IT-23-0017-GIL 08/18/2023 ALTERNATIVE APPORTIONMENT

> Petition for alternative apportionment cannot be granted based on the information provided. (GIL)

August 18, 2023

NAME
ADDRESS

Re: Petition for Alternative Apportionment
COMPANY
Tax Year Ended: ##/##/####

Dear NAME:

This is in response to your petition to use an alternative method of allocation or apportionment. Department of Revenue ("Department") 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 on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs. See 2 Ill. Adm. Code 1200.110. The purpose of a GIL is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c). You may access our website at www.tax.illinois.gov to review regulations, letter rulings, and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL.

For the reasons discussed below, your petition cannot be granted at this time.

Your petition states as follows:

> Pursuant to Illinois Revised Statutes 35 ILCS 5/304(f), COMPANY1 and the affiliates with which it files a combined Illinois Corporation Income Tax return (collectively the "BUSINESS") respectfully request alternative apportionment for the gain from the sale of a discrete segment of the BUSINESS's business. We understand that, pursuant to the Department of Revenue's regulations, alternative apportionment is to be granted only if the "application of the statutory formula will lead to a grossly distorted result." The factual situation discussed herein is unique and one of those unusual situations where the application of the statutory apportionment rules does not produce a fair - or constitutional - apportionment formula.

As discussed in more detail below, on DATE, the BUSINESS sold a portion of its SEGMENT1 business consisting of its SEGMENT1 COMPANIES in NUMBER states primarily in the Southeast and Mid-Atlantic to a private equity firm (the "TRANSACTION"). A SEGMENT1 COMPANY is an INDUSTRY company that provides SEGMENT1 SERVICES. By its very nature, the conduct of a SEGMENT1 business is markedly different from most other businesses. The conduct of a SEGMENT1 business is completely centered around a locality, with the licenses to operate, the activities and infrastructure, and the customers and goodwill all located in the same jurisdiction. Except for COMPANY2, a COMPANY1 entity typically only operated as a SEGMENT1 COMPANY in one jurisdiction. The BUSINESS's Illinois SEGMENT1 COMPANY, COMPANY3, was included in the TRANSACTION but represented less than one percent of the value of the TRANSACTION.

The BUSINESS continues to operate its other SEGMENT2 business in Illinois, the bulk of which relates to the legacy business of COMPANY4. Illinois's taxation of the BUSINESS's gain resulting from the TRANSACTION should be limited only to that amount related to the Illinois SEGMENT1 COMPANY; any taxation of the gain related to other states would be an unconstitutional imposition of tax on extraterritorial values.

Accordingly, Illinois's statutory method for taxation of the BUSINESS's gain from its sale of the SEGMENT1 businesses would be an unconstitutional imposition of tax on extraterritorial values. Under any reasonable attribution method - attribution by means of (a) the location of the customers of the SEGMENT1 operations that were sold, (b) the location where the purchaser will benefit from its acquisition of the SEGMENT1 operations, (c) the location of the operations of the SEGMENT1 business that was sold, or (d) the location of the goodwill from the SEGMENT1 operations that were sold - less than one percent of the gain would be attributable to Illinois. Using the statutory apportionment method to tax a greater portion of the BUSINESS's gain from the sale of the SEGMENT1 operations would be distortive and would result in taxable income that does not reflect the BUSINESS's business in Illinois. Thus, the BUSINESS hereby requests alternative apportionment.

FACTS

The SEGMENT1 Business

A SEGMENT1 COMPANY is the SEGMENT1 COMPANY, i.e., SEGMENT1 companies, each of which had a regional monopoly with respect to the SEGMENT1 SERVICES in a specific region. This monopolistic structure changed in YEAR when Congress tried to spur competition by requiring SEGMENT1 COMPANIES to provide access to their systems at regulated rates to other carriers that would resell the service to local telephone customers. Even though other companies - SEGMENT2 COMPANIES - were now able to

compete with SEGMENT1 COMPANIES to provide SEGMENT1 service, the SEGMENT1 COMPANIES retained their historic responsibility to own and maintain the INDUSTY infrastructure in the regions they served. Because a SEGMENT1 COMPANY must maintain the INDUSTRY infrastructure in its "home" location, and because such infrastructure allows the SEGMENT1 COMPANY to provide SEGMENT1 SERVICES only in such location, a SEGMENT1 COMPANY's business and revenue are, by its very nature, tied to the location in which the SEGMENT1 COMPANY business operates. Said another way, a SEGMENT1 COMPANY's infrastructure, operations, customers, and goodwill are all located in the same jurisdiction.

