

IT 11-0002-GIL 01/21/2011 SUBTRACTION MODIFICATIONS – ENTERPRISE AND FOREIGN
TRADE ZONES

General Information Letter: Dividends do not qualify for the subtraction for the enterprise zone subtraction unless the corporation paying the dividends conducts at least 95% of its business activities in the enterprise zone.

January 21, 2011

Dear:

This is in response to your letter dated September 17, 2010 in which you state the following:

COMPANY1 (“COMPANY1”) is requesting a letter ruling pursuant to 2 ILAC 1200.110. This request for a Private Letter Ruling (“PLR”) is prepared by the undersigned who is acting as power of attorney for COMPANY1 pursuant to an original Form 2848, Power of Attorney, enclosed herein. As required by 2 ILAC 1200.110(b)(3), COMPANY1 affirmatively represents or requests the following:

1. This PLR is not requested with regard to hypothetical or alternative proposed transactions. The PLR is requested to determine the income tax consequences of the actual business practices of COMPANY1.
2. The issues presented in this letter ruling request are not currently under investigation or audit by the Illinois Department of Revenue.
3. Additionally, such issues are not pending in any litigation involving the Illinois Department of Revenue and COMPANY1 or a related taxpayer.
4. Also, as required by 2 ILAC 1200.110(b)(4), neither COMPANY1 nor COMPANY2, its power of attorney for purposes of this PLR request, have any subjective knowledge of any ruling issued to COMPANY1 or a predecessor by the Illinois Department of Revenue on the same or similar issues or of any previously submitted ruling requests on the same or similar issues.
5. COMPANY1 knows of no authority contrary to the authorities referred to and cited in this PLR request.
6. COMPANY1 requests that certain information be deleted from the PLR prior to dissemination to others, including its name, address, description of its products being sold and the firm name of its power of attorney.

Facts

1. COMPANY1 (“COMPANY1”) is an Illinois Corporation formed on or around X/XX/2006. It is headquartered at STREET, CITY1, Illinois ZIP CODE.
2. COMPANY1 has elected to be taxed as an “S” Corporation for purposes of federal and state income taxation pursuant to IRC §1362 and ILAC 100.9750.
3. COMPANY3 (“COMPANY3”) is an Illinois Corporation formed on or around X/XX/2004. For federal income tax purposes, COMPANY3 elected to be treated as an “Interest Charge-Domestic International Sales Corporation” as defined by IRC §992 by filing IRS form 4876-A. COMPANY3 is wholly-owned by COMPANY1.
4. COMPANY3 has established a separate federal employer identification number.

5. COMPANY3 opened and maintains bank accounts in its own corporate name to receive and disburse funds.
6. COMPANY3 maintains separate corporate and financial books and records.
7. COMPANY3 files an annual IRS form 1120 IC-DISC. By filing form 1120 IC-DISC, COMPANY3 validates that it is in compliance with the export asset and export income tests contained in the Internal Revenue Code.
8. COMPANY3 was formed to act as a conduit for export sales made by COMPANY1.
9. All the operations of COMPANY1 and COMPANY3 are located at STREET, CITY1, Illinois ZIP CODE. These Illinois operations are within the geographic boundaries of the Illinois LOCATION Enterprise Zone, which was formed on March XX, 19XX and includes portions of CITY1, CITY2, CITY3, CITY4 and COUNTY within its geographic boundaries.
10. Company3 is paid a commission by COMPANY1 as COMPANY1 export sales conduit. This amount of this commission is determined as the greater of the following: 1) 4% of the qualified export sales transacted with the IC-DISC as the conduit; or 2) 50% of the export taxable income generated by COMPANY1 as the exporter.
11. Pursuant to the federal income tax law, the commissions received by COMPANY3 must either be paid as a dividend to the COMPANY1, as the IC-DISC shareholder, or accumulated and "loaned" back to COMPANY1 to fund operations.
12. On an annual basis, COMPANY3 affirmatively declares and pays dividends to its shareholder, COMPANY1, in amount equivalent to its commission income generated through its activities as an IC-DISC.
13. COMPANY1 has treated the dividends from COMPANY3 as income on the relevant federal 1120S and Illinois Form IL-1120-ST income tax returns filed for past tax years.
14. Since COMPANY1 is an S Corporation, the dividends received by COMPANY1 from COMPANY3 are effectively "passed through" as income to the individual shareholders of COMPANY1.
15. As relevant to this letter ruling request, the dividend income received by COMPANY1 from COMPANY3 is reported to each shareholder of COMPANY1 as a distributive share of COMPANY1s' dividend income apportionable or allocable to Illinois, as appropriate, on Illinois Schedule K-1-P.
16. The individual shareholders receiving distributive shares of COMPANY1s' dividend income apportionable or allocable to Illinois have an individual income tax return filing obligation in Illinois related to such income.

