IT 15-0002 GIL 3/27/2015 Partnerships
Seat on an exchange is not a qualified investment securities or "equipment reasonably necessary to carry on" the activities of an investment partnership, but deposits insured by the Securities Investment Protection Corporation are qualified investment securities.

March 27, 2015

Re: General Information Letter Request, Illinois Investment Partnership Test

Dear Mr. XXXX:

This is in response to your letter dated November 5, 2013 in which you request a legal tax ruling whether Illinois would recognize certain assets as "qualifying investment securities" or otherwise . The Department's 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). The nature of your letter and the information provided require that we respond with a General Information Letter.

Your letter states as follows:

> We are writing to request a General Information Letter under 2 IL.Adm.Code Sec. 1200.120, on behalf of our client ("Taxpayer") in relation to their qualification as an Illinois investment partnership pursuant to 35 ILCS 5/1501(a)(11.5). Specifically, taxpayer requests guidance regarding qualifying assets for purposes of the 90% asset test under 35 ILCS 5/1501(a)(11.5)(A)(i).
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> Taxpayer is a partnership for federal and Illinois income tax purposes. Taxpayer's business is that of a trader, as the partnership was formed for the primary purpose of proprietary trading of its members. More than 90% of the taxpayer's gross income is from interest, dividends, and gains from the sale of qualifying investment securities. The taxpayer is not a "dealer" in securities as defined under Internal Revenue Code §475. The assets of the taxpayer consist primarily of qualifying investment securities and other assets necessary to conduct its trading business.
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> The taxpayer has identified certain intangible assets which are not investments, but which are reasonably necessary to carry on its activities as an investment partnership. These intangible assets are not specifically listed in 35 ILCS 5/1501(a)(11.5)(B) as qualifying investment securities, but should be considered qualified assets similar to "office space and equipment reasonably necessary to carry on its activities as an investment partnership." The taxpayer requests guidance regarding whether these intangible assets identified would be deemed qualifying assets under 35 ILCS 5/1501(a)(11.5)(A)(i) in meeting the 90% qualifying asset test portion of the Illinois investment partnership test. Specifically, taxpayer requests guidance on

the following assets: seats or memberships on securities exchanges, cash in brokerage and other accounts which are not FDIC insured, and receivable due from brokers and dealers.

The taxpayer has seats or memberships on various exchanges including EXCHAGE 1 and EXCHANGE 2. As a proprietary trading company these seats or memberships allow the taxpayer to trade directly in securities without the need for middleman such as a broker or dealer. These seats or memberships are not primarily held for investment. These memberships permit the taxpayer to trade on the exchanges for the taxpayer's own account. The taxpayer is required to maintain compliance with the respective exchanges in order to maintain these memberships. The taxpayer believes that the seats or memberships in the exchanges are reasonably necessary to carry on its activities as an investment partnership and should be considered qualifying under 35 ILCS 5/1501(a)(11.5)(A)(i).

The taxpayer has cash balances with various broker-dealers which are necessary in order to execute trades and maintain margin requirements required by securities regulators and exchanges. Some of the aforementioned cash balances are not in Federal Deposit Insurance Corporation (FDIC) bank accounts, but are instead on account with broker-dealers. The cash balances on account with broker-dealers are often insured by the Securities Investor Protection Corporation (SIPC). The financial institutions which the taxpayer regularly maintains cash and receivable balances with include the broker-dealer subsidiaries of the following financial institutions: BANK 1, BANK 2, BANK 3, BANK 4, BANK 5, and BANK 6. The taxpayer believes that these cash accounts are reasonably necessary to carry on its activities as an investment partnership and should be considered the same as deposits at banks or other financial institutions qualifying under 35 ILCS 5/1501(a)(11.5)(A)(i). The taxpayer also has receivable balances from most of these same brokers-dealers. These receivable are necessary in order for the taxpayer to conduct its trading business, as these receivable result from trading with broker-dealers. Some of these receivables relate to securities sold short, and the sums due to the taxpayer are often restricted as collateral for the securities borrowed. The taxpayer believes that these receivables are reasonably necessary to carry on its activities as an investment partnership qualifying under 35 ILCS 5/1501(a)(11.5)(A)(i).

RESPONSE

Section 205(b) of the Illinois Income Tax Act (35 ILCS 5/205) provides that partnerships are not subject to the regular Illinois income tax imposed under Section 201(a) and (b) of the Illinois Income Tax Act (35 ILCS 5/201), but that partnerships other than "investment partnerships" are subject to the personal property tax replacement income tax imposed under Section 201(c) and (d) of the Illinois Income Tax Act. As stated in your letter, the taxpayer is a partnership for federal and Illinois income tax purposes.