History of the BUSINESS

The BUSINESS is involved in the conduct of an INDUSTRY business, which was formed over the years through the merger and acquisition of various INDUSTRY companies, including COMPANY5, COMPANY6, COMPANY2, and COMPANY4. Prior to the acquisition of COMPANY4 in YEAR, the BUSINESS was primarily involved in the provision of INDUSTRY SERVICES to SEGMENT1 CUSTOMERS.

In YEAR, COMPANY7 acquired COMPANY6, with the combined company changing its name to COMPANY5. Prior to this acquisition, COMPANY7 and COMPANY6 each conducted a SEGMENT1 business operating largely in REGIONS.[1] The COMPANY5 operations expanded in YEAR when COMPANY5 acquired COMPANY2, whose primary operations were as the SEGMENT1 in NUMBER REGION STATES.[2] The addition of COMPANY2 operations resulted in COMPANY5 becoming the third largest SEGMENT1 COMPANY in the United States.

On MONTH DAY, YEAR COMPANY5 acquired COMPANY4 in a deal valued at approximately $$$ billion. The acquisition of COMPANY4 is notable because, unlike the previous transactions, the acquisition of COMPANY4 resulted in COMPANY5 expanding its business operations to encompass the conduct of a different type of business - one focused on providing advanced communications and technology services to large enterprise customers:

> COMPANY5 and COMPANY4 have in the past focused primarily on serving different geographic areas and customer segments. COMPANY5 is a mid-sized SEGMENT1 COMPANY that provides voice, broadband, and video services to business and residential customers in rural, suburban and urban territories. COMPANY4 serves some SEGMENT2 customers

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1 Statement from Acting Chairman of Agency, Agency ##-##, Memorandum, Opinion & Order

2 COMPANY2 also operated a small SEGMENT2 business, primarily long-distance, now known as COMPANY8. Unlike the SEGMENT1 COMPANIES that were sold as part of the TRANSACTION that primarily operated in one jurisdiction, COMPANY2 operates as the SEGMENT1 in NUMBER states.

> both within and outside of its SEGMENT1 territory, but its fiber-based footprint for high-demand services such as SEGMENT2 SERVICE is limited relative to that of its largest competitors, especially outside of its SEGMENT1 territory. COMPANY5 has a relatively modest ASSET and a small resale-based presence in the international SEGMENT2 market. In fact, it holds a small ownership interest in only one ASSET2 in the U.S. and otherwise leases all of its international SEGMENT2 capacity (including to and from the U.S.) from others.
>
> In contrast, COMPANY4 serves no SEGMENT1 customers. It focuses on serving SEGMENT2 customers. Most of COMPANY4's customers are located outside of COMPANY5's SEGMENT1 territory. COMPANY4 serves customer locations via its own SEGMENT2 facilities where possible, but COMPANY4 SEGMENT2 facilities do not reach the majority of the customer locations it serves. Where this is the case, COMPANY4 serves the customer locations via end user connections leased from another INDUSTRY COMPANY. Still, COMPANY4 has been able to use those connections to become a leader in the provisioning of high-demand SEGMENT2 services to customers, again primarily outside of COMPANY5's SEGMENT1 territory. COMPANY4 also has a significant SEGMENT2 business.[3]

On MONTH DAY, YEAR COMPANY5 announced that it had changed its name to COMPANY1. After this change, all SEGMENT2 BUSINESS was marketed under the name COMPANY1. BUSINESS continues to use the COMPANY5 brand as the customer-facing brand for its legacy SEGMENT1 business, while the MATERIAL brand is being used for the SEGMENT2 SERVICES sold to SEGMENT1 customers in what was historically the SEGMENT1 space.

The TRANSACTION of a Portion of the SEGMENT1 Business

In recent years, BUSINESS made the strategic decision to focus its operations on those portions of its business that use more advanced infrastructure, including the less rural portion of its SEGMENT1 business and the entirety of its SEGMENT2 business. Accordingly, on MONTH DATE, YEAR, BUSINESS entered into an agreement to TRANSACT its SEGMENT1 operation in NUMBER states to an affiliate of COMPANY9. The TRANSACTED operations were located in the following NUMBER states: TRANSACTION STATES. The sale to COMPANY9 (the "TRANSACTION") was finalized on MONTH DAY, YEAR, with BUSINESS receiving $$$ billion in consideration for the sale. (The consideration consisted of approximately $$$ billion of cash and $$$ billion of assumption of indebtedness.)[4]

[3] AGENCY APPLICATION.