Issue

Is an individual shareholder of COMPANY1 with an income tax return filing obligation in Illinois

entitled to deduct from the shareholder's Illinois Adjusted Gross Income an amount equal to such shareholders' distributive share of the dividend paid by COMPANY3 to COMPANY1 pursuant to IITA §203 and ILAC 100.2480?

Ruling Desired

Yes. The dividend income received by COMPANY1s' shareholders may be excluded from such shareholders' Illinois Adjusted Gross Income pursuant to IITA §203 and ILAC 100.2480.

Discussion and Analysis

IITA Section 203(a)(2)(J) provides for an exclusion from Adjusted Gross Income for the following:

An amount equal to those dividends included in such total which were paid by a corporation which conducts business operations in an Enterprise Zone or zones created under the Illinois Enterprise Zone Act or a River Edge Redevelopment Zone or zones created under the River Edge Redevelopment Zone Act, and conducts substantially all of its operations in an Enterprise Zone or zones or a River Edge Redevelopment Zone or zones.

Pursuant to IITA Section 203 (a)(2)(J), individual taxpayers are entitled to subtract from adjusted gross income an amount equal to dividends paid by a corporation which conducts business operations in an Enterprise Zone created under the Illinois Enterprise Zone Act, and conducts all or substantially all of its operations in the Enterprise Zone.

ILAC 100.2480(b), Enterprise Zone Dividend Subtraction, defines "conduct[ing] all or substantially all of its operations in the Enterprise Zone as follows:

(b) A corporation conducts substantially all of its business within an Enterprise Zone when 95% or more of its total business activity during a taxable year is operated within an Enterprise Zone. For the purpose of this Section, business activity within an Enterprise Zone shall be measured by means of the factors ordinarily applicable to the corporation under subsection (a), (b), (c), or (d) of IITA Section 304 except that, in the case of a corporation ordinarily required to apportion business income under subsection (a) of Section 304, such corporation shall not use the sales factor in the computation. Thus, for example, for taxable years ending on or after December 31, 2000, for purposes of determining whether dividends may be subtracted under this Section, a corporation that apportions its business income under subsection (a) of Section 304 using only the sales factor in accordance with subsection (h) of Section 304 must still compute its property and payroll factors.

In measuring the business activity of a corporation within an Enterprise Zone, the apportionment factors of that corporation shall be determined without regard to the factors or business activity of any other corporation and, in the case of a corporation engaged in a unitary business with any other person, the apportionment factors of that corporation shall be determined as if it were not engaged in a unitary business with such other person.

(1) Section 304 Corporations: A corporation using Section 304 to apportion

business income to Illinois shall compare the corporation's property and payroll within an enterprise Zone to the corporation's property and payroll everywhere. The result of the property and payroll factor computations shall be divided by 2 (by one if either the property or payroll factor has a denominator of zero). If the amount so computed is 95% or greater, the dividends paid by the corporation shall qualify for this subtraction. In the case where a corporation does not have any payroll or property within an Enterprise Zone, the corporation is not conducting any of its business operations within an Enterprise Zone for the purpose of this Section.

(2) All Other Corporations: A corporation using a 1-factor apportionment formula under subsection (b), (c) or (d) of IITA Section 304 shall determine business activity conducted within an Enterprise Zone by comparing business income from sources within the Enterprise Zone and everywhere else pursuant to its ordinarily applicable factor under subsection (b), (c) or (d) of Section 304. A corporation using an alternative method of apportionment under Section 304(f) shall petition the Department for approval of an appropriate method of determining its qualification under this Section, and only upon the Department's approval shall the corporation be allowed to use a method not provided in this Section.

COMPANY3 should be deemed to "conduct all or substantially all of its operations" in the LOCATION Enterprise Zone pursuant to ILAC 100.2480(b)(1) or, in the alternative, pursuant to ILAC 100.2480(b)(2)

As a C Corporation IC-DISC, COMPANY3 does not file a Form-IL-1120. As a result, it does not compute separate company Illinois apportionment factor pursuant to IITA 304. However, as an IC-DISC, COMPANY3 does the following from its location in the LOCATION Enterprise Zone:

- COMPANY3 maintains bank accounts in its own corporate name to receive and disburse funds;
- COMPANY3 maintains separate corporate and financial books and records;
- COMPANY3 files an annual IRS form 1120 IC-DISC. By filing form 1120 IC-DISC, COMPANY3 validates that it is in compliance with the export asset and export income tests contained in the Internal Revenue Code;
- COMPANY3 acts as a conduit for export sales made by COMPANY1 and is a party to a Sales Franchise Agreement executed between COMPANY3 and COMPANY1;
- Pursuant to the Sales Franchise Agreement, COMPANY3 generates commissions paid by COMPANY1. The amount of this commission is determined as the greater of the following: 1) 4% of the qualified export sales transacted with the IC-DISC as the conduit; or 2) 50% of the export taxable income generated by COMPANY1 as the exporter. COMPANY3 calculates this commission payment.
- The commissions received by COMPANY3 are paid as a dividend to the COMPANY1, and the Board of Directors of COMPANY3 prepares resolutions and consents

documenting the Board's actions in relation to the dividend declaration on an annual basis.

