501(a)(27) defines the term "unitary business group," in part, as follows:

The term “unitary business group” means a group of persons related through common ownership whose business activities are integrated with, dependent upon and contribute to each other.

...

Common ownership in the case of corporations is the direct or indirect control or ownership of more than 50% of the outstanding voting stock of the persons carrying on unitary business activity. Unitary business activity can ordinarily be illustrated where the activities of the members are: (1) in the same general line (such as manufacturing, wholesaling, retailing of tangible personal property, insurance, transportation or finance); or (2) are steps in a vertically structured enterprise or process (such as the steps involved in the production of natural resources, which might include exploration, mining, refining and marketing); and, in either instance, the members are functionally integrated through the exercise of strong centralized management (where, for example, authority over such matters as purchasing, financing, tax compliance, product line, personnel, marketing and capital investment is not left to each member). In no event, however, will any unitary business group include members which are ordinarily required to apportion business income under different subsections of Section 304 except that for tax years ending on or after December 31, 1987 this prohibition shall not apply to a unitary business group composed of one or more taxpayers all of which apportion business income pursuant to subsection (b) of Section 304, or all of which apportion business income pursuant to subsection (d) of Section 304, and a holding company of such single-factor taxpayers (see definition of “financial organization” for rule regarding holding companies of financial organizations). If a unitary business group would, but for the preceding sentence, include members that are ordinarily required to apportion business income under different subsections of Section 304, then for each subsection of Section 304 for which there are two or more members, there shall be a separate unitary business group composed of such members. For purposes of the preceding two sentences, a member is “ordinarily required to apportion business income” under a particular subsection of Section 304 if it would be required to use the apportionment method prescribed by such subsection except for the fact that it derives business income solely from Illinois.

As this section indicates, the determination of the composition of a unitary business group requires a factual determination as to whether a group of persons engage in certain integrated activities. Primarily for this reason, the Department does not issue rulings regarding the composition of a unitary business group. Consequently, we are unable to rule, as you request, that COMPANY1 and its subsidiaries must file one financial organization unitary return for the tax year ending November 30, 2009. However, as discussed below, because COMPANY1 and each of its subsidiaries included on the consolidated federal income tax return are financial organizations for the group’s taxable year ending November 30, 2009, the rule in Section 1501(a)(27) prohibiting members which are ordinarily required to apportion business income under different subsections of Section 304 from constituting a unitary business group does not apply in this case.

Section 304 of the Illinois Income Tax Act (“IITA”; 35 ILCS 5/304) contains apportionment rules that determine the amount of business income of a nonresident that is taxable in Illinois where the income is derived from Illinois and one or more other states. Under Section 304(a) and (h), the general apportionment rule requires a taxpayer to multiply its business income for the taxable year by its sales factor. Section 304(a)(3)(A) defines the “sales factor” as the fraction consisting of the taxpayer’s total sales in Illinois during the taxable year over its total sales everywhere during the taxable year.

The apportionment required under Section 304(a) is to be performed following the close of the taxpayer's taxable year. The taxpayer determines its total business income for the taxable year, and then apportions to Illinois that part of such income that bears the same ratio as the taxpayer's Illinois sales for the taxable year bears to total taxable year sales.

IITA Section 304(c) provides a special apportionment formula for financial organizations. The same basic methodology applies as under Section 304(a), except that instead of using the sales factor a financial organization multiplies its business income by the fraction of its business income from Illinois sources over its total business income from all sources.

IITA Section 1501(a)(8) defines the term "financial organization" as follows:

(A) The term "financial organization" means any bank, bank holding company, trust company, savings bank, industrial bank, land bank, safe deposit company, private banker, savings and loan association, credit union, currency exchange, cooperative bank, small loan company, sales finance company, investment company, or any person which is owned by a bank or bank holding company. For the purposes of this Section a "person" will include only those persons which a bank holding company may acquire and hold an interest in, directly or indirectly, under the provisions of the Bank Holding Company Act of 1956 (12 U.S.C. 1841, et seq.), except where interests in any person must be disposed of within certain required time limits under the Bank Holding Company Act of 1956.

(B) For purposes of subparagraph (A) of this paragraph, the term "bank" includes (i) any entity that is regulated by the Comptroller of the Currency under the National Bank Act, or by the Federal Reserve Board, or by the Federal Deposit Insurance Corporation and (ii) any federally or State chartered bank operating as a credit card bank.

Department of Revenue Regulations Section 100.9710(b) states as follows regarding the financial organization definition:

Entities Engaged in Financial Organization Activities and Other Activities. For purposes of this Section, an entity that is classified as a "bank" under subsection (e) of this Section; as a "bank holding company" under subsection (f) of this Section; or as a person owned by a bank or bank holding company under subsection (g) of this Section, is a "financial organization" regardless of whether the entity is predominantly engaged in the business activities characteristic of a financial organization. In order for any other entity to be characterized as a "financial organization" in any tax year, the entity must be predominantly engaged in the business activities of a financial organization during the year. For this purpose, an entity engaged in business activities of a financial organization, as well as other business activities in the same tax year, is predominantly engaged in the business activities of a financial organization during that year only if more than 80% (50% in the case of a sales finance company under subsection (d)(10) of this Section) of the entity's gross income, averaged over a period of three years, which includes the current tax year and the immediately preceding two tax years, is derived from the business activities characteristic of one or more of the categories of financial organization defined in this Section for which the entity otherwise qualifies. For purposes of this subsection, gross income shall include only amounts that are received in the ordinary course of the entity's regular business activities and that are included in net income under the Illinois Income Tax Act. For purposes of determining whether an entity is predominantly

engaged in the business activities of a financial organization when an entity is formed in a current tax year or in its immediately preceding tax year, only the years for which the entity is in existence will be used in determining whether the entity meets the 80% test (or 50% test in the case of a sales finance company under subsection (d)(10) of this Section).

