IT 24-0009 GIL 9/25/2024 ALTERNATIVE APPORTIONMENT

Petition for alternative apportionment not filed timely with the Department.

September 25, 2024

NAME
TITLE
COMPANY1
ADDRESS

Re: Petition for Alternative Apportionment
COMPANY2
FEIN: ##-#######
Tax Year Ended: MM/DD/YEAR

Dear NAME:

This is in response to your petition to use an alternative method of allocation or apportionment which was received by the Department on September 16, 2024. 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 2 Ill. Adm. Code Section 1200.120(b) and (c), which may be found on the Department's website at tax.illinois.gov. For the reasons discussed below, your petition cannot be granted at this time.

Your petition for the YEAR tax year ended states as follows:

> **Request**
> The taxpayer would like to request the use of separate accounting as an alternative apportionment method to report Illinois taxable income/loss on Illinois Partnership Tax Return (Form IL-1065) for tax period MM/DD/YEAR and after for COMPANY2 (taxpayer). Pursuant to 86ILAC100.3390(a)(l) the use of separate accounting will more clearly reflect the taxable income/loss attributable to Illinois.
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> **Background**
> COMPANY2 was formed in STATE MM/DD/YEAR. At this time the taxpayer owned one office building in CITY, STATE. The next year (YEAR) the taxpayer purchased ### additional office buildings including one in STATE2. As time went by the taxpayer grew and expanded the rental activities to other states. In YEAR the taxpayer owned ##-## total office buildings in STATE, STATE2, STATE3, and STATE4. The taxpayer's primary line of business has been rental real estate until YEAR. In MONTH of YEAR the taxpayer purchased a hotel in STATE2 to once again expand their business with rental real estate remaining the primary activity.

The first (and only) building purchased in Illinois was on MM/DD/YEAR located at ADDRESS.

In YEAR, the taxpayer began engaging in business loans for another revenue stream. At this time the taxpayer owned ##-## office buildings in STATE, STATE2, STATE4, STATE5, and STATE6; a BUSINESS1 business in STATE; and a hotel in STATE2.

In MONTH of YEAR the taxpayer acquired a large BUSINESS2 business in STATE2. This business has been producing a significant amount of income in STATE2 and has considerably increased the taxpayer's gross revenue and taxable income. In YEAR the taxpayer acquired a new BUSINESS2 business in STATE which also produces a significant amount of gross revenue and taxable income.

The taxpayer sold their hotel in STATE2 in YEAR and had a significant gain from this sale. Current business operations include owning and leasing ##-## office buildings in various states, a BUSINESS1 business in STATE, and BUSINESS2 ventures in STATE2 and STATE.

Illinois Standard Apportionment Law

Illinois uses the single sales factor apportionment formula as provided in 86ILAC 100.3500(b)(2). This method calculates percentage of sales in Illinois by taking total sales in Illinois (numerator) over total sales everywhere (denominator). The calculated percentage is used to multiply the Federal taxable income/loss adjusted for Illinois applicable items to get Illinois taxable income/loss.

YEAR Sales Formula results:

- In YEAR gross receipts in Illinois were $$,$$$,$$$ from the rental of real estate located in Illinois
- Total receipts from all activities everywhere were $$$,$$$,$$$
- This results in an apportionment factor of %%%
- The federal taxable income for YEAR for all activities was $$$$,$$$,$$$
- STATE5 taxable income was **$$$,$$$ (YEAR)**

YEAR2 Sales Formula results:

- In YEAR2 gross receipts in Illinois were $$$$,$$$,$$$ from the rental of real estate located in Illinois.
- Total receipts from all activities everywhere were $$$$,$$$,$$$
- This results in an apportionment factor of %%%
- The federal taxable income for YEAR2 for all activities was $$$$,$$$,$$$
- Illinois taxable income was **$$$,$$$ (YEAR)**

YEAR3 ESTIMATED Sales Formula results:
The following YEAR3 amounts below are all estimates based on financial records, but the tax returns have yet to be filed. The taxpayer filed federal and state extensions.

- In YEAR3 gross receipts in Illinois estimated $$,$$$,$$$ from the rental of real estate located in Illinois
- Total receipts from all activities everywhere estimated $$$,$$$,$$$
- This results in an apportionment factor of %%%
- The federal taxable income for YEAR3 for all activities estimated $$$,$$$,$$$
- Illinois taxable income estimated to be **$$$,$$$ (YEAR)**

The taxpayer has used the standard apportionment method since the initial purchase of an Illinois property in YEAR until YEAR.

