

IT 13-0012 GIL 10/24/2013 Alternative Apportionment

A petition to use an alternative method of apportionment cannot be granted without a showing that the statutory method fails to reflect the market for the taxpayer's goods, services or other sources of business income and a showing that the requested alternative better reflects that market.

October 24, 2013

Re: Petition for Alternative Apportionment

Dear Xxxx:

This is in response to your letter dated September 3, 2013 in which you request permission to use an alternative method of allocation or apportionment. Department of Revenue ("Department") regulations require that the Department issue only two types of letter rulings, Private Letter Rulings ("PLRs") and General Information Letters ("GILs"). 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 against the Department, but only as to the taxpayer issued the ruling and only to the extent the facts recited in the PLR are correct and complete. GILs do not constitute statements of Department policy that apply, interpret or prescribe the tax laws and are not binding against the Department. See 2 Ill. Adm. Code 100.1200(b) and (c). For the reasons discussed below, your petition cannot be granted at this time.

Your letter states as follows:

We are writing to you on behalf of our client, COMPANY A. and Subsidiaries ("COMPANY A"). XXXXXXXX and you had a discussion a number of months ago relating to this matter. COMPANY A is seeking the Illinois Department of Revenue's approval of an alternative apportionment formula under IITA § 304(f) and 86 Ill. Adm. Code § 100.3390(e)(2).

Per your conversations with XXXXXXXX, we have enclosed the following;

- COMPANY A's original 2012 Form IL-1120 for the short year January 1, 2012 through January 9, 2012 ("short year");
- Form IL-1120-V "Payment Voucher for Corporation Income and Replacement Tax";
- A check payable to the "Illinois Department of Revenue" in the amount of \$95,722.00; and,
- A 2012 Form 1120-X for the above mentioned short year.

As you can see from the amended return, if COMPANY A's request is granted it would pay \$XX,XXX in tax rather than the \$XX,XXX on the original return. Below are the facts that we believe support our request for an alternative apportionment formula.

#### Facts

COMPANY A is headquartered in STATE. It designs and manufactures compressors for residential and light commercial air conditioning, heat pump and refrigeration applications. It is one of the largest compressor manufacturers in the world and the only one that can claim its units are made in the U.S.A.

In early 2012 COMPANY A underwent a reorganization, which resulted in the short year period of nine days. During this brief period, COMPANY A had \$XXX,XXX in Illinois sales out of \$X,XXX,XXX in total sales. This resulted in a greatly inflated apportionment percentage of 6.7391% for the short period. Historically, COMPANY A's Illinois apportionment factor has

been lower. For the tax year 2011, it was 3.8347. The ratio of Illinois sales for the entire 2012 calendar year were essentially what they had been in prior years, however, because a fair portion of the Illinois sales were concentrated in the first few days of January; this contributed to the significant inflation of the apportionment factor for the short year. As a result, COMPANY A requests that the Company use its prior year's apportionment percentage for purposes of apportioning income for the short year.

During the first nine days in January of 2012, COMPANY A made \$XXX,XXX in sales to Illinois customers. If they had sought specific accounting ("revenue only") to apportion their income; COMPANY A would have paid \$X,XXX in replacement tax and \$XX,XXX in income tax, for a total of \$XX,XXX. COMPANY A's proposal to use the 2011 apportionment percentage results in \$XX,XXX in replacement tax and \$XX,XXX in income tax for a total due of \$XX,XXX. COMPANY A seeks the ability to use the prior year's apportionment percentage because it more fairly represents the business it transacted in Illinois.

Prior to the reorganization, COMPANY A amassed a significant Net Operating Loss ("NOL") at the federal and state levels. For the short period ending 1/9/XX, COMPANY A offset its income with the NOL on its federal return and its state returns in other jurisdictions. However, COMPANY A could not use its Illinois NOL to offset the income from the short year in Illinois, as Illinois NOLs were limited to \$100,000 by the legislature for the period in question. The federal and state NOLs were eliminated due to the reorganization. As a result, COMPANY A was placed in the unenviable position of having an Illinois NOL to offset the Illinois income, but it was unable to use in the short year and it will never be able to use it due to it being eliminated by the reorganization. Other Illinois taxpayers with Illinois NOLs are simply deferring the benefit of their NOLs to a future date. COMPANY A however, has permanently lost the benefit of its Illinois NOL.