Under this regulation, the determination of whether a taxpayer is classified as a financial organization is made following the close of the taxable year. The 80% test set forth in the regulation is not applied to determine apportionment on an item-by-item basis, nor on a daily, weekly, monthly, quarterly, or other basis. This is consistent with the application of the general apportionment method, which is applied to the taxpayer's business income for the taxable year. If the taxpayer meets the 80% test (based on its average gross income for the current tax year and two prior tax years) then it is a financial organization for the entire taxable year and all of its business income for that tax year is apportioned under IITA Section 304(c).

The determination of whether a taxpayer is a financial organization on the basis of its status as a bank, bank holding company, or person owned by a bank or bank holding company is made similarly. If a taxpayer is a bank, bank holding company, or person owned by a bank or bank holding company as of the close of the taxpayer's taxable year, then it is a financial organization for apportionment purposes with respect to its entire taxable year and all of its business income for that tax year is apportioned under IITA Section 304(c).

Regarding the definition of "bank holding company," Department Regulations Section 100.9710(f) states:

The term "bank holding company" means an entity that directly or indirectly owns, controls or has power to vote 25% or more of any class of voting securities of any bank or of any other bank holding company (see 12 USC 1841(a)), and which is registered with the Board of Governors of the Federal Reserve System under Section 1844(a) of the Bank Holding Company Act of 1956 (12 USC 1844(a)).

Department Regulations Section 100.9710(g) states the special rule for persons owned by a bank or bank holding company.

The term "financial organization" under the Illinois Income Tax Act includes any person that is owned by a bank (within the meaning of subsection (d)(1) of this Section or subsection (e) of this Section) or by a bank holding company (within the meaning of subsection (f) of this Section). For purposes of this provision, the term "person" includes only those persons in which a bank holding company may acquire and hold an interest, directly or indirectly, under the provisions of the Bank Holding Company Act of 1956 (12 USC 1841) and Regulation Y promulgated thereunder by the Board of Governors of the Federal Reserve System (12 CFR 225), and does not include any person that must be disposed of within certain required time limits under the Bank Holding Company Act of 1956. Under this provision, an entity that would not otherwise be a "financial organization" is deemed to be a financial organization for any period during which it is owned by a bank or bank holding company. For example, prior to the enactment of Public Law 106-102, 12 USC 1843(c)(8) authorized bank holding companies to own insurance companies in certain circumstances. 12 USC 1843(c)(8) allows a bank holding company that owned an insurance company prior to November 12, 1999, to continue to own that insurance company. An insurance company owned by a bank holding company is a

“financial organization” for purposes of the IITA, even though the insurance company would not otherwise be a financial organization. The fact that an entity that is not owned by a bank holding company would be a financial organization under this provision if it were owned by a bank holding company, or that the entity in the past may have been owned by a bank holding company and therefore characterized as a financial organization, is irrelevant to the determination of whether the entity is a financial organization.

Applying the above to the facts in this case, and based upon your representation that COMPANY1 was a bank holding company as of the close of its taxable year ending November 30, 2009, COMPANY1 is a financial organization for apportionment purposes for that entire taxable year and all of its business income for that taxable year must be apportioned under IITA Section 304(c). In addition, because each subsidiary included on COMPANY1’s consolidated federal income tax return is owned by a bank holding company as of the close of the subsidiary’s taxable year ending November 30, 2009, each subsidiary is a financial organization for that entire taxable year. Therefore, each subsidiary is required to apportion business income under subsection (c) of Section 304 for such taxable year. It follows that the rule in Section 1501(a)(27) prohibiting members which are ordinarily required to apportion business income under different subsections of Section 304 from constituting a unitary business group does not apply to the group’s taxable year ending November 30, 2009. Accordingly, provided that the activities of COMPANY1 and its subsidiaries are “integrated with, dependent upon, and contribute to each other,” as required under Section 1501(a)(27), COMPANY1 is required to file a combined Illinois income tax return for the taxable year ending November 30, 2009 including each of the subsidiaries included on its federal consolidated return.

This ruling shall bind the Department for the taxable year ending November 30, 2009, except as limited pursuant to 2 Ill. Adm. Code 1200.110(d) and (e). The facts upon which this ruling is based are subject to review by the Department during the course of any audit, investigation or hearing and this ruling shall bind the Department only if the material facts as recited in this ruling are correct and complete. This Private Letter Ruling is revoked and will cease to bind the Department 10 years after the date of this letter under the provisions of 2 Ill. Adm. Code 1200.110(e) or earlier if there is a pertinent change in statutory law, case law, rules or in the factual representations recited in this ruling.

I hope this information is helpful. If you have questions concerning this Private Letter Ruling, you may contact me at (217) 782-2844. If you have further questions related to the Illinois sales tax laws, please visit our website at www.tax.illinois.gov or contact the Department’s Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Terry D. Charlton
Chairman, Private Letter Ruling Committee