

No subtraction modification is allowed for refund of state taxes included in corporation's federal taxable income.

August 31, 2015

Re: Subtraction for Non-Illinois Income

Dear Mr. XXXX:

This is in response to your letter dated August 12, 2015, in which you request a letter ruling. The nature of your request and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. *See* 86 Ill. Adm. Code 1200.120(b) and (c), which may be found on the Department's web site at [www. tax.illinois.gov](http://www.tax.illinois.gov).

In your letter you have stated the following:

I am writing in response to the letter referenced above regarding the change made to our 2013 COMPANY, Inc. Illinois tax return (Form IL-1120). We included the amount \$968,404.00 on Schedule M, Line 33 as an Other Subtraction from our federal taxable income base. The facts below will describe why this income is not taxable in the state of Illinois.

In 2013, COMPANY, Inc. received refunds from New York City relating to an overpayment of taxes in prior years (2008 - 2010). Since there was no receivable established for these refunds, they were recorded in our income statement and included as a part of our 2013 Federal taxable income.

COMPANY first registered to do business in the state of Illinois on March 27, 2013. During the refund years, COMPANY did not have employees or real property in the state of Illinois, so the company did not file a tax return in the state of Illinois. As such, no tax deductions were taken, and the refunds included in the 2013 Federal taxable income would not be taxable in the state of Illinois.

Illinois Form IL-1120 uses Federal taxable income as a starting point on Step 2, Line 1. When completing the 2013 Illinois Form IL-1120, we were uncertain what line should be used to reflect non-taxable income. The adjustment may not fall on Schedule M, Line 33, since it is not specifically described in Publication 101, but there does not seem to be another line that fits the description of non-taxable income.

Response

Under Section 203(b) of the Illinois Income Tax Act (35 ILCS 5/203), the computation of a corporation's "net income" taxed by Illinois begins with the taxpayer's federal taxable income, as properly computed for the taxable year. Various addition and subtraction modifications are then made, and the resulting "base income" is then allocated and apportioned to Illinois. Section 203(h) provides that no modification may be made to taxable income unless expressly provided in Section 203. There is no provision in Section 203 that allows a subtraction for income that is not allocated or apportioned to Illinois, and so the Schedule M, Other Additions and Subtractions (for businesses), properly does not allow such a subtraction.

In this case, your argument is that the refund is not properly allocable or apportionable to Illinois. Section 304(a) of the Illinois Income Tax Act (35 ILCS 5/304) apportions business income of nonresidents to Illinois using the sales factor. Section 1501(a)(1) of the Illinois Income Tax Act (35 ILCS 5/1501) provides:

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 the deductions allocable thereto. Such term does not include compensation or the deductions allocable thereto.

Under this definition, a federal income tax deduction for state or local income taxes imposed on business income of a corporation would be a deduction allocable to business income, and any taxable refund of that tax would properly be characterized as business income. As business income, the refund would be apportioned to Illinois in the same manner and to the same extent as the taxpayer's other business income for the taxable year.

Section 304(f) of the Illinois Income Tax Act provides:

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.

If your assertion that the refund is not properly taxable by Illinois is correct, the solution would be to file a petition to be allowed to use an alternative apportionment method or to separately account for that refund. The procedures for filing a petition are contained in 86 Ill. Adm. Code Section 100.3390, which can be found at:

<http://www.ilga.gov/commission/jcar/admincode/086/086001000M33900R.html>

Since COMPANY has already filed its return for 2013, Section 100.3390(e)(2) provides that the petition should be filed with an amended return applying the alternative apportionment method requested. If you have any questions regarding the filing of a petition, you may contact me at (217) 524-3951 or at paul.caselton@illinois.gov.

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 are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b).

Sincerely,

Paul S. Caselton
Deputy General Counsel – Income Tax