Partnership is treated as a member of the unitary business group for all purposes if the partnership is more than 90% owned by members of the group. (This is a GIL.)

June 1, 2023

NAME/ADDRESS

Re: Illinois Income Tax – Elimination of Intercompany Transactions More Than 90%
Owned Partnership Treatment

Dear NAME:

This is in response to your letter dated February 7, 2023, in which you request information about the elimination of intercompany transactions with a partnership that is more than 90% owned by members of the unitary business group. The nature of your request and the information you have provided require that we respond with a General Information Letter ("GIL"), which is designed to provide general information, is not a statement of Department policy, and is not binding on the Department. See 2 Ill. Adm. Code Section 1200.120(b) and (c), which may be found on the Department's website at www.tax.illinois.gov.

Your letter states as follows:

> We are writing to on behalf of a taxpayer ("Taxpayer") to request a General Information Letter under 2 Ill. Admin. Code § 1200.120. Taxpayer is requesting a general information letter regarding the valid and proper tax treatment of several intercompany transactions between a 100% owned unitary partnership and Taxpayer's combined group under 86 Ill. Admin. Code § 100.5200. As such the Taxpayer respectfully requests that the Illinois Department of Revenue rule on the issue presented below.
>
> Taxpayer is not currently under audit and does not have litigation pending with the Illinois Department of Revenue ("Department"). Further, the issue addressed in this General Information Letter is not an issue being examined as part of a Department audit. Neither the Taxpayer nor the Taxpayer's representatives are aware of any contrary rulings, cases, statutes or regulations to the position requested in this letter.
>
> **FACTS**
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> Taxpayer is a US corporation organized under the laws of a state other than of Illinois. Taxpayer, through its subsidiaries, manufactures and sells tangible personal property. In addition to Taxpayer's headquarters located outside of Illinois, the Group owns facilities throughout the US and

manufacturing facilities worldwide, as well as innovation and operations centers. For federal income tax purposes Taxpayer is the common parent of an affiliated group of US corporations that files a US federal consolidated tax return ("Consolidated Group"). Taxpayer currently files a unitary combined return with its subsidiaries in Illinois.

In order to combine separately owned intellectual property ("IP") in a single IP entity and to better position the Group with regard to legal and business financial risks related to the legacy and acquired IP, Taxpayer implemented a structure to create a separate IP entity. The separate entity will afford the Group flexibility in case of future business restructurings in two different ways –

(1) allowing the Group to independently license IP to a separated business, in case of a future separation of a particular business, and (2) providing an opportunity for the Group to monetize a portion of the IP value by selling portions of the IP entity to external stakeholders/parties. To effectuate the implemented plan, Taxpayer performed the following steps ("Transaction"):

1. Taxpayer created a wholly owned limited liability company ("LLC") under the laws of a state other than Illinois.
2. Taxpayer transferred certain IP to the LLC ("Transferred IP") in exchange for an equity interest in the LLC and three separate loans pursuant to a Trademark Purchase Agreement.
3. Taxpayer contributed 20% of its interest in the LLC to its wholly owned subsidiary ("SubCo"), a corporation previously created under the laws of a state other than Illinois, that is, and has always been, part of the Group and the Consolidated Group.
    i. The transfer results in the LLC to now be classified as a partnership for federal income tax purposes.
    ii. The creation of the partnership results in gain recognitions for federal income tax purposes as the partnership is outside the federal consolidated group.
    iii. Taxpayer continues to own 100% of the partnership.
4. The LLC (hereinafter "Partnership") and Taxpayer entered into a license agreement, whereby the Partnership licenses certain rights to the Transferred IP back to the Taxpayer for continued use in its business. *See* Exhibit A

In conjunction with the execution of the Transaction, Partnership will enter into service agreements with Taxpayer (and other related entities) to receive IP-related services, including services related to development, enhancement, management, and protection of the Transferred IP, which will allow Partnership to maximize the utilization and profits related to the Transferred IP. The Transferred IP does not include goodwill or going concern value.

