

Private Letter Ruling: Receipts from sale of assets comprising a business segment are excluded from the sales factor as being from an occasional sale.

March 1, 2013

Dear:

This is in response to your letter dated August 1, 2012, in which you request a Private Letter Ruling on behalf COMPANY1. Review of your request for a Private Letter Ruling disclosed that all information described in paragraphs 1 through 8 of subsection (b) of 2 Ill. Adm. Code Section 1200.110 appears to be contained in your request. The Private Letter Ruling will bind the Department only with respect to COMPANY1 for the issue or issues presented in this ruling. 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 in your letter, as supplemented on December 11, 2012, are as follows:

In conformity with the requirements of 2 Ill. Adm. Code 1200.110, I respectfully request a Private Letter Ruling ("PLR") on behalf of COMPANY1 (formerly known as COMPANY2) ("COMPANY1" or "Taxpayer"). Copies of a Power of Attorney authorizing my representation of COMPANY1 are attached.

Neither COMPANY1 nor any related taxpayer is currently under audit by the Illinois Department of Revenue (the "Department" or "IDOR") or involved in litigation with IDOR concerning the issues that are the subject of this ruling request. To the best of the knowledge of COMPANY1 and COMPANY1's representative, the Department has not previously ruled on the same or a similar issue for COMPANY1 or a predecessor to Taxpayer. Neither COMPANY1, nor any related taxpayer, or any representatives of COMPANY1 have previously submitted the same or a similar issue to the Department, but withdrew it before a letter ruling was issued. This ruling request applies to the Illinois income tax treatment of a transaction entered into in 2011. All interested parties are identified, as are the business reasons for the transaction. An analysis of the relation of the material facts to the issues is set forth below. A complete statement of the facts and other information pertinent to the request for ruling is set forth below.

#### STATEMENT OF FACTS

COMPANY1 (formerly known as COMPANY2) is a leader in enterprise analytics. COMPANY1 captures, analyzes and creates insight from unstructured conversations, emails, employee desktop activity and customer data.

COMPANY1's executive offices are currently located at STREET, CITY1, Illinois. Prior to June 1, 2011, the company's executive offices were located in CITY2, Illinois.

Beginning in 2008, the Company operated in two business segments: the UNIT1 and the UNIT2. The UNIT1 focuses on solutions that improve the reliability of call recording and applies human behavioral modeling to analyze and improve customer interactions and help optimize the performance of call center agents. The UNIT1 is primarily a hosted solution and delivered as a managed subscription service. The UNIT2 focuses on helping clients realize the benefits of transitioning their contact centers to a single

network infrastructure from the traditional two-network (voice network and separate data network) model.

On March X, 20XX COMPANY1 entered into an Acquisition Agreement providing for the sale of all its assets used in the UNIT2 to a subsidiary of COMPANY3. On May X, 20XX COMPANY1 completed the sale of UNIT2 to COMPANY4, a STATE limited liability company and wholly-owned subsidiary of COMPANY3. Pursuant to the terms of the Acquisition Agreement, COMPANY3 acquired substantially all of the assets, and assumed certain of the liabilities, related to the UNIT2 Business and the "COMPANY2" registered trademark/trade name. The proceeds from the sale of the UNIT2 Business net of adjustments and prior to transaction costs were approximately \$XXX.

The sale of the assets used in the UNIT2 was an incidental or occasional sale. This sale is the only such sale of assets used in the course of COMPANY1's business that has occurred from the inception of the business in 19XX.

### STATEMENT OF AUTHORITIES

Section 201 of the Illinois Income Tax Act (the "IITA") provides in relevant part that "[a] tax measured by net income is hereby imposed on every individual, corporation, trust and estate for each taxable year ending after July 31, 1969 on the privilege of earning or receiving income in or as a resident of this State." 35 ILCS 5/201

IITA Section 1501 defines various terms used in the Illinois Income Tax Act and defines the term "person" at Section 1501(a)(18) to include corporations. 35 ILCS 5/1501(a)(18). IITA Section 1501(a)(20) defines the term "resident." Corporations are not included in the definition of the term "resident." IITA Section 1501(a)(14) defines the term "nonresident" as ". . . a person who is not a resident." Therefore, corporations are "nonresidents" for purposes of the Illinois Income Tax Act.

Article 3 of the Illinois Income Tax sets forth the manner in which the income of a taxpayer is allocated and apportioned. Pursuant to Article 3, nonbusiness income is allocated and business income of a multistate taxpayer is apportioned. IDOR regulation 100.3310 provides that "the business income of a person other than a resident is allocated to Illinois if such person's income is derived solely from Illinois." The rule also makes clear "every person who derives business income from Illinois and one or more other states must apportion such business income between Illinois and such other state or states in accordance with the provisions of IITA Section 304."

The terms "business income" and "nonbusiness income" are defined in IITA Section 1501. IITA Section 1501 (a)(l) defines the term business income as follows:

The term 'business income' means all income that may be treated as apportionable business income under the Constitution of the United States. Business income is net of deductions allocable thereto. Such term does not include compensation or the deductions allocable thereto. For each taxable year beginning on or after January 1, 2003, a taxpayer may elect to treat all income other than compensation as business income. This election shall be made in accordance with rules adopted by the Department, and, once made, shall be irrevocable.

IITA Section 1501(a)(13) states "[t]he term 'nonbusiness income' means all income other than business income or compensation."

In Section 100.3015 of the IDOR rules, the IDOR explains the mechanics of the business income election authorized by IITA Section 1501(a)(l). (86 111 Adm. Code 100.3015) Section 100.3015(b) provides that the election shall be made on the original return filed by the person making the election for the taxable year to which the election applies, or on a corrected return filed prior to the due date (including extensions) for the return.

