Temporary interruption in Illinois of shipment from another state to other states or to a foreign country in which the taxpayer is not subject to tax will not cause the sale to be thrown back to Illinois.

August 22, 2024

NAME
TITLE
PARTNERSHIP
ADDRESS

E-MAIL

Re: Request for Private Letter Ruling – Apportionment-Sales Factor
COMPANY1
FEIN: ##-#######
For all tax years beginning on or after MM/DD/YEAR

Dear NAME:

This is in response to your e-mail dated June 26, 2024, in which you requested a Private Letter Ruling on behalf of COMPANY1. and its combined subsidiaries seeking confirmation as to whether the sale of certain tangible personal property will be within Illinois for purposes of 35 ILCS Section 5/304(a).

The 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 Section 1200.110 is contained in your request.

This Private Letter Ruling will bind the Department only with respect to the combined group that includes COMPANY1 for the issues presented in this ruling. Issuance of this ruling is conditioned upon the understanding that neither COMPANY1 nor any related taxpayer is 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 them are as follows:

> We are writing on behalf of our client, COMPANY1 and combined subsidiaries ("Taxpayer") to request a private letter ruling pursuant to Illinois Administrative Code Section 1200.110. In accordance with such section, the Taxpayer and its representative ("Representative") attest to the following:
>
> 1. The Taxpayer is not under audit for any tax, nor is the Taxpayer the subject of any pending litigation related to this request;
> 2. The requested ruling relates to the Corporation Income Tax ("CIT") for all periods beginning on or after MM/DD/YEAR
> 3. To the best of our knowledge, the Taxpayer and Representative are

not aware of any contradicting authorities or any rulings covering the specific facts and questions addressed herein;

4. Neither the Taxpayer nor its Representative have previously requested a ruling from the Department of Revenue ("Department") on this issue; and
5. The Taxpayer and Representative are not aware of any relevant authorities not disclosed herein which contradicts the ruling request.

We attach a Power of Attorney authorizing us to represent the Taxpayer for this purpose.

Statement of Facts

Taxpayer is a leading cross-platform global games company with a focus on content and digital markets. The Taxpayer's headquarters and US manufacturing facilities, including its inventory, are located in STATE. Taxpayer files an Illinois combined corporate income tax return that includes all members of its federal consolidated group ("Combined Group"), including COMPANY2("COMPANY2").

COMPANY2 supplies game content and gaming machines to licensed gaming entities. COMPANY2's products ship from its manufacturing and assembly facilities located in STATE. All contract negotiations and final contracts are approved by employees located in STATE. COMPANY2 currently has offices located in Illinois. While some of COMPANY2's employees located in Illinois are sales representatives or visit customer locations, none of the Company's inventory is stored at or shipped from the Illinois office, and Illinois employees are not responsible for final sales approval. Finally, there is no manufacturing or assembly performed in Illinois.

During 2023, COMPANY2 began utilizing a centrally located distribution center ("DC") in Illinois to reduce distribution network miles, freight spend and greenhouse gas emissions. A third-party unrelated to the Taxpayer owns and operates the DC and the Taxpayer does not separately lease space or have employees located at the DC. In addition, the Taxpayer, including COMPANY2, does not store inventory at the DC and none of the Taxpayer's other businesses utilize the Illinois DC. All products are manufactured and shipped from STATE, and already sold to and destined for customers in the Eastern portion of the US and COUNTRY, prior to reaching the Illinois DC.

COMPANY2 utilizes the Illinois DC solely to accommodate further shipping. There are no modifications, product changes, or alterations to the products occurring at the DC. There are over three hundred gaming jurisdictions in the US that impose strict shipping restrictions on COMPANY2's products such that the products themselves cannot be changed or repackaged once shipping has begun. Each

time inventory is placed on a truck, the truck is sealed. Upon arrival at the DC, the truck is unsealed, and the contents are moved to different trucks depending on the destination of the products. For example, multiple shipments of products combine into a single shipment, or products move from one delivery truck to another, with the goal of reducing overall mileage, freight spend, and greenhouse gas emissions. Once products are placed back onto trucks, the trucks are resealed. Products are generally located at the DC for as little as a few hours and for up to 7 days, but on average products remain at the DC for 2 to 3 days.