Partnership will receive royalties (from Taxpayer) in the tax year, with increases on an annual basis, into perpetuity for its license of the IP. Partnership will also pay to Taxpayer interest related to the loans described above. Based on the IP-related operations and estimated cash flow, it is expected that Partnership will have sufficient business activity and earnings to service the interest and principal of the Loans. It is assumed that Partnership would have been able to obtain debt similar to the loans from external sources. Separately, under the terms of the LLC agreement, Taxpayer and SubCo will share in the profits and losses of Partnership in proportion to their LLC interest.

ISSUE

Taxpayer would like to confirm transactions between Partnership, Taxpayer and SubCo should be eliminated, including the net gain related to the Transferred IP, the royalty income received by Partnership for Taxpayer's use of the Transferred IP, and the service income derived from the intercompany service agreements related to the IP for the taxable base and respective sales factor apportionment for the Illinois purposes.

APPLICABLE ILLINOIS LAW

Illinois imposes a Business Corporation Income Tax and a Personal Property Replacement Income Tax on corporations doing business in Illinois.[1]

A. Illinois Combined Income Tax Reporting

Any person subject to Illinois income tax may be a member of a unitary business group and required to use combined apportionment.[2] Only corporations who are members of a unitary business group are required to file combined returns.[3] Partnerships may not be included in a combined return. However, partnerships that are substantially owned or controlled (90% or more) by unitary corporate partners must file a separate unitary combined partnership return.[4] If the unitary group owns less than 90% of the partnership, then the partnership is not a complete member of the unitary group (i.e., the partnership does not file a separate unitary return). Instead the corporate partner includes in its apportionment factors its share of a unitary partnership's apportionment factors (i.e., apportionment factors flow up).

[1] 35 ILCS 5/201(a) & (c).
[2] 86 Ill. Admin code § 100.9700(b).
[3] 35 ILCS 5/502(e); 86 Ill. Admin code § 100.5200.
[4] 86 Ill. Admin code § 100.3380(d)(4); Illinois Form Schedule UB: Instructions for Unitary Combined Business Group Computation.

A unitary business group is "a group of persons related through common ownership whose business activities are integrated with, dependent upon, and contribute to each other." [5] For corporations, common ownership is evidenced by the direct or indirect control or ownership of more than 50 percent of the outstanding voting stock of the persons carrying on the unitary business activity.[6] In the case of any other entity, common ownership means direct or indirect ownership of an interest sufficient to exercise control over the activities of the entity. [7] Further, Illinois regulations set forth specific factors that may illustrate that a corporation and partnership are part of a unitary business, specifically where the activities of the members are:

(1) in the same general line (such as manufacturing, wholesaling, retailing of tangible personal property, insurance, transportation or finance); or (2) are steps in a vertically structured enterprise or process (such as the steps involved in the production of natural resources, which might include exploration, mining, refining, and marketing); and, in either instance, the members are functionally integrated through the exercise of strong centralized management (where, for example, authority over such matters as purchasing, financing, tax compliance, product line, personnel, marketing and capital investment is not left to each member). 35 ILCS 5/1501(a) (27)

B. Illinois Combined Income Tax Computation

The starting point for calculating Illinois taxable income is the federal taxable income as applied after federal net operating loss deduction and special deductions.[8] The Illinois combined base income is determined by first computing the combined group's combined federal taxable income and then modifying by the combined group's combined Illinois addition and subtraction amounts.[9] Federal taxable income means separate taxable income that would be computed by each member for purposes of a federal consolidated return.[10] When a partnership engages in a unitary business with its corporate partners and is substantially owned or controlled by members of the unitary business group, income from the partnership must be included in the combined base income.[11] Once the combined group's base income is determined, combined apportionment

[5] 35 ILCS 5/1501(a)(27)(A)
[6] *Id*.
[7] *Id*.
[8] *Id*.
[9] 35 ILCS 5/203(b)(1), (e)(1).
[10] 86 Ill. Admin. Code § 100.5270(b); Illinois Form Schedule UB: Instructions for Unitary Combined Business Group Computation.
[11] 86 Ill. Admin. Code § 100.5270(b)(1)

method is used to apportion the combined income.[12] When the combined group composed solely of members that apportion their business income under the same rules, the combined group's combined business income shall be apportioned using the total Illinois factors of the combined group and total everywhere factors of the unitary business group.[13]