[4] PRESS RELEASE.

The TRANSACTION was structured as the sale of each of the SEGMENT1 entities that operate in the NUMBER-state region.[5] This included the Illinois SEGMENT1 COMPANY, COMPANY3, and NUMBER other legal entities. As part of the TRANSACTION, COMPANY1, and COMPANY9 agreed to treat the TRANSACTION as a sale of assets for income tax purposes.[6] Under the Purchase Agreement, COMPANY9 is required to provide a proposed allocation of the purchase price as required (the "Section 1060 Allocation").[7] At the time of this petition, the final closing statement has not been agreed between the BUSINESS and the purchaser of the SEGMENT1 TRANSACTION. As a result, the final Section 1060 Allocation has not been determined. However, the preliminary draft purchase price allocation prepared by FIRM, a third-party valuation firm, shows that the amount of consideration allocable to the Illinois SEGMENT1 COMPANY is %%% which represents less than one percent of the total consideration received by BUSINESS.

LAW & ANALYSIS

The Department of Revenue ("Department") has the authority to grant alternative apportionment pursuant to 35 ILCS 5/304(f), which provides:

> [i]f 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:
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> (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

[5] *See* Section 2.1 of the Purchase Agreement, which is available in the Form 8-K filed DATE. WEBSITE

[6] *See* Section 6.l(a) of the Purchase Agreement.

[7] *See* Section 6.l(d) of the Purchase Agreement. While COMPANY9 is responsible for providing the initial proposed Section 1060 Allocation, BUSINESS engaged FIRM, an independent third-party valuation firm, to prepare a preliminary draft purchase price allocation.

business income.

The Department's regulations provide that alternative apportionment is appropriate when "the statutory formula results in the taxation of extraterritorial values or operates unreasonably and arbitrarily in attributing to Illinois a percentage of income that is out of all proportion to the business transacted in this State ..." 86 Ill. Admin. Code 100.3390(c)

The legislature gave the Department the authority to grant alternative apportionment; such alternative apportionment must be used if the statutory apportionment formula results in imposition of a tax that is unconstitutional.

The Due Process Clause, as interpreted by the United States Supreme Court, mandates that "the income attributed to the State for tax purposes must be rationally related to 'values connected with the taxing State.'"[8] In other words, a state is prohibited from taxing income "which cannot in fairness be attributed to the taxpayer's activities within the State."[9]

With respect to a unitary business conducting operations in many states, the traditional statutory method of attributing income to a taxing state is to apply an apportionment formula to the income conducted by the entire unitary business. However, the rationale for use of the apportionment method does not apply to taxation of the gain from the sale of a business like an SEGMENT1 company.

The unitary business principle was created in the property tax context for the purpose of determining the tax base for certain horizontally integrated businesses - such as railroads and telegraph companies - that conducted their business operations in many states. The unitary business principle was applied to these horizontally integrated businesses because it was determined that the isolated value of such a business' property located within a state did not reflect the true value of the business' property; the value was instead dependent upon all of the business' property and operations, including that property and operations located outside of the state. Accordingly, the courts determined that the only way to properly value the in-state property of a horizontally integrated business was to value the unitary business' property (both within and without the state) and attribute a portion of the unitary value to the taxing state. As the Supreme Court noted:

> When States attempted to value railroad or telegraph companies for property tax purposes, they encountered the difficulty that what makes such a business valuable is the enterprise as a whole, rather than the track or wires that happen to be located within a State's borders. The Court held that, consistent with the Due Process Clause, a State could base its tax

[8] *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 272-73 (1978) (citation omitted).

[9] *Allied-Signal, Inc. v Director, Div. of Taxation*, 504 U.S. 768 (1992).