Ruling Requested

The Taxpayer requests a ruling that sales of COMPANY2's products that pass through the Illinois DC and are destined for another state or country are not includible in the numerator of COMPANY2's Illinois sales factor. Specifically, the Taxpayer requests a ruling that confirms that COMPANY2's products that pass through the Illinois DC are not "delivered to a purchaser in Illinois" or "shipped from a warehouse, factory, or other place of storage in Illinois" for purposes of determining the numerator of COMPANY2's sales factor. Accordingly, COMPANY2's sales that pass through the Illinois DC are not includible in the numerator of its sales factor for purposes of computing the Combined Group's Illinois apportionment percentage.

Discussion and Relevant Authorities

Taxpayers that are members of a unitary group are required to file a combined corporate net income tax return in Illinois.[1] Tax is based on the combined group's apportioned business income.[2] Combined business income is apportioned using the ratio of each members sale's "in Illinois" to the group's total sales everywhere ("Sales Factor").

To compute the Sales Factor for sales of tangible personal property, Illinois law provides that sales are "in Illinois" (i.e., included in the numerator of ratio) if:

(i) the property is delivered or shipped to a purchaser, other than the US government, within Illinois regardless of f.o.b. point or other conditions of the sale ("Clause I"); or

(ii) the property is shipped from an office, store, warehouse, factory or *other place of storage* in Illinois and either the purchaser is the US government, or the person is not taxable in the state of the purchaser ("Throwback Rule"/"Clause II").[3]

[1] Tax Law Sec. 502.
[2] Tax Law Sec. 304(e).
[3] IITA Sec. 304(a)(3). Note that while the statute uses the phrase "not taxable in the STATE of purchaser," the Throwback Rules has also been applied to foreign sales. See, for example, *General Information Letter IT 95-0147-GIL*.

Clause I-Destination Sales
For purposes of determining whether sales are included in the numerator of the Sales Factor pursuant to Clause I, Illinois regulations provide that property is delivered or shipped to a purchaser within the State if the *shipment terminates in the State*, even though the property is subsequently transferred by the purchaser to another state ("Destination Rule"). For example, where a corporation makes a sale to a purchaser who maintains a central warehouse in the State at which all merchandise purchases are received, and the purchaser reships the goods to its branch stores in other states for sale, all of the corporation's products shipped to the purchaser's warehouse in Illinois is property "delivered or shipped to a purchaser within Illinois and included in the numerator of the Sales Factor."[4]

In a 2014 private letter ruling ("PLR"), the Department determined that sales purchased from an affiliate and temporarily shipped to a freight forwarder's facilities in Illinois were not "within Illinois" for purposes of determining the numerator of the taxpayer's sales factor.[5] In that ruling, the taxpayer ("Company 1") shipped goods ordered by its affiliate ("Company 2") to Company 2's customers located outside Illinois via an affiliated freight forwarder ("AFF") hired by Company 2. The AFF picked up the products at Company 1's manufacturing facilities located outside Illinois and shipped such products (at Company 2's direction) to AFF's facilities in Illinois which its consolidated such shipments with other products purchased by Company 2. Company 1's products were ready for shipping to other states or countries with no further labeling or packaging changes required. In addition, there were no modifications, no product changes, and no alterations made to the products while at the Illinois facility. The products would remain at the AFF's facilities for a brief time (from a few hours to a couple of days). The taxpayer requested confirmation that its shipment of products to Company 2's AFF in Illinois did not cause such products to be "shipped to or delivered" to a customer in Illinois. In determining that Company 1's sales were not sales "within Illinois," the Department ruled that Company 1's products shipped to Illinois merely to accommodate further shipping to a predetermined destination outside Illinois, and the taxpayer was not engaged in a warehouse function in Illinois. Accordingly, Company 1's sales were not made within the State for purposes of computing the numerator of its sales factor.

Clause II-Origin Sales (Throwback Sales)
There is little authority addressing whether, under facts similar to these, sales are included in the numerator of the Sales Factor pursuant to Clause II (i.e., Throwback). However, the Illinois Appellate Court in *Filtertek Inc. v. Department of Revenue*[6] determined that the taxpayer was subject to the Throwback Rule for sales purchased from an affiliate located in Puerto Rico and destined for customers

[4] IL Reg. Sec. 100.3370(c)(1)(C).
[5] PLR IT 14-0002-Corporate Income Tax.
[6] *Filtertek, Inc. v. Department of Revenue*, 541 N.E. 2d 385, July 20, 1989.