Combined business income should be determined by treating all members of the unitary business group as if they constitute a federal consolidated group and by applying the federal regulations for determining consolidated taxable income.[14] Therefore, in computing a unitary business group's combined business income to be apportioned to Illinois, items of income and deduction arising from transactions between members of the group must be eliminated whenever necessary to avoid distortion of the denominators used by the group in calculating apportionment factors, or of the numerators used by the group or by ineligible members in calculating apportionment factors.[15] In the case where a partnership is a complete member of the unitary group (i.e., more than 90% owned), intercompany items between the partnership and its corporate partners must be excluded from the combined base income.[16] A modification may be required for intercompany transactions within a unitary business group.[17]

ANALYSIS

A. The Illinois Unitary Combined Group

In Illinois, a partnership must be included in the unitary business group if substantially all of the interests in it are owned or controlled by members of the same unitary business group.[18] Substantial interest is met if more than 90% of the federal taxable income of the partnership is allocable to any member of the unitary business group or any member who would have been included in the unitary business group if not excluded under 80/20 exclusion.[19] Before the Transaction, Taxpayer files a unitary Illinois combined income tax return with its subsidiaries including SubCo. After the Transaction, Partnership meets the substantial interest test because it's 100% directly and indirectly owned by common parent Taxpayer and its wholly owned subsidiary SubCo. Therefore, Partnership will join as a new member of the Illinois unitary business group with Taxpayer and SubCo and file a separate unitary partnership return.

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[12] 35 ILCS 5/304(e)
[13] 86 Ill. Admin. Code § 100.5270(b)(1)
[14] 86 Ill. Admin. Code § 100.5270(b)(1)
[15] *Id.*
[16] Illinois Form Schedule UB: Instructions for Unitary Combined Business Group Computation.
[17] 86 Ill. Admin. Code § 100.5270(b)(1)
[18] 86 Ill. Admin. Code § 100.3380(d)(4)
[19] *Id*.

Any member of a unitary business group not included in the Illinois combined return must file a separate return and compute its apportionable business income by using the base income and apportionment factors of the unitary combined group.[20] Partnership is a partnership and not included in the Illinois combined corporation income tax return as filed by the unitary business group.

B. Intercompany transactions between Taxpayer and Partnership should be eliminated from Illinois combined business income and combined apportionment

Illinois defines taxable income as taxable income as reported federally and applies federal consolidated rules for determining combined taxable income. To determine the combined group income, Illinois treats all members in the unitary business group as if they were in a federal consolidated group and applies the federal consolidated rules.[21] The federal consolidated rules treat members of the consolidated group as a single corporation and applies the "matching rule" to intercompany transactions in order to prevent "intercompany transactions from creating, accelerating, avoiding, or deferring consolidated taxable income (or consolidated tax liability)."[22] Therefore the Partnership should be treated as a corporation under federal consolidated rules when determining combined income and combined apportionment. After the Transaction, Taxpayer receives interest income and service fee income from its wholly owned subsidiary Partnership and pays royalty expense to Partnership for the use of Transferred IP. Such interest income, service fee income and royalty expense should be eliminated in the computation of combined business income. Since Partnership is not part of the federal consolidated group, Taxpayer also records a gain in relation to the sale of IP to Partnership on its federal consolidated income tax return. However, such gain should be eliminated as intercompany transactions in determining Taxpayer's combined Illinois business income since Partnership is a member of the Illinois unitary business group.

Furthermore, the gain, royalty, service and interest income between Taxpayer and its wholly owned subsidiary Partnership should be excluded from the Illinois combined apportionment because they are eliminated and to avoid distortion of the denominators used by the group in calculating apportionment factors, or of the numerators used by the group or by ineligible members in calculating apportionment factors.