Fair Apportionment Under Due Process and Commerce Clause, U.S. Constitution The U.S. Supreme Court has held that a state must apply its tax on interstate commerce by fairly determining the apportionment or allocation formula and not discriminate against interstate commerce. An apportionment formula is fair if under both the Due Process Clause and Commerce Clause it satisfies the standards of both the internal and external consistency. Internal consistency requires that if the formula were applied to every jurisdiction, it would result in no more than 100% of the taxpayer's unitary income being subject to tax. External consistency requires the apportionment factor or factors must actually reflect the reasonable sense of how income is generated within the state.

Most states have adopted statutes imposing a standard apportionment methodology applicable to taxpayers that file a corporate income tax return, unless the taxpayer operates in a specialized industry (e.g., airlines), in which case a specialized apportionment methodology may be applicable. Because the standard apportionment methodology may not accurately reflect how income is attributable to a specific state for all taxpayers, state apportionment statutes typically provide that a taxpayer may request, or a taxing authority may require, the use of an apportionment methodology deviating from the statutory methodology, or an "alternate methodology".

Illinois Alternative Apportionment Law
Illinois provides that, if the allocation and apportionment provisions of IITA Section 304(a) through (e) do not fairly represent the extent of the person's business activity in this state, or do not fairly represent the market for the person's goods, services or other sources of business income, the person may petition the Director and request an alternative apportionment formula. The taxpayer respectfully requests the Illinois Director to grant permission to use the separate accounting method under 86ILAC100.3390(a)(l). The facts and circumstances of our request to follow.

Facts
The initial Illinois income tax return was filed for COMPANY2 in YEAR. The taxpayer purchased # office building in Illinois in YEAR and at the time owned ###-### total office buildings in various states. The apportionment percent in the initial year was %%% with an overall federal taxable loss. As the taxpayer has diversified its operations and expanded into ACTIVITIES activities outside of Illinois the Illinois apportionment factor has become skewed and no longer a fair representation of the Illinois activities. Under the standard single sales factor, the taxpayer is subject to tax on more than 100% of its income/loss in violation of the internal consistency requirement.

Further, it does not meet the external consistency requirement as the single sales factor Illinois taxable loss is greater or equal to total Illinois sales. It distorts the Illinois source income as it does not allow for any of the Illinois business expenses or deductions as a consequence of apportioning all the income from the out of state activities of ACTIVITIES in STATE2, STATE3, and other states outside of Illinois. The taxpayer has a separate general ledger for each property/business venture and is able to track the income/losses attributable to each property in each separate state.

Supports and Analysis
The taxpayer is providing support with this letter to demonstrate how the single sales factor apportionment method is not a fair representation for the business activity in Illinois.

The taxpayer's gross receipts in Illinois have increased slightly over the past three years but the income apportioned to the state has increased and the federal taxable
income has almost doubled. The first set of supports and analysis are listed in the bullet points below.

- Gross income comparison for tax years YEAR, YEAR and YEAR.
- The gross income for all three years are categorized into different types of businesses and different states.
- In YEAR and YEAR, the total gross income everywhere increased from $$$.$ million to $$$.$ million.
- The large increase was due to the BUSINESS2 sales in STATE2 when comparing YEAR and YEAR. In YEAR, the BUSINESS2 sales was $$$.$ million and YEAR was $$$.$ million.
- In YEAR, total gross income is estimated to be $$$ million.
- Federal taxable income in YEAR was $$$ million and YEAR was $$$ million. This increase is due to the ACTIVITIES in STATE2. In YEAR it is estimated to be $$$ million.

The second set of support and analysis are listed in the bullet points below.

- Included are income statements for the property located in Illinois for taxable years YEAR, YEAR and YEAR. The income statements accurately report the taxable loss for the Illinois rental properties.
- For YEAR, YEAR and YEAR, if separate accounting method was used, Illinois would have had taxable losses of $($$$,$$$), $($$$,$$$) and $($$$,$$$) respectively. The use of separate accounting accurately and fairly represents the taxpayer's business activity in Illinois.

Conclusion
COMPANY2 is primarily a rental real estate entity with properties located in # states. This has been its main source of income from YEAR - YEAR. In YEAR the ACTIVITIES venture acquired in STATE2 significantly increased overall income and profits. We believe the income earned from the BUSINESS activity has skewed Illinois taxable income when the single sales factor apportionment methodology is utilized. Due to the taxpayer effectively reporting profit and loss by each rental property located in each separate state and by separately reporting the BUSINESS2 income from STATE2, ACTIVITIES activities from STATE3, and each line of business by states, the taxpayer can more accurately report the income/loss in Illinois using the separate accounting method.

