IT 18-0003-PLR 11/29/2018 SALES FACTOR -INTANGIBLE PROPERTY

Taxpayer originating loans to customers in ordinary course of business is Dealer

November 29, 2018

Re: Request for Private Letter Ruling
TAXPAYER
FEIN: ####

Dear Xxxxx:

This is in response to your letter dated June 12, 2018 in which you request a Private Letter Ruling on behalf of TAXPAYER. 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 TAXPAYER. Issuance of this ruling is conditioned upon the understanding that TAXPAYER 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 states as follows:

On behalf of our client, TAXPAYER (FEIN: ####, hereinafter referred to as "Taxpayer"), we respectfully request the issuance of a private letter ruling ("PLR") by the Illinois Department of Revenue ("Department") pursuant to 2 Ill Adm. Code 1200.110.

General Information

1. This PLR is not requested for hypothetical or alternatively proposed transactions; but rather to determine the income tax consequences of an actual transaction engaged in by Taxpayer, as described below.

2. Taxpayer is not currently engaged in litigation with the Department with regard to this or any other tax matter.

3. The Department has not previously ruled regarding this matter for Taxpayer. Neither Taxpayer nor Grant Thornton LLP has submitted the same or similar issue to the Department on behalf of Taxpayer.

4. We are aware of no authority contrary to the authorities referred to and cited below.

Statement of Facts

Taxpayer is a Delaware limited partnership established to provide partners with current income and long-term capital appreciation. This is achieved primarily by originating senior secured loans directly to North American middle market companies. The taxpayer serves as a senior secured lender primarily to U.S. companies with less than $25 million EBITDA which require financing to fund corporate events such as a buyout, recapitalization, ownership transfer, sourcing of expansion and capital growth or refinancing.

Taxpayer is managed by COMPANY (hereinafter "COMPANY"). Through COMPANY's management, the taxpayer has access to an asset management and origination platform, which includes a national transaction sourcing network. It is noteworthy that while the taxpayer is not directly subject to regulation as an investment company, COMPANY is subject to regulation by the United States Securities and Exchange Commission as a Registered Investment Advisor.

Taxpayer is actively engaged in the business of originating and investing in senior secured loans and is treated as such for federal income tax purposes. Accordingly, under the Internal Revenue Code interest income earned by the taxpayer is treated as ordinary income and included on its Form 1065. Taxpayer generates interest income in Illinois and other states from loans secured by assets located across the United States.

By statute, Taxpayer would be considered a dealer in securities for federal income tax purposes. However, the taxpayer qualifies for an exemption under Treas. Reg. 1.475(c)-1(c). This regulation provides a taxpayer with an exception from using the mark-to-market method of accounting. Taxpayer is trying to determine if it would still be considered a dealer for Illinois Income Tax purposes, and thus, allowed to apportion its income under Illinois Income Tax Act 304(a)(3)(C-5)(iii)(a).

Requested Rulings

Though Taxpayer is not a dealer for federal income tax purposes because of the regulatory exemption under Treas. Reg. 1.475(c)-1(c), Taxpayer is otherwise a dealer as defined by 26 USC 475 and thus is considered a dealer for purposes of Illinois Income Tax Act 304(a)(3)(C-5)(iii)(a)?

Analysis

Illinois has various methods of sourcing interest income; the sourcing depends upon whether the taxpayer is classified as a dealer within the meaning of 26 USC 475. If the taxpayer is not a dealer, interest income is sourced to Illinois if the taxpayer's income-producing activity is performed in Illinois. However, if the taxpayer is a dealer, 35 ILCS 5/304(a)(3)(C-5)(iii)(a) states:

> "in the case of a taxpayer who is a dealer in the item of intangible property within the meaning of Section 475 of the Internal Revenue Code, the income or gain is received from a customer in this State. For purposes of this subparagraph, a customer is in this State if the customer is an individual, trust or estate who is a resident of this State and, for all other customers, if the customer's commercial domicile is in this State. Unless the dealer has actual knowledge of the residence or commercial domicile of a customer during the taxable year, the customer shall be deemed to be a customer in this State if the billing address of the customer, as shown in the records of the dealer, is in this State."

In looking to federal tax law, Section 475(c)(1) of the Internal Revenue Code ("Code") defines a "dealer in securities" as a taxpayer who:

(A) regularly purchases securities from or sells securities to customers in the ordinary course of a trade or business; or

(B) regularly offers to enter into, assume, offset, assign, or otherwise terminate positions in securities with customers in the ordinary course of a trade or business.

In the ordinary course of business, Taxpayer originates loans directly with customers, that is, Taxpayer makes loans by advancing cash in exchange for debt obligations of its customers. As Taxpayer regularly originates loans to customers, Taxpayer meets the definition of a "dealer in securities" as defined in the Code.

In general, Section 475 of the Code requires a dealer in securities to use a merk-to-market method of accounting. By regulatory grace, however, the IRS effectively provides a taxpayer with an exception (by not viewing the taxpayer as a dealer) from this mark-to-market accounting if the taxpayer does not engage in more than "negligible sales" of securities it has originated to customers. (Treas. Reg. 1.475-1(c)(1)(i)).

A taxpayer with "negligible sales" nonetheless may elect out of this regulatory exemption by filing its return using the mark-to-market method of accounting described in Section 475(a). (Treas. Reg. 1.475(c)-1(c)(1)(ii))

In summary, Taxpayer meets the definition of a "dealer in securities" as defined by the Code. Taxpayer, however, qualifies for a regulatory exemption not to use the mark-to-market method of accounting. Since taxpayer would technically meet the dealer definition under 475(c) but for the exemption, the rule allows them to elect dealer status if they want it. As a result, it would appear Taxpayer could still be considered a dealer for Illinois income tax purposes.