SUMMARY

[20] 86 Ill. Admin. Code § 100.5215(b)
[21] *Id*.
[22] Treas. Reg. 1.1502-13(a)(1).

> Based on the above analysis, transactions between Partnership and Taxpayer, the Partnership will file a separate unitary return using the combined group's denominator and the separate company numerator. Further, the Partnership should be treated as a corporation to determine what should be eliminated in calculating its taxable income and apportionment, including the net gain related to the Transferred IP, the royalty income received by Partnership for Taxpayer's use of the Transferred IP, the interest income received by Taxpayer in, and the service income derived from the intercompany service agreements related to the IP for the taxable base and respective sales factor apportionment for Illinois purposes. We would appreciate if the Department would confirm our understanding.
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> If you have any questions regarding the information contained herein, do not hesitate to contact me at the contact information listed above.

RULING

Section 1501(a)(27)(A) of the Illinois Income Tax Act ("IITA", 35 ILCS 5/101 et seq.) defines a "unitary business group" ("UBG") as "a group of persons related through common ownership whose business activities are integrated with, dependent upon and contribute to each other." 86 Illinois Administrative Code Section 100.9700(e) ("Ill. Adm. Code") provides "in the case of a corporation, common ownership means direct or indirect control or ownership of more than 50% of the corporation's outstanding voting stock" and "[i]n the case of any other entity, common ownership means direct or indirect ownership of an interest sufficient to exercise control over the activities of the entity." Additional factors to consider in the UBG analysis include strong centralized management, general line of business, and vertically structured enterprises. *See* 86 Ill. Adm. Code Sections 100.9700(g) and (h). 86 Ill. Adm. Code Section 100.5205(c) provides "[m]embership in a unitary business group is mandatory if the criteria for inclusion are met, and is determined under IITA Section 1501(a)(27) and Section 100.9700 of this Part."

IITA Section 304(e) provides:

> Where 2 or more persons are engaged in a unitary business as described in subsection (a)(27) of Section 1501, a part of which is conducted in this State by one or more members of the group, the business income attributable to this State by any such member or members shall be apportioned by means of the combined apportionment method.

86 Ill. Adm. Code Section 100.5215 provides for the filing of separate unitary returns under IITA Section 304(e), and specifically provides in Section 100.5215(a) "not every member of a unitary business group is eligible to join in the filing of a combined return…." Pursuant to Section 100.5215(b):

> Each member of a unitary business group who is subject to Illinois income tax and who properly does not join in the filing of a combined return must file a separate return, and compute its business income apportionable to Illinois by computing the base income of the unitary business group in accordance with Section 100.5270(a)(1) and by multiplying the business income included in the base income by an apportionment fraction computed by using the Illinois apportionment factor or factors applicable to the return filer under IITA Section 304 and the everywhere factor or factors of the entire unitary business group.

The computation of combined net income and tax pursuant to IITA Section 304(e) is further explained in 86 Ill. Adm. Code Section 100.5270. Combined base income is "determined by treating all members of the unitary business group (including ineligible members) as if they constituted a federal consolidated group and by applying the federal regulations for determining consolidated taxable income, ……" 86 Ill. Adm. Code Section 100.5270(a)(1). Combined business income shall be apportioned to Illinois as provided in 86 Ill. Adm. Code Section 100.5270(b)(1):

> In the case of a combined group composed solely of members that apportion their business income under the same subsection of IITA Section 304 (that is, insurance companies apportioning business income under IITA Section 304(b), financial organizations apportioning business income under IITA Section 304(c), federally regulated exchanges apportioning business income under IITA Section 304(c-1), transportation companies apportioning business income under IITA Section 304(d), and all other businesses apportioning business income under IITA Section 304(a)), the combined group's combined business income shall be apportioned using the total Illinois factors of the combined group and total everywhere factors of the unitary business group. In the case of a combined group that includes members that apportion their business income under different subsections of IITA Section 304, the combined group's combined business income is apportioned as provided in Section 100.3600. Items of income and deduction arising from transactions between members of the unitary business groups shall be eliminated whenever necessary to avoid distortion of the denominators used by the unitary business group in calculating apportionment factors, or of the numerators used by the combined group or by ineligible members of the group in calculating apportionment factors.