> assessments upon "the proportionate part of the value resulting from the combination of the means by which "the business was carried on, a value existing to an appreciable extent throughout the entire domain of operation." *Adams Express Co. v. Ohio State Auditor*, 165 U.S. 194, 220-221 (1897) (citing *Western Union Telegraph Co. v. Attorney General of Massachusetts*, 125 U. S. 530 (1888)); *Massachusetts v. Western Union Telegraph Co.*, 141 U.S. 40 (1891); *Maine v. Grand Trunk R. Co.*, 142 U.S. 217 (1891); *Pittsburgh, c., C. & St. L. R. Co. v. Backus*, 154 U.S. 421 (1894); *Cleveland, c., C. & St. L. R. Co. v. Backus*, 154 U. S. 439 (1894); *Western Union Telegraph Co. v. Taggart*, 163 U. S. 1 (1896); *Pullman's Palace Car Co. v. Pennsylvania*, 141 U. S. 18 (1891).
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> *Adams Express* recognized that the principles that permit a State to levy a tax on the capital stock of a railroad, telegraph, or sleeping car company by reference to its unitary business also allow proportional valuation of a unitary business in enterprises of other sorts. As the Court explained: "The physical unity existing in the former is lacking in the latter; but there is the same unity in the use of the entire property for the specific purpose, and there are the same elements of value arising from such use." 165 U.S., at 221.[10]

In the state income tax context, the unitary business principle is most often used to determine whether income from different business activities can be jointly apportioned to a state in computing the state tax base. The Supreme Court has recognized that it is typically virtually impossible to allocate each sale or receipt to a state and, thus, has allowed the states to use apportionment formulas to determine the approximate portion of income of a unitary business that is attributable to the taxing state.[11] The use of an apportionment formula to compute the tax of a unitary business is typically constitutional because "all the factors in [the unitary] enterprise are essential to the realization of profits" and, thus, the profits can be jointly apportioned to the various states in which the enterprise conducts business.[12] However, the use of an apportionment formula is constitutional only if it fairly reflects the business conducted in the taxing state.[13] The Supreme Court has held that the use of an apportionment formula is not

[10] *Allied-Signal, Inc. v. Director, Div. of Taxation*, 504 U.S. 768, 777 - 78 (1992).

[11] *See e.g., Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159 (1983); *Mobil Oil Corp. v. Commissioner of Taxes of Vt.*, 445 U.S. 425 (1980).

[12] *Butler Brothers v. McColgan*, 315 U.S. 501 (1940); *Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell*, 283 U. S. 123 (1931).

[13] *See, e.g., Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell*, 283 U.S. 123 (1931); *Bass, Ratcliff & Gretton, Ltd v. State Tax Comm'n,* 266 U.S. 271 (1924).

permitted when the income being apportioned "was earned in the course of activities unrelated to [those] in [the taxing state]."[14]

Application

Unlike most businesses, it is quite easy to attribute the gain from the sale of the SEGMENT1 businesses to a specific jurisdiction because of the localized nature of the SEGMENT1 business sold in the TRANSACTION. That is particularly true here where the Section 1060 Allocation will dictate how much of the purchase price relates to each entity that was sold in the TRANSACTION.

Whether market-sourcing or cost of performance is used, all metrics result in the Gain being attributable to the relevant local jurisdiction where the SEGMENT1 business is operated. The Gain from the TRANSACTION is wholly attributable to local factors - the SEGMENT1 infrastructure and operations that are located within the relevant jurisdiction, the customers that are located in that jurisdiction, and the licenses to operate the SEGMENT1 business in that jurisdiction. The SEGMENT1 businesses are discrete, localized businesses by nature because they are not permitted or able to operate outside of their dedicated jurisdictions.

In the situation of the TRANSACTION, the SEGMENT1 operations in Illinois were only conducted by one entity, COMPANY3. The portion of the tax gain on the TRANSACTION related to that specific entity has been preliminary determined to be %%%%%, which is less than one percent of the value of the overall deal.

Conclusion

Alternative apportionment is necessary to maintain the constitutionality of Illinois's tax on the gain on the TRANSACTION. Accordingly, Petitioner respectfully requests alternative apportionment pursuant to 35 ILCS 5/304(f). Specifically, Petitioner requests that the Department permit it to allocate to Illinois only that portion of the gain that relates to the Illinois SEGMENT1 COMPANY, as will be determined by the Section 1060 Allocation.

As noted above, the final Section 1060 Allocation has not yet been determined. Therefore, BUSINESS reserves the right to amend this petition when the Section 1060 Allocation is finalized. Please contact NAME at PHONE or EMAIL if you need additional information or would like to discuss this request in more detail.