The above-cited business activities of COMPANY3 constitute all of its operations and all such business activities are performed at its location in the LOCATION Enterprise Zone.

As a result, it is patent that all of COMPANY3 "business operations," as the term should be construed for purposes of IITA §203 and ILAC 100.2480(b)(1) are conducted in the LOCATION Enterprise Zone.

In the alternative, ILAC 100.2480(b)(2) provides an additional test for determining whether "all or substantially all" of COMPANY3 operations are conducted in the LOCATION Enterprise Zone. Assuming that COMPANY3 should be hypothetically entitled to apportion its income using the single sales-factor methodology set forth in IITA §304, ILAC 100.2480(b)(2) requires that COMPANY3 determine its business activity conducted within an Enterprise Zone by comparing business income from sources within the Enterprise Zone and everywhere else. As stated in the facts above, COMPANY3 only source of income is its receipt of commissions paid to it by COMPANY1 pursuant to the Sales Franchise Agreement executed between the parties, and all of this income was received within the Enterprise Zone. Since it received all of its business income from sources within the Enterprise Zone, COMPANY3 would meet the 95% test set forth as a condition precedent to the claiming of the IITA Section 203(a)(2)(J) dividend exclusion.

Conclusion

An executed Power of Attorney Form is attached authorizing COMPANY2 to act on COMPANY1's behalf in this matter.

Ruling of the Department

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

The nature of your inquiry calls for factual determinations which the Department will not make in a private letter ruling. We are therefore required to respond with a GIL. GILs are designed to provide background information on specific topics. GILs, however, are not binding on the Department.

The Illinois Income Tax Act ("IITA," 35 ILCS 5/101 et seq.) permits individuals to deduct dividends included in federal adjusted gross income that were "paid by a corporation which conducts business operations in an Enterprise Zone or zones created under the Illinois Enterprise Zone Act ... and conducts substantially all of its operations in an Enterprise Zone or zones." IITA Section 203(a)(2)(J).

Your letter correctly cites to the Illinois Administrative Code Section 100.2480(b) as the authority on how to determine whether a corporation "conducts substantially all of its operations in an Enterprise Zone." Section 100.2480(b)(1) pertains to IITA Section 304(a) corporations while 100.2480(b)(2) pertains to Insurance Companies (IITA Section 304(b)), Financial Organizations (IITA Section

304(c)), and Transportation Services Companies (IITA Section 304(d)). COMPANY3 is not an Insurance Company, Financial Organization or a business furnishing transportation services making Illinois Administrative Code Section 100.2480(b)(1) the applicable provision to COMPANY3. Illinois Administrative Code Section 100.2480(b)(1) states as follows:

100.2480(b): A corporation conducts substantially all of its business within an Enterprise Zone when 95% or more of its total business activity during a taxable year is operated within an Enterprise Zone. For the purpose of this Section, business activity within an Enterprise Zone shall be measured by means of the factors ordinarily applicable to the corporation under subsection (a), (b), (c), or (d) of IITA Section 304 except that, in the case of a corporation ordinarily required to apportion business income under subsection (a) of Section 304, such corporation shall not use the sales factor in the computation. Thus, for example, for taxable years ending on or after December 31, 2000, for purposes of determining whether dividends may be subtracted under this Section, a corporation that apportions its business income under subsection (a) of Section 304 using only the sales factor in accordance with subsection (h) of Section 304 must still compute its property and payroll factors.

In measuring the business activity of a corporation within an Enterprise Zone, the apportionment factors of that corporation shall be determined without regard to the factors or business activity of any other corporation and, in the case of a corporation engaged in a unitary business with any other person, the apportionment factors of that corporation shall be determined as if it were not engaged in a unitary business with such other person.

(1) Section 304 Corporations: A corporation using Section 304 to apportion business income to Illinois shall compare the corporation's property and payroll within an enterprise Zone to the corporation's property and payroll everywhere. The result of the property and payroll factor computations shall be divided by 2 (by one if either the property or payroll factor has a denominator of zero). If the amount so computed is 95% or greater, the dividends paid by the corporation shall qualify for this subtraction. ***In the case where a corporation does not have any payroll or property within an Enterprise Zone, the corporation is not conducting any of its business operations within an Enterprise Zone for the purpose of this Section.***

Emphasis added.

Your letter does not indicate that COMPANY3 has any payroll or property within the Illinois LOCATION Enterprise Zone. The above emphasized portion of Illinois Administrative Code Section 100.2480(b)(1) clearly states that without any payroll or property COMPANY3 is not conducting any of its business operations within the Enterprise Zone for purposes of IITA Section 203(a)(2)(J). Unless there are facts to dispute this, COMPANY1 is not entitled to deduct shareholders' distributive share of dividends paid by COMPANY3.

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

Sincerely,

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Heidi Scott
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