

IT 14-0002 PLR 4/24/2014 Apportionment – Sales Factor

Temporary interruption in Illinois of shipment from another state to a foreign country in which the taxpayer is not subject to tax will not cause the sale to be thrown back to Illinois.

April 24, 2014

Re: Request for Private Letter Ruling  
Company

Dear Xxxxx:

This is in response to your letter dated February 12, 2014, in which you request a Private Letter Ruling on behalf of Company and its subsidiaries. Review of your request for a Private Letter Ruling indicates that all information described in paragraphs 1 through 8 of subsection (b) of 2 Ill. Adm. Code 1200.110 is contained in your request. This Private Letter Ruling will bind the Department only with respect to the combined group that includes Company. Issuance of this ruling is conditioned upon the understanding that Company and/or any related taxpayer(s) is not 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:

Company 2, as authorized representative for Company requests a Private Letter Ruling in accordance with 2 Ill. Adm. Code 1200.110, to the effect that certain sales of tangible personal property destined for Country are not Illinois sourced sales as provided for in 86 Ill. Adm. Code 100.3370(c)(1)(C).

#### Disclosures

In accordance with 2 Ill. Adm. Code 1200.110(b)(3), the subject of this request is not being examined as part of an audit by the Illinois Department of Revenue (“Department”) and is 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the taxpayer and its representatives have not previously submitted the same or a similar issue to the Department and withdrawn it before a letter ruling was issued.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

Company for purposes of this request includes itself and all of its subsidiaries included in its combined Illinois income tax return as outlined in the “Statement of Facts” section below. Company 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 consolidated federal income tax return.

#### Tax Year

The ruling is requested for tax year ended June 30, 2012.

## Statement of Facts

Company is a worldwide leader in the development, manufacture and marketing of high quality, high-fidelity audio products, lighting solutions and electronic systems, as well as digitally integrated audio and infotainment systems for the automobile industry. Company is organized under the laws of State, and is commercially domiciled in State 2. One of its operating subsidiaries, Company 3 also a State corporation, provides automakers with both audio systems leveraging Company's stable of consumer brands, as well as infotainment systems combining navigation, wireless connectivity, and multimedia capabilities. Company 3 is included in Company's combined Illinois unitary return and has taxable nexus in Illinois.

Company 3 has manufacturing facilities in State 3 and State 4. Company enters into agreements with Company 4 for the sale of automotive audio components. Company 4 may act as agent for other Company 4 affiliates purchasing audio components to be used in Company 4 vehicles, including those manufactured in Country. All products sold by Company 3 to Company 4 are at Company's facilities in State 3 or State 4. Title to the products purchased by Company 4 is at Company 3 facilities.

In most cases, Company 4 arranges for products purchased from Company to be picked up by Company 5 an affiliate of Company 4, which acts as Company 4's freight forwarder at Company State 3 and State 4 facilities. Company 5 also acts as a freight forwarder for third parties and is not an exclusive freight forwarder of Company 4. All products picked up by Company 5 are destined for Company 4 or its affiliates' locations in Country. Company 5 initially ships the Company 3 products to Company 5's facilities in Illinois to be consolidated with other products purchased by Company 4 for shipment to Country. To the best of Company 3's knowledge, Company 5 makes no modifications, no product changes, and no alterations to the products that are picked up from Company 3. All Products sold to Company 4 are ready to be shipped to Country with no further labeling or packaging changes. Title to all products shipped by Company 5 pass to Company 4 at Company 3 facilities.

On occasion, if Company 4 arranges for Company 5 to pick up products destined for Country from Company 3's facilities and those products are not ready for shipment, Company 3 arranges for a third party to ship those products to Company 5's freight forwarding facilities in Illinois. Similar to products picked up by Company 5, no modifications, no product changes and no alterations are made by Company 5 for products that are delivered to Company 5 by Company. Title to all products shipped by third parties passes to Company 5 at Company 3 facilities.

## Ruling Requested

For purposes of sourcing sales for Illinois sales factor purposes, sales of tangible personal property from Company 3 to Company 4 that are destined for Country should not be sourced to Illinois. This equally applies whether a third party is used to transport Company 3 product to a freight forwarder in Illinois or Company 3 is responsible for transporting its products to a freight forwarder in Illinois. In both cases, Illinois is not the destination state of the sale of tangible personal property between Company 3 and Company 4.

## Discussion

Base income that constitutes business income from sales of tangible property is apportioned to Illinois under Illinois Income Tax Act ("IITA") Section 304(a)(3)(A) and (B). This section provides the following:

IITA Section 304(a)(3) Sales Factor:

(A) 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.

(B) Sales of tangible personal property are in this State if:

(i) The property is delivered or shipped to a purchaser, other than the United States government, within this State regardless of the f.o.b. point or other conditions of sale; or

(ii) The property is shipped from an office, store, warehouse, factory or other place of storage in this State and either the purchaser is the United States government or the person is not taxable in the state of the purchaser; provided, however, that premises owned or leased by a person who has independently contracted with the seller for the printing of newspapers, periodicals or books shall not be deemed to be an office, store, warehouse, factory or other place of storage for purposes of this Section. Sales of tangible personal property are not in this State if the seller and purchaser would be members of the same unitary business group but for the fact that either the seller or purchaser is a person with 80% or more of total business activity outside of the United States and the property is purchased for resale.