outside Illinois. In that case, the taxpayer, which had a manufacturing facility and a small sales force located in Illinois, had an agreement to purchase and distribute products manufactured by its affiliate in Puerto Rico. The taxpayer in Illinois was responsible for reselling the products to out-of-State customers and storing the products until delivery to customers. The Taxpayer argued that such sales were really sales that originated from Puerto Rico and were merely transshipped through Illinois to their final destination outside Illinois. The Court determined, however, that the taxpayer, and not its affiliate, was responsible for delivery, quality assurance, and billing, and therefore was in fact a reseller. Accordingly, for purposes of applying the State's throwback rule, the taxpayer's sales originated from its location within Illinois.

Conclusion

Based on the foregoing authority, the Taxpayer submits that COMPANY2's sales of products that pass through the Illinois DC are not includible in the numerator of its sales factor since such sales do not terminate in, or originate, from Illinois.

With respect to Clause I, COMPANY2's sales do not terminate in Illinois merely because they flow through the Illinois DC. Specifically, COMPANY2's sales are includible in the numerator of its sales factor only if COMPANY2 delivers or ships such sales to a purchaser, other than the US government, within Illinois. Pursuant to Illinois regulations, property is delivered or shipped to a purchaser within the State if the shipment *terminates in the State.*

Under the facts set forth above, COMPANY2's sales do not terminate in the State. In this instance, only the seller (i.e., COMPANY2) will utilize the Illinois DC. Customers do not temporarily store goods in Illinois for distribution outside the State. That is, customers do not maintain a warehouse or other distribution center in Illinois; they do not lease space at the Illinois DC; they do not authorize shipment to the Illinois DC or accept goods arriving at the Illinois DC for future shipment outside the State. Accordingly, COMPANY2's sales that ship through the Illinois DC do not terminate in Illinois for purposes of computing the numerator of its sales factor.

Likewise, with respect to Clause II, COMPANY2's sales do not originate from Illinois. While not directly addressing Clause I, the Department's conclusion in its 2014 PLR similarly applies to the application of Clause II. In that ruling, the Department determined that sales temporarily shipped to a freight forwarder's facilities in Illinois did not terminate in Illinois for purposes of computing the numerator of the sales factor. In that case, Company 1 sold products to Company 2 who used an AFF that temporarily stored such products in Illinois to facilitate further shipping. In that decision, the Department determined that Company 1's sales arriving temporarily in Illinois did not "terminate" in Illinois for purposes of determining the numerator of the Company 1's sales factor. The Department's

conclusion was based on the following factors: prior to being shipped to the freight forwarder's facilities in Illinois, the products were already sold and ready to be shipped with no further labeling or packaging changes required; there were no modifications, product changes, or alterations made to the products while at the Illinois facility; the products remained at the freight forwarder's facilities for a short time (from a few hours to a couple of days); and the taxpayer did not have any production facilities in Illinois. Accordingly, the Company 1's sales did not terminate in Illinois.

Similarly, if the use of a freight forwarder's facilities in Illinois does not result in goods *terminating* in Illinois for purposes of Company 1's sales, it is logical that such sales do not *originate* from Illinois for purposes of Company 2's sales.[7] That is, the use of a freight forwarder does not interrupt the stream of interstate commerce for products already sold to a purchaser. As with the companies in the 2014 PLR, COMPANY2 accepts, processes and packages all orders from its headquarters outside Illinois (i.e., STATE). COMPANY2 packages are ready for shipment and destined for customers located outside Illinois prior to leaving its facilities in STATE. In addition, like the taxpayers in the 2014 PLR, when goods are temporarily at the DC to facilitate further shipping, there are no product modifications, changes, or alterations to the products. In fact, state regulations prohibit any product changes while at the Illinois DC. As with Company 1 and 2's products, COMPANY2's products will be at the DC for a brief period only to accommodate further shipping to a predetermined destination outside Illinois. Finally, unlike the taxpayer in *Filtertek,* COMPANY2 does not have any production facilities in Illinois from which it sells (or resells) products. Unlike the taxpayer in *Filtertek*, but like the taxpayers in the 2014 PLR, the sole purpose for the temporary stop in Illinois is to accommodate further shipping. Accordingly, COMPANY2's sales that passthrough the Illinois distribution center do not originate from Illinois for purposes of computing the numerator of its Illinois sales factor.