Conclusion

If the Taxpayer is not a dealer because they qualify for the exemption under Treas. Reg. 1.475(c)-1(c), the taxpayer would still be considered a dealer for purposes of IITA 304(a)(3)(C-5)(iii)(a).

We respectfully request a private letter ruling from the Department regarding this matter. Should you disagree with this opinion, please contact me to discuss this opinion prior to issuing a ruling. If you have any further questions or require any additional information, please contact me.

RULING

Section 304(a)(3)(A) of the Illinois Income Tax Act ("IITA" ; 35 ILCS 5/304(a)(3)(A)) defines the sales factor for taxpayers other than insurance companies, financial organizations, federally regulated exchanges, and transportation companies, as follows:

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(a)(3)(C-5) provides, in part, that, for taxable years ending on or after December 31, 2008, sales, other than sales governed by paragraphs (B), (B-1), (B-2), (B-5) and (B-7), are in this State if any of the following criteria are met:

> (iii) In the case of interest, net gains (but not less than zero) and other items of income from intangible personal property, the sale is in this State if:
>
> (a) in the case of a taxpayer who is a dealer in the item of intangible personal property within the meaning of Section 475 of the Internal Revenue Code, the income or gain is received from a customer in this State. For purposes of this subparagraph, a customer is in this State if the customer is an individual, trust or estate who is a resident of this State and, for all other customers, if the customer's commercial domicile is in this State. Unless the dealer has actual knowledge of the residence or commercial domicile of a customer during a taxable year, the customer shall be deemed to be a customer in this State if the billing address of the customer, as shown in the records of the dealer, is in this State; or
>
> (b) in all other cases, if the income-producing activity of the taxpayer is performed in this State or, if the income-producing activity of the taxpayer is performed both within and without this State, if a greater proportion of the income-producing activity of the taxpayer is performed within this State than any other state, based on performance costs.

Section 475 of the Internal Revenue Code (IRC) prescribes use of the mark-to-market accounting method for dealers in securities. Section 475(c)(1) defines a "dealer in securities" to mean a taxpayer who:

> (A) regularly purchases securities from or sells securities to customers in the ordinary course of a trade or business; or
>
> (B) regularly offers to enter into, assume, offset, assign or otherwise terminate positions in securities with customers in the ordinary course of a trade or business.

Section 475(a) requires that a dealer in securities apply the mark-to-market method of accounting. Section 475(b) allows for exceptions to mark-to-market accounting for dealers, providing that subsection (a) shall not apply to certain securities held by a dealer including:

> (B)(i) any security described in subsection (c)(2)(C) which is acquired (including originated) by the taxpayer in the ordinary course of a trade or business of the taxpayer and which is not held for sale, and (ii) any obligation to acquire a security described in clause (i) if such obligation is entered into in the ordinary course of such trade or business and is not held for sale.

Pursuant to these provisions, Treas. Reg. § 1.475(c)-1(c)(1) provides for the following exemption from dealer status:

> A taxpayer that regularly purchases securities from customers in the ordinary course of a trade or business (including regularly making loans to customers in the ordinary course of a trade or business of making loans) but engages in no more than negligible sales of the

> securities so acquired is not a dealer in securities within the meaning of section 475(c)(1) unless the taxpayer elects to be so treated or, for purposes of section 471, the taxpayer accounts for any security (as defined in section 475(c)(2)) as inventory.

Under IITA Section 304(a)(3)(C-5)(iii), whether interest, net gains, and other items of income from intangible personal property are assigned to Illinois for sales factor purposes depends on whether the taxpayer "is a dealer in the item of intangible personal property within the meaning of Section 475 of the Internal Revenue Code." If the taxpayer is a dealer within the meaning of IRC Section 475, the gross receipts are assigned to Illinois if the customer is in Illinois. If the taxpayer is not a dealer within the meaning of IRC Section 475, the gross receipts are assigned to Illinois under Section 304(a)(3)(C-5)(iii)(b) if the income-producing activity is in Illinois. For this purpose, a taxpayer is a dealer with respect to an item of intangible personal property if the taxpayer is actually a dealer with respect to the item under IRC Section 475, or would be a dealer with respect to the item under IRC Section 475 if the item were a security as defined in IRC Section 475(c)(2).

Your letter represents that the Taxpayer derives interest income by making loans to customers in the ordinary course of its trade or business. You represent that the Taxpayer is not a dealer in securities within the meaning of IRC Section 475(c)(1) by virtue of the exemption allowed under Treas. Reg. § 1.475(c)-1(c)(*1*) to taxpayers who make only negligible sales of loans that they originate and who do not elect out of the exemption. The particular sourcing rule under IITA Section 304(a)(3)(C-5)(iii) to be applied should not depend on whether a taxpayer does or does not elect out of the dealer exemption available under Treas. Reg. 1.475(c)-1(c)(*1*). In either case, the taxpayer earns interest by making loans to customers in the ordinary course of its trade or business. Accordingly, for purposes of IITA Section 304(a)(3)(C-5)(iii), a taxpayer who is eligible for the exemption under Treas. Reg. 1.475(c)-1(c)(*1*) is considered a dealer in securities with respect to loans it originates to customers whether or not the taxpayer elects out of the exemption. In this case, then, Taxpayer must include the interest income from loans made to its customers in the numerator of its Illinois sales factor under IITA Section 304(a)(3)(C-5(iii)(a) if the customer is a resident of Illinois or its commercial domicile is in this State.

This ruling shall bind the Department as provided herein. 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 shall bind the Department for all taxable years, except as limited pursuant to 2 Ill. Adm. Code 1200.110(d) and (e).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)