Section 1501(a)(11.5)(A) of the Illinois Income Tax Act defines "investment partnership" as follows:

> The term "investment partnership" means any entity that is treated as a partnership for federal income tax purposes that meets the following requirements:
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> > (i) no less than 90% of the partnership's cost of its total assets consists of qualifying investment securities, deposits at banks or other financial institutions,

> and office space and equipment reasonably necessary to carry on its activities as an investment partnership;
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> (ii) no less than 90% of its gross income consists of interest, dividends, and gains from the sale or exchange of qualifying investment securities; and
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> (iii) the partnership is not a dealer in qualifying investment securities.

In order for the taxpayer's intangible assets to qualify as "qualifying investment securities," they must meet one of the definitions found in 86 Ill. Adm. Code § 100.9730(b). This regulation indicates that *only* the listed assets qualify.

Section 1501(a)(11.5)(B) of the Illinois Income Tax Act defines "qualifying investment securities" as follows:

> (i) common stock, including preferred or debt securities convertible into common stock, and preferred stock;
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> (ii) bonds, debentures, and other debt securities;
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> (iii) foreign and domestic currency deposits secured by federal, state, or local governmental agencies;
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> (iv) mortgage or asset-backed securities secured by federal, state, or local governmental agencies;
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> (v) repurchase agreements and loan participations;
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> (vi) foreign currency exchange contracts and forward and futures contracts on foreign currencies;
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> (vii) stock and bond index securities and futures contracts and other similar financial securities and futures contracts on those securities;
>
> (viii) options for the purchase or sale of any of the securities, currencies, contracts, or financial instruments described in items (i) to (vii), inclusive;
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> (ix) regulated futures contracts;
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> (x) commodities (not described in Section 1221(a)(1) of the Internal Revenue Code) or futures, forwards, and options with respect to such commodities, provided, however, that any item of a physical commodity to which title is actually acquired in the partnership's capacity as a dealer in such commodity shall not be a qualifying investment security;
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> (xi) derivatives; and
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> (xii) a partnership interest in another partnership that is an investment partnership.

Seats or memberships on securities do not qualify under any of the listed categories. Even if not held for investment and reasonably necessary for the taxpayer to conduct its business, they do not fall under any definition of office space or equipment. The asset test does not include

any other assets, even those that may be reasonably necessary to carry on activities as an investment partnership.

You indicated that the taxpayer has cash balances with certain broker-dealers, and that some of the balances are insured by the Securities Investor Protection Corporation (SIPC). Assets that qualify for the 90% test include "qualifying investment securities [and] deposits at banks or other financial institutions." The term "financial institution" is not defined in the statute or regulations. However, banks and similar institutions are frequently exempted from regulation as brokers or dealers under the federal securities laws, indicating that brokers and dealers are generally not in the same category as banks. See, e.g., the definitions of "broker" and "dealer" in 15 U.S.C. Section 78c. Accordingly, deposits with broker-dealers would not come within the meaning of "deposits at banks or other financial institutions."

86 Ill. Adm. Code § 100.9730(b)(3) states that "qualifying investment securities" means and includes:

> *Foreign and domestic currency deposits secured by federal, state, or local governmental agencies.* (IITA Section 1501(a)(11.5)(B)(iii)) "Currency deposits secured by federal, state or local government agencies" means any balance in a demand or time deposit at a bank, savings and loan, or similar financial institution and that is insured by the Federal Deposit Insurance Corporation or by a similar deposit insurance agency of a state or local government, including any balance in an otherwise insured account that is in excess of any insurance limit. Deposits secured by a foreign government agency, but not by an agency of the federal or of a state or local government, do not qualify.

The SIPC is a federal agency similar to the FDIC, therefore, the currency accounts it secures qualify under 35 ILCS 5/1501(a)(11.5)(A)(i).

Your letter indicates that the taxpayer has receivable balances that result from the taxpayer's trading activities. 86 Ill. Adm. Code § 100.9730(b)(2) states that "qualifying investment securities" means and includes:

> *Bonds, debentures, and other debt securities.* (IITA Section 1501(a)(11.5)(B)(ii)) "Debt security" means any note, bond, debenture or other evidence of indebtedness, or any evidence of an interest in or right to subscribe to or purchase any of the foregoing. (See 26 CFR 1.864-2(c)(2)(i) (2007).)

An account receivable is money which is owed to a company for a product or services. It is an evidence of indebtedness owned by the taxpayer, and thus would qualify under 35 ILCS 5/1501(a)(11.5)(A)(i).

As stated above, this is a general information letter which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you have any further questions, you may contact me at (217) 524-7580.

Sincerely,
Matthew Crain
Associate Counsel (Income Tax)