Based on the foregoing, since COMPANY2's sales that pass through the Illinois DC do not terminate in or originate from Illinois, such sales are not includible in the numerator of COMPANY2's sales factor for purposes of determining the Combined Group's Illinois apportionment factor.

We respectfully request that the Department issue the requested ruling with the Taxpayer's name redacted. We further request that the Taxpayer be permitted to withdraw the ruling request in the event the Department's concludes is contrary to that of the Taxpayer. Should you have any questions or need additional information please contact me at (###) ###-#### or E-MAIL.

[7] While private letter rulings may be relied upon only by the party requesting the ruling, the analysis contained therein provides insight to the Department's position.

RULING

Section 304 of the Illinois Income Tax Act ("IITA"; 35 ILCS 5/304) contains apportionment rules that determine the amount of business income of a nonresident that is taxable in Illinois where the income is derived from Illinois and one or more other states. Under IITA Section 304(a) and (h), the general apportionment rule requires a taxpayer to multiply its business income for the taxable year by its sales factor. IITA Section 304(a)(3)(A) defines the "sales factor" as the fraction consisting of the taxpayer's total sales in Illinois during the taxable year over its total sales everywhere during the taxable year. The apportionment required under IITA Section 304(a) is to be performed following the close of the taxpayer's taxable year. The taxpayer determines its total business income for the taxable year, and then apportions to Illinois that part of such income that bears the same ratio as the taxpayer's Illinois sales for the taxable year bears to total taxable year sales.

IITA Section 304(a)(3)(B) provides various rules for determining whether sales are sourced to Illinois for sales factor purposes. IITA Section 304(a)(3)(B)(i) provides that sales of tangible personal property are sourced to Illinois if:

> The property is delivered or shipped to a purchaser, other than the United States government, within this State regardless of the f.o.b. point or other conditions of the sale.

With regard to this section, 86 Ill. Adm. Code Section 100.3370(c)(1)(C) states:

> Property is delivered or shipped to a purchaser within this State if the shipment terminates in this State, even though the property is subsequently transferred by the purchaser to another state.
>
> Example: A corporation makes a sale to a purchaser who maintains a central warehouse in this State at which all merchandise purchases are received. The purchaser reships the goods to its branch stores in other states for sale. All of the corporation's products shipped to the purchaser's warehouse in this State is property "delivered or shipped to a purchaser within this State".

The Department, relying on decisions of courts in other UDITPA-based states, determined that the "destination rule" shall apply for purposes of applying IITA Section 304(a)(3)(B)(i) [*See* IT 03-0034-GIL (Nov. 3, 2003)]. Under this rule, even though a taxpayer's customer may receive physical possession of the property outside Illinois, a sale may nonetheless constitute an Illinois sale where the destination of the property sold is Illinois.

In the instant case, the destination of COMPANY2's sales is to customers in the Eastern portion of the U.S. and COUNTRY. Your petition indicates that COMPANY2 utilizes the Illinois DC solely to accommodate further shipping. Your petition represents all gaming

content and gaming machines are manufactured and shipped from STATE, and no modifications, product changes, or alterations to the products occur at the Illinois DC. Rather, as you represent, the property is merely located in Illinois at the Illinois DC for short periods of time, sometimes for as little as a few hours but other times up to 7 days, but on average the products only remain at the Illinois DC for 2 to 3 days in order to be consolidated with other products into a single shipment or transferred to another outgoing delivery truck. In addition, your petition represents that COMPANY2 does not own or operate the Illinois DC, does not separately lease space or have employees located at the Illinois DC, does not store inventory at the Illinois DC, and none of COMPANY1's other businesses utilize the Illinois DC. Assuming these facts are true, shipment of the property does not terminate in Illinois. The products are shipped to Illinois merely to accommodate further shipping to a predetermined destination outside Illinois, and the taxpayer is not engaged in a warehouse function in Illinois. Accordingly, the sales of COMPANY2's products that pass through the Illinois DC intended for destination to customers in the Eastern portion of the U.S. and COUNTRY are not sales within this State under the provisions of IITA Sections 304(a)(3)(B)(i) and 304(a)(3)(B)(ii).

This ruling shall bind the Department for the taxable year beginning on MM/DD/YEAR, and for subsequent tax years, except as limited pursuant to 2 Ill. Adm. Code Section 1200.110(d) and (e). 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 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,

Jennifer Uhles
Associate Counsel (Income Tax)