IITA Section 303 details the manner in which the nonbusiness income of any person other than a resident is allocated. IITA Section 303(b)(3) states that "[c]apital gains and losses from sales or exchanges of intangible personal property are allocable to this State if the taxpayer had its commercial domicile in this State at the time of such sale or exchange." IITA Section 304 details the manner in which the business income of a corporation is apportioned between Illinois and other states.

IITA Section 304(a) provides for single factor apportionment based on sales. IITA Section 304(a)(3) states in pertinent part that the sales factor is "a fraction, the numerator of which is the total sales of the person in this State during the taxable year, and the denominator of which is the total sales of the person everywhere during the taxable year." IITA Section 304(f) provides that "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 portion of the person's business activity, if reasonable . . . (4) the employment of any other method to effectuate an equitable allocation and apportionment of the person's business income."

The Department has adopted regulations pursuant to IITA Section 304(f) to address what the Director has determined are certain situations in which the normal sales factor does not fairly represent the extent of a person's business activity in Illinois. (See 86 111. Adm. Code 100.3380). Specifically, Section 100.3380(c)(2) states that "where gross receipts arise from an incidental or occasional sale of assets used in the regular course of the person's trade or business, 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."

## ANALYSIS

COMPANY1 is a taxpayer subject to the Illinois Income Tax Act. COMPANY1 earns and reports income and files tax returns with the State of Illinois and other states in which it conducts business. As a corporation, COMPANY1 is a non-resident of Illinois for Illinois income tax purposes. As a non-resident with income subject to taxation in multiple states that files returns in such states, COMPANY1 is required to determine the amount of business income apportionable to Illinois by comparing sales in Illinois to sales everywhere. The taxable year in which COMPANY1 recognizes gains on the sale of UNIT2 began after January X, 20XX. Therefore, COMPANY1 may elect to treat all income, other than compensation, as business income. Section 100.3380(c)(2) of the IDOR rules requires COMPANY1 to exclude the proceeds from the sale of UNIT2 from the numerator and denominator of its sales factor as "an incidental or occasional sale of assets used in the regular course of the person's trade or business . . . ."

### RULINGS REQUESTED

1. COMPANY1 may elect to treat the gains from the sale of its UNIT2 as "business income" pursuant to IITA Section 1501 (a)(l).
2. As required by Section 100.3380(c)(2) of the IDOR rules, the gross receipts received by COMPANY1 from the sale of the UNIT2 business must be excluded from the numerator and denominator of COMPANY1's sales factor.

The taxpayer is unable to locate any authority contrary to the views set forth above. In the event that the Department wishes additional information, please contact the undersigned at your convenience. In the event that the Department disagrees with the analysis set forth above, anticipates an adverse ruling or anticipates declining to issue a binding private letter ruling, Taxpayer respectfully requests a meeting to discuss this matter prior to the issuance of any final ruling by the Department.

### **Ruling of the Department**

Section 304(a) of the Illinois Income Tax Act (the "IITA"; 35 ILCS 5/101 et seq.) provides:

If a person other than a resident derives business income from this State and one or more other states, then, for tax years ending on or before December 30, 1998, and except as otherwise provided by this Section, such person's business income shall be apportioned to this State by multiplying the income by a fraction, the numerator of which is the sum of the property factor (if any), the payroll factor (if any) and 200% of the sales factor (if any), and the denominator of which is 4 reduced by the number of factors other than the sales factor which have a denominator of zero and by an additional 2 if the sales factor has a denominator of zero. For tax years ending on or after December 31, 1998, and except as otherwise provided by this Section, persons other than residents who derive business income from this State and one or more other states shall compute their apportionment factor by weighting their property, payroll, and sales factors as provided in subsection (h) of this Section.

Other apportionment formulas are provided in Section 304 of the IITA for insurance companies, financial organizations, federally regulated exchanges, and transportation companies, but the facts stated in your request indicate that COMPANY1 does not qualify to use any of these formulas.

Section 304(h)(3) of the IITA provides that, for taxable years ending on or after December 31, 2000, only the sales factor shall be used to apportion business income under Section 304(a) of the IITA.

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, without a petition, permit or 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.

Section 1501(a)(1) of the IITA provides:

For each taxable year beginning on or after January 1, 2003, a taxpayer may elect to treat all income other than compensation as business income.

If COMPANY1 makes this election for 2011, its gain on the sale of the assets related to the UNIT2 will be treated as business income, regardless of whether the gains otherwise meet the definition of business income.

Section 1501(a)(21) of the IITA defines "sales" for purposes of the sales factor to include all gross receipts of the taxpayer characterized as business income. However, pursuant to the authority granted to the Director under Section 304(f) of the IITA, the Department has adopted 86 Ill. Adm. Code Section 100.3380(c)(2), which provides:

Where gross receipts arise from an incidental or occasional sale of assets used in the regular course of the person's trade or business, 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.

You have represented that the sale of the assets related to the UNIT2 is an incidental or occasional sale of assets of COMPANY1, and that no similar sale has occurred in the history of COMPANY1. Based on this representation, if COMPANY1 elects to treat all of its income for 2011 as business income, the gain on its sale of the assets related to the UNIT2 is business income, the gain will be apportioned using the sales factor of COMPANY1 under Section 304(a) of the IITA, and the gross receipts from the sale will be excluded from the numerator and denominator of the sales factor under 86 Ill. Adm. Code Section 100.3380(c)(2).

The facts upon which this ruling are 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 ruling will cease to bind the Department if there is a pertinent change in statutory law, case law, rules or in the material facts recited in this ruling. Pursuant to 2 Ill. Admin. Code Section 1200.110(e), this ruling is automatically revoked as of ten years after the date of issuance, if not revoked earlier.

Very truly yours,

Brian Stocker  
Chairman, Private Letter Ruling Committee