RULING

Section 304(a) of the Illinois Income Tax Act ("IITA" 35 ILCS 5/304) provides that when a nonresident derives business income from Illinois and one or more other states, such income shall be apportioned to Illinois by multiplying the income by the taxpayer's apportionment

[14] *Mobil Oil Corp. v. Commissioner of Taxes of Vt.*, 445 U.S. 425 (1980).

factor. For taxable years ending on and after December 31, 1998, except in the case of an insurance company, financial organization, transportation company, or federally regulated exchange, the apportionment factor is equal to the sales factor. IITA Section 304(a)(3) defines the sale factor as a fraction, the numerator of which is the total sales of the person in Illinois during the taxable year, and the denominator of which is the total sales of the person everywhere during the taxable year.

Section 304(f) of the IITA states:

> 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.

86 Ill. Adm. Code Section 100.3380(a)(2) provides:

> The Director has determined that, in the instances described in this Section, the apportionment provisions provided in IITA Section 304(a) through (e) and (h) do not fairly represent the extent of a person's business activity or market within Illinois. For tax years beginning on or after the effective date of a rulemaking amending this Section to prescribe a specific method of apportioning business income, all nonresident taxpayers shall apportion their business income employing that method in order to properly apportion their business income to Illinois. Taxpayers whose business activity or market within Illinois is not fairly represented by a method prescribed in this Section and who want to use another method for a tax year beginning after the effective date of the rulemaking adopting that method may obtain permission to use that other method by filing a petition under Section 100.3390. For tax years beginning prior to the effective date of the rulemaking adopting a method of apportioning business income, the Department will not require a taxpayer to adopt that method; provided, however, if any taxpayer has used that method for any of those tax years, the taxpayer must continue to use that method for that tax year. Moreover, a taxpayer may file a petition under Section 100.3390 to use a method of apportionment prescribed in this Section for any open tax year beginning prior to the effective date of the rulemaking adopting that method, and

> that petition shall be granted in the absence of facts showing that that method will not fairly represent the extent of a person's business activity or market in Illinois.

86 Ill. Adm. Code Section 100.3390(c) provides:

> An alternative apportionment method may not be invoked, either by the Director or by a taxpayer, merely because it reaches a different apportionment percentage than the required statutory formula.

In order to make a determination under IITA Section 304(f) as to whether or not the apportionment provisions of subsections (a) through (e) and of subsection (h) reflect the market for the person's goods, services, or other sources of business income, it is necessary that the taxpayer first determine its apportionment under such sections. If the apportionment under such sections does not fairly reflect the taxpayer's market, then an alternative apportionment method may be permitted. Your request does not indicate whether the taxpayer has determined its apportionment under IITA Section 304. Your request contains no information relative to the market for the taxpayer's goods, nor does it contain information by which a determination can be made as to whether the apportionment resulting under IITA Section 304 fails to fairly reflect that market. Your request contains no evidence that the statutory apportionment formula does not fairly represent the extent of the taxpayer's business activities in Illinois or that an alternative method produces a more reasonable result.

The facts stated in your petition are not sufficient to satisfy the burden set forth in 86 Ill. Adm. Code Section 100.3390(c). The petition must explain why the statutory formula distorts business activity in Illinois and why your proposed alternative apportionment method would fairly and accurately apportion income to Illinois based upon the business activity in Illinois. Your petition contains no analysis showing why the requested alternative apportionment formula is superior to the statutory formula, other than to show it is necessary to maintain the constitutionality of Illinois' tax on the gain on the TRANSACTIONS. Your petition is merely a showing that the requested alternative apportionment formula reaches a different result than the required statutory formula. Furthermore, you indicate in your petition the final Section 1060 Allocation has not been determined. The Department does not issue PLRs based on preliminary allocation determinations.[15]

Because your request merely states that an allocation to Illinois of only the portion of the gain that relates to the Illinois SEGMENT1 (as yet to be determined by the Section 1060 Allocation) more accurately reflects your Illinois activity, this petition does not meet the regulatory requirement and cannot be granted at this time.

Accordingly, your petition for alternative apportionment for tax year ended MONTH DATE, YEAR cannot be granted. However, if you have additional information related to this request that was not previously submitted, you may supplement your petition and the Department will reconsider your request. Please note that 86 Ill. Adm. Code Section 100.3390(e)(1) requires a petition to be filed at least 120 days prior to the due date (including extensions) for the first

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[15] The Department also notes the discrepancy in the petition of the reported preliminary draft purchase price allocation as %.%%%% and %.%%%%.

return for which permission is sought to use the alternative apportionment method. In addition, each PLR request submitted to the Department for consideration must include certain information outlined in 2 Ill. Adm. Code Section 1200.110.

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

Sincerely,

Jennifer Uhles
Associate Counsel (Income Tax)