The language of IITA Section 304(a)(3)(B)(i) is identical to that of Section 16(a) of the Uniform Division of Income for Tax Purposes Act ("UDITPA"). Section 16(a) of UDITPA was incorporated as article IV of the Multistate Tax Compact. The Official Commentary on the Illinois Income Tax Act states:

Article 3 of the Act provides rules for the allocation and apportionment of business income and non-business income between Illinois and other states. For the most part this is accomplished by embodying ... the principles of the Multistate Tax Compact which was adopted by Illinois effective July 1, 1967. ... Adoption of the provisions of the Compact was believed desirable in the interest of interstate uniformity and consistency with existing Illinois law. (*Caterpillar Tractor Company v. Lenckos*, 84 Ill. 2d 102, 177 (1981), quoting Official Commentary on the Illinois Income Tax Act).

Consistent with the purpose of the sales factor, and to promote the goal of uniformity among UDITPA states, the destination rule has been applied by Illinois for purposes of IITA Section 304(a)(3)(B)(i). See Illinois General Information Letter No. IT 03-0034, 11/03/2003. Illinois has consistently used the destination rule when determining whether a taxpayer is subject to tax for throwback purposes. See *Hartmarx Corporation and Subsidiaries v. Glen Bower, Director, Department of Revenue*, 723 NE2d 820, 243 Ill. Dec. 517, 12/23/1999 and *Dover Corporation v. The Department of Revenue*, 271 Ill. App. 3d 700, 208 Ill Dec 167, 648 NE2d 1089, 03/31/1995.

The Department has incorporated the "destination" rule in its regulations. 86 Ill. Adm. Code Section 100.3370(c)(1)(C). This section provides:

Property is delivered or shipped to a purchaser within this State if the shipment terminates in this State, even though the property is subsequently transferred by the purchaser to another state.

Illinois looks to the state of destination of the tangible personal property that is being purchased. The method of pick-up and delivery is not dispositive on where a particular sale of tangible personal property will be sourced for sales factor apportionment purposes.

In the case at hand, the purchaser of Company 3 audio components is Company 4. Although Company 5 is Company 3's freight forwarder and the Company 3 audio components may physically be located in Company 5's facilities in Illinois for a short duration, the Company 3 shipments do not terminate in Illinois. Company 4. has no production facilities in Illinois and all Company 3 products that may be temporarily in Illinois are ultimately destined for Country. To the best of Company 3's knowledge neither Company 5 nor any other party at the direction of Company 4. is making modifications or alterations of the Company 3 products in Illinois. All Company products are packaged and labeled for shipment to Country with no further alterations being required.

Illinois' destination rule should apply to all sales made by Company 3 to Company 4 and Country should be the proper destination for these sales because the same terminates in Country.

In addition, you have represented that, to the best of Company 3's knowledge, product would remain at Company 5's Illinois facilities for a very short time, less than 2 days or perhaps only a few hours.

### **RULING**

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(a)(3) provides various rules for determining whether sales are sourced to Illinois for sales factor purposes. IITA Section 304(a)(3)(B)(i) provides that sales of tangible personal property are sourced to Illinois if:

The property is delivered or shipped to a purchaser, other than the United States government, within this State regardless of the f.o.b. point or other conditions of the sale.

With regard to this section, Department Regulations Section 100.3370(c)(1)(C) states:

Property is delivered or shipped to a purchaser within this State if the shipment terminates in this State, even though the property is subsequently transferred by the purchaser to another state. Example: A corporation makes a sale to a purchaser who maintains a central warehouse in this State at which all merchandise purchases are received. The purchaser reships the goods to its branch stores in other states for sale. All of the corporation's products shipped to

the purchaser's warehouse in this State is property "delivered or shipped to a purchaser within this State".

In Letter Ruling IT-03-0034-GIL (Nov. 3, 2003), the Department, relying on decisions of courts in other UDITPA-based states, determined that the "destination rule" shall apply for purposes of applying IITA Section 304(a)(3)(B)(i). Under this rule, even though a taxpayer's customer may receive physical possession of the property outside Illinois, a sale may nonetheless constitute an Illinois sale where the destination of the property sold is Illinois.

In the instant case, the destination of Company 3's sales to Company 4 is Country. Your letter indicates that all products either picked up by Company 5, or delivered by third party carrier to Company 5 Illinois facilities, are destined for Company 4 or an affiliate's manufacturing facilities in Country. You also represent that neither Company 5 nor another person makes any modifications, product changes, or alterations to the property. Rather, the property is merely stored in Illinois by Company 5 for short periods of time, less than 2 days or perhaps only a few hours, in order to be consolidated with other products to be shipped to Country. Assuming these facts are true, shipment of the property does not terminate in Illinois. The products are shipped to Illinois merely to accommodate further shipping to a predetermined destination in Country, and the taxpayer is not engaged in a warehouse function in Illinois. Accordingly, the sales to TEMA are not sales within this State under the provisions of IITA Section 304(a)(3)(B)(i). See Matter of the Appeal of Mazda Motors of America (Central), Inc., 1994 WL 776168 (Cal. St. Bd. Eq. 1994) and Visiocorp USA, Inc. v. Mich. Dep't of Treas., 2011 WL 1938386 (Mich. Tax Tribunal 2011).

This ruling shall bind the Department for the taxable year ending June 30, 2012, 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 and incorporated 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.

Sincerely,

Brian L. Stocker  
Chairman, PLR Committee (Income Tax)