86 Ill. Adm. Code Section 100.9700(b) provides:

> b) Persons Required to Use Combined Apportionment
> Any person subject to Illinois income taxation may be a member of a unitary business group and required to use combined

> apportionment under IITA Section 304(e). Only corporations (other than subchapter S corporations) who are members of a unitary business group are required to file combined returns under IITA Section 502(e). For the treatment of certain partners and partnerships engaged in a unitary business, see Section 100.3380(d). Every member of a unitary business group who is neither a corporation required to join in a combined return nor a partnership excluded from combined apportionment under Section 100.3380 shall determine the Illinois portion of its business income pursuant to IITA Section 304(e) by computing the combined business income of the unitary business group in the manner prescribed in Section 100.5270(a), and apportioning that unitary business income to Illinois using the combined everywhere apportionment factors of the unitary business group and that person's own Illinois apportionment factors. If one or more other members of the unitary business group have taxable years different from the taxable year of the taxpayer filing the return, that taxpayer shall compute the combined business income of the group for its taxable year by including the incomes of the members using a different taxable year in the manner prescribed by Section 100.5265.

A partnership is "excluded from combined apportionment under Section 100.3380" when the special rules for the apportionment of business income under 86 Ill. Adm. Code Section 100.3380(d)(1) and (2) apply to the partnership.

86 Ill. Adm. Code Section 100.3800(d)(4) provides for an exception to the alternative apportionment methods prescribed in 86 Ill. Adm. Code Sections 100.3380(d)(1) and (2):

> If substantially all of the interests in a partnership (other than a publicly-traded partnership under IRC section 7704) are owned or controlled by members of the same unitary business group as the partnership, the partnership shall be treated as a member of the unitary business group for all purposes, and, for purposes of applying IITA Section 305(a) to any nonresident partner who is not a member of the same unitary business group, the business income of the partnership apportioned to this State shall be determined using the combined apportionment method prescribed by IITA Section 304(e). For purposes of this subsection (d), substantially all of the interests in a partnership are owned or controlled by members of the same unitary business group if more than 90% of the federal taxable income of the partnership is allocable to one or more of the following persons:
>
> A) any member of the unitary business group;

B) any person who would be a member of the unitary business group if not for the fact that 80% or more of that person's business activities are conducted outside the United States;

C) any person who would be a member of the unitary business group except for the fact that the person and the partnership apportion their business incomes under different subsections of IITA Section 304 and, therefore, for taxable years ending prior to December 31, 2017, would be excluded from a unitary business group in which the partnership is a member; or

D) any person who would be disallowed a deduction for losses by IRC section 267(b), (c) and (f)(1) by virtue of being related to any person described in subsection (d)(4)(A), (B) or (C), as well as any partnership in which a person described in subsection (d)(4)(A), (B) or (C) is a partner.

Therefore, the statutory apportionment method under IITA Section 304(e) applies in instances where more than 90% of the partnership interest is owned by other UBG members.

Your inquiry is to whether intercompany transactions between members of the unitary group will be eliminated under 86 Ill. Adm. Code Section 100.5270(b)(1) which provides "[i]tems of income and deduction arising from transactions between members of the unitary business groups shall be eliminated whenever necessary to avoid distortion of the denominators used by the unitary business group in calculating apportionment factors, or of the numerators used by the combined group or by ineligible members of the group in calculating apportionment factors." Specifically, your letter inquires whether service fee income, interest income, royalty expense, and the gain from the sale of intellectual property (IP) to Partnership should be eliminated among the various entities.

Intercompany eliminations are required only if distortion occurs. You indicate in your letter that SubCo, a wholly owned subsidiary of Taxpayer, "is, and has always been, part of" Taxpayer's combined group. Taxpayer maintains 80% direct ownership in Partnership and 20% indirect ownership in Partnership through SubCo. As substantially all of the interests in Partnership (90% or more) are owned or controlled by members of the same UBG as the Partnership, then Partnership is treated as a member of the UBG for all purposes pursuant to 86 Ill. Adm. Code Section 100.3380(d)(4) regardless of the other unitary tests.