Based on the facts, analysis and explanation presented the single sales factor apportionment is not a fair and accurate method that represents COMPANY2's activity in Illinois. The single sales factor method does not accurately apportion the income to the state where the taxpayer's income-producing activities occur, i.e., accurately report the Illinois rental income from the properties located in Illinois. It results in the taxpayer paying tax in a state where there is not taxable income and appears to violate the Commerce Clause and Due Process Clause. Therefore, the taxpayer requests the use of an alternate apportionment methodology, the use of separate accounting method, to calculate Illinois taxable income/loss, Form IL-1065 for years ending MM/DD/YEAR.

To conclude, the taxpayer respectfully requests the Illinois Director to grant permission to use the separate accounting method under 86ILAC100.3390(a)(l).

I confirm that these statements are made under the penalties of perjury and to the best of my knowledge and belief are true, correct, and complete.

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 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)(A) defines the "sales 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 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:
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> > (1) Separate accounting;
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> > (2) The exclusion of any one or more factors;
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> > (3) The inclusion of one or more additional factors which will fairly represent the person's business activities or market or in this State; or
> >
> > (4) The employment of any other method to effectuate an equitable allocation and apportionment of the person's business income.

Taxpayers who wish to use an alternative method of apportionment under IITA Section 304(f) are required to file a petition complying with the requirements of 86 Ill. Adm. Code Section 100.3390.

86 Ill. Adm. Code Section 100.3390(e) describes timely filed petitions:

> e) Timely Filed Petitions. A taxpayer petition for use of a separate accounting method or any other alternative apportionment method will not be considered by the Director unless that petition has been timely filed. A taxpayer who petitions the Director for an alternative apportionment formula does so subject to the Department's right to verify, by audit of the taxpayer's return and supporting books and records within the applicable statute of limitations, the facts submitted as the basis of the petition. A petition for alternative allocation or apportionment is timely filed if the petition is filed:
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> > 1) 120 days prior to the due date of the tax return (including extensions) for which permission to use an alternative method is sought. A taxpayer who does not petition more than 120 days prior to the due date of the original return must file the return and pay tax

according to the statutorily approved allocation or apportionment method. If the petition is approved, the Department shall grant permission to use an alternative apportionment method in the form of a private letter ruling issued under 2 Ill. Adm. Code 1200.110.

2) as an attachment to a return amending an original return which was filed using the statutory allocation and apportionment rules. A taxpayer who has not filed a petition for alternative apportionment under subsection (e)(1), or whose subsection (e)(1) petition has been rejected, may thereafter file a petition with an amended return. The explanations section of the amended return should state that the amended return includes a petition for alternative apportionment that should be referred to the Legal Services Bureau/Income Tax, and a copy of the amended return should be mailed to the Legal Services Bureau/Income Tax, at the address in subsection (d). If the amended return results in a claim for refund, the Department will consider the petition, along with any other issues raised in the claim for refund, pursuant to the procedures set forth at Section 100.9400.

3) as part of a protest, an action filed under the State Officers and Employees Money Disposition Act [30 ILCS 230] or a petition to the Illinois Independent Tax Tribunal regarding a notice of deficiency issued as a result of the audit of the taxpayer's return and supporting books and records; provided that the audit adjustments being protested result in the need for the petition for alternative apportionment. Alternative apportionment may not be raised in a protest, a court filing or a petition to the Illinois Independent Tax Tribunal regarding a notice of deficiency unless the taxpayer has requested in writing that the auditor allow the use of alternative apportionment and the request was denied, or the audit disallows an alternative method of apportionment used by the taxpayer on its return. The disallowance of the use of alternative apportionment in an audit may be reviewed by the Informal Conference Board.

Your petition for alternative apportionment is not timely under 86 Ill. Adm. Code Section 100.3390(e)(1) as it was not filed more than 120 days prior to the due date of the tax return for the year at issue. Accordingly, to obtain permission to use an alternative apportionment formula for tax year ended YEAR, taxpayer COMPANY2 must file its Illinois income tax return for that tax year using the statutorily prescribed apportionment formula and then follow the petition procedures set forth in 86 Ill. Adm. Code Section 100.3390(e)(2) or (e)(3).

Therefore, your petition for alternative apportionment for tax year ended YEAR, cannot be granted. If you still believe that your petition should be granted, please supplement the petition in accordance with the provisions of 86 Ill. Adm. Code Section 100.3390, and we will reconsider your request.

As stated above, this is a General Information Letter. A General Information Letter 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)