### Summary

Given the circumstances in this instance, the standard apportionment formula in the Illinois Income Tax Act operates unreasonably and arbitrarily in attributing income to Illinois that is out of all proportion to the business transacted within the state. For the short year, the statutorily prescribed formula grossly distorts the sales activity in the state and as a result the income apportioned to Illinois. That coupled with the suspension of the NOL placed COMPANY A in a situation described above.

As a result, we request your authorization allowing COMPANY A to use the apportionment percentage from 2011 to apportion Illinois income for the short year 2012. Additionally, we request that the Department refund \$XX,XXX of the tax submitted with this letter and accompanying returns.

### **RULING**

Section 304(f) of the Illinois Income Tax Act ("IITA" 35 ILCS 5/304(f)) states:

If the allocation and apportionment provisions of subsections (a) through (e) and of subsection (h) do not, for taxable years ending before December 31, 2008, fairly represent the extent of a person's business activity in this State, or, for taxable years ending on or after December 31, 2008, fairly represent the market for the person's goods, services, or other sources of business income, 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 or market in this State; or
- (4) The employment of any other method to effectuate an equitable allocation and apportionment of the person's business income.

Department Regulations Section 100.3390(c) states, regarding the burden of proof of the party seeking to utilize an alternative apportionment method:

A departure from the required apportionment method is allowed only where such methods do not accurately and fairly reflect business activity in Illinois. 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.

Although Regulations section 100.3390(c) does not reflect the changes made to IITA Section 304(f) under P.A. 98-478, the taxpayer's burden of proof will remain generally unchanged, except that the relevant inquiry shifts to whether the statutory formula fairly reflects the market for the taxpayer's goods, services, or other sources of business income.

The facts stated in your letter are not sufficient to satisfy the burden set forth in section 100.3390(c). Your letter indicates that because an unusually high proportion of Illinois sales were made during the course of an unusually short taxable year, the taxpayer's Illinois apportionment factor is substantially higher than its historical average. From this you argue that the statutory formula grossly distorts the sales activity in Illinois and the income apportioned to Illinois. However, whether an amount of income apportioned to Illinois for a taxable year properly reflects the taxpayer's Illinois market does not depend on the market for the taxpayer's goods in prior taxable years. The intent of the apportionment provisions is to produce an apportionment percentage that reflects Illinois' relative share of the market for the taxpayer's goods for the particular taxable year being apportioned. It is certainly not an unexpected result, then, that for a taxable year in which the taxpayer makes an unusually large amount of Illinois sales relative to the amount of its out-of-state sales, it will have an unusually high apportionment percentage. There is no requirement that the apportionment provisions produce a factor in line with historical averages.

In addition, your petition fails to show that the proposed alternative method fairly and accurately apportions income to Illinois. You propose that instead of using the apportionment percentage for the 2012 short taxable year, the taxpayer be permitted to use its apportionment percentage from the 2011 taxable year. You indicate that the latter is more consistent with the taxpayer's historically lower Illinois sales factor. However, it is the income for the taxpayer's 2012 short taxable year that is being

apportioned and taxed. It is not clear why the amount of Illinois sales in 2011 better reflects the market for the taxpayer's goods during the 2012 short year than the amount of sales for the 2012 short year itself.

For the reasons stated above, your request for an alternative apportionment method cannot be granted. However, if you have additional information related to this request that was not previously submitted, you may supplement your petition and we will reconsider your request. 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. Your petition was filed September 19, 2013, and will allow the taxpayer to use the requested method on original returns due on or after January 17, 2014 if ultimately granted.

Sincerely,

Brian Stocker  
Chair, PLR Committee

cc: Kevin Anguish  
Income Tax Processing  
2-219

bc: Daily file  
Correspondence file: Grant Thornton LLP  
IITA file : 304(f) Alternative Allocation Petition Denials #4