Under 86 Ill. Adm. Code Section 100.5215, the members of the UBG that are not part of the combined group will compute their combined base income by applying the rules of Section 100.5270. If Taxpayer and Partnership are proper members of a UBG, then 86 Ill. Adm. Code Section 100.5270(a)(1) requires the combined

group members to compute their federal taxable income by treating all members of the UBG (including ineligible members) if they were members of a federal consolidated group and apply the federal consolidated return regulations.

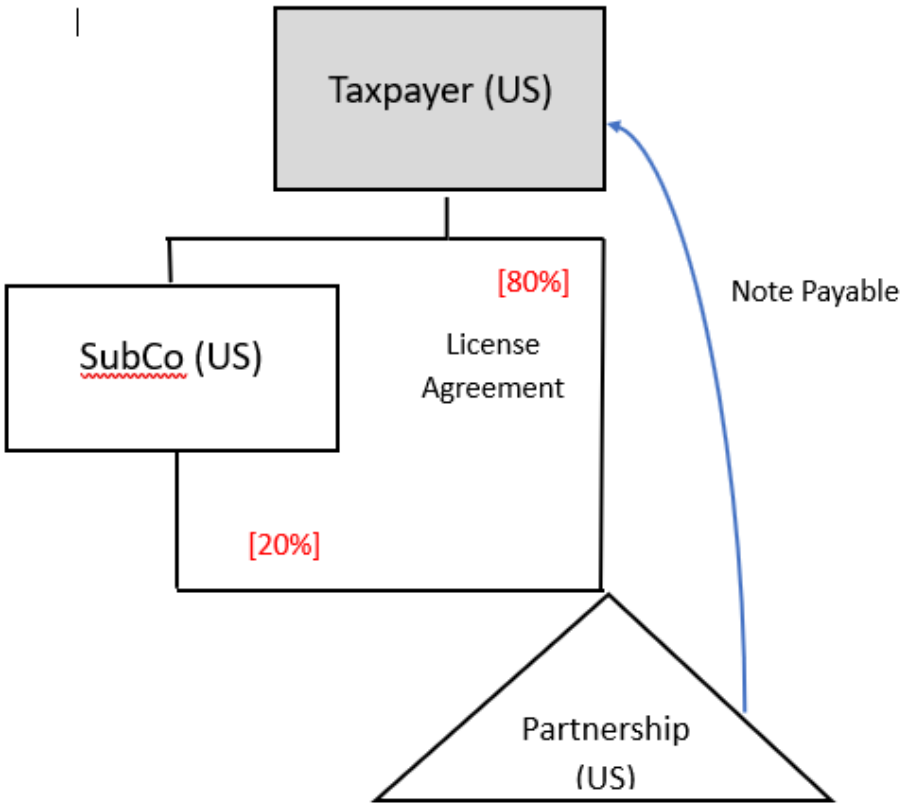
As Partnership is to be treated as a member of the UBG under 86 Ill. Adm. Code Section 100.3380(d)(4), then all members will be entitled to the intercompany eliminations of the service fee income, interest income, and royalty expense as provided by 86 Ill. Adm. Code Section 100.5270(b)(1) to avoid distortions in the apportionment factor. Failure to eliminate from the sales factor a transfer between members of a UBG would alter the sales factor of the group. If the gain in relation to the sale of IP to the Partnership is not recognized under the federal consolidated return regulations, then the gain will not be recognized in computing the combined base income of the UBG members.

As stated above, this is a GIL. A GIL does not constitute a statement of Department policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department.

Sincerely,

Jennifer Uhles
Associate Counsel (Income Tax)

Exhibit A- Abbreviated Ending Structure



Expected Intercompany Transactions

- Interest from Partnership to Taxpayer
- Service fee from Partnership to Taxpayer
- Royalty from Taxpayer to Partnership