**Section 100.3380 Special Rules (IITA Section 304)**

a) Determining Business Activity Within Illinois

1) Petition

IITA Section 304(f) provides that *if the allocation and apportionment provisions of subsections (a) through (e) and of subsection (h) do not fairly represent the extent of a person's business activity in this State, the person may petition for, or the Director may require, in respect of all or any part of the person's business activity, if reasonable:*

A) *Separate accounting;*

B) *The exclusion of any one or more factors;*

C) *The inclusion of one or more additional factors which will fairly represent the person's business activities in this State; or*

D) *The employment of any other method to effectuate an equitable allocation and apportionment of the person's business income.*

2) Director's Determination

The Director has determined that, in the instances described in this Section, the apportionment provisions provided in subsections (a) through (e) and (h) of IITA Section 304 do not fairly represent the extent of a person's business activity 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 are directed to apportion their business income employing that method in order to properly apportion their business income to Illinois. Taxpayers whose business activity within Illinois is not fairly represented by a method prescribed in this Section and who do not want to use that method for a tax year beginning after the effective date of the rulemaking adopting that method must file a petition under Section 100.3390 of this Part requesting permission to use an alternative method of apportionment. 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 such tax year, the taxpayer must continue to use that method that tax year. Moreover, a taxpayer may file a petition under Section 100.3390 of this Part 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 such petition shall be granted in the absence of facts showing that such method will not fairly represent the extent of a person's business activity in Illinois.

b) Property Factor. The following special rules are established in respect to the property factor in IITA Section 304(a)(1):

1) If the subrents taken into account in determining the net annual rental rate under Section 100.3350(c) of this Part produce a negative or clearly inaccurate value for any item of property, another method that will properly reflect the value of rented property may be required by the Director or requested by the person. In no case however shall the value be less than an amount that bears the same ratio to the annual rental rate paid by the person for the property as the fair market value of that portion of the property used by the person bears to the total fair market value of the rented property.

Example: A corporation rents a 10-story building at an annual rental rate of $1,000,000. The corporation occupies two stories and sublets eight stories for $1,000,000 a year. The net annual rental rate of the taxpayer must not be less than two-tenths of the corporation annual rental rate for the entire year, or $200,000.

2) If property owned by others is used by the person at no charge or rented by the person for a nominal rate, the net annual rental rate for the property shall be determined on the basis of a reasonable market rental rate for such property.

c) Sales Factor. The following special rules are established in respect to the sales factor in IITA Section 304(a)(3):

1) In the case of sales where neither the origin nor the destination of the sale is within this State, and the person is taxable in neither the state of origin nor the state of destination, the sale will be attributed to this State (and included in the numerator of the sales factor) if the person's activities in this State in connection with the sales are not protected by the provisions of P.L. 86-272, 15 USC 381-385. Although P.L. 86-272, by its terms covers only sales of tangible personal property, its rules regarding a state's power to impose a net income tax, for purposes of this special rule, will be applied whether the sale is of tangible or intangible property.

Example: A corporation's salesman operates out of an office in Illinois. He regularly calls on customers both within and without Illinois. Orders are approved by him and transmitted to the corporation's headquarters in State A. If the property sold by the salesman is shipped from a state in which the corporation is not taxable to a purchaser in a state in which the corporation is not taxable, the sale is attributable to Illinois.

2) Where gross receipts arise from an incidental or occasional sale of assets used in the regular course of the person's trade or business, such gross receipts shall be excluded from the sales factor. For example, gross receipts from the sale of a factory or plant will be excluded.

3) Where the income producing activity in respect to business income from intangible personal property can be readily identified, such income is included in the denominator of the sales factor and, if the income producing activity occurs in this State, in the numerator of the sales factor as well. For example, usually the income producing activity can be readily identified in respect to interest income received on deferred payments on sales of tangible property (Section 100.3370(a)(1)(A) of this Part).

4) Where business income from intangible property cannot readily be attributed to any income producing activity of the person, the income cannot be assigned to the numerator of the sales factor for any state and shall be excluded from the denominator of the sales factor. The following provisions illustrate this concept:

A) Subpart F (26 USCA 951-964) income is passive income generated by the mere holding of an intangible. For taxable years ending on or after December 31, 1995, Subpart F income is excluded from the sales factor under IITA Section 304(a)(3)(D). For prior taxable years, there is a rebuttable presumption that Subpart F income is not includable in either the numerator or the denominator of the sales factor. If a taxpayer wishes to include Subpart F income in either the numerator or the denominator of the sales factor, the burden of proof is on the taxpayer to identify the income producing activities and to situs those activities within a particular state, or

B) where business income in the form of dividends received on stock during taxable years ending before December 31, 1995, or interest received on bonds, debentures or government securities results from the mere holding of intangible personal property by the person, such dividends and interest shall be excluded from the denominator of the sales factor.

5) In the case of sales of business intangibles (including, by means of example, without limitation, patents, copyrights, bonds, stocks and other securities), gross receipts shall be disregarded and only the net gain (loss) shall be included in the sales factor.

EXAMPLE: In 1990, Corporation A, a calendar year taxpayer, sells stock with an adjusted basis of $98,000,000 for $100,000,000, realizing a federal net capital gain of $2,000,000. Only the net capital gain of $2,000,000 is reflected in A's sales factor for the taxable year ending December 31, 1990.

d) Unitary Partners: Inclusion of shares of partnership unitary business income and factors in combined unitary business income and factors of partners.

1) IITA Section 304(e) provides that whenever *2 or more persons are engaged in a unitary business as described in IITA Section 1501(a)(27), 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.* Because partnerships may be members of a unitary business group within the meaning of IITA Section 1501(a)(27), this provision requires a partnership to use combined apportionment when it is engaged in a unitary business with one or more of its partners. However, partners who are not engaged in a unitary business with the partnership are required to include their shares of the partnership's business income apportioned to Illinois in their Illinois net incomes under IITA Section 305(a), and those partners' business activities in Illinois would not be represented fairly by their shares of partnership income computed by combining the business income and apportionment factors of the partnership with the business income and apportionment factors of its unitary partners.

2) Accordingly, except in a case in which substantially all of the interests in the partnership (other than a publicly-traded partnership under section 7704 of the Internal Revenue Code) are owned or controlled by members of the same unitary business group, when the business activities of a partnership and any of its partners' business activities constitute a unitary business:

A) The partner's distributive share of the business income and apportionment factors of the partnership shall be included in that partner's business income and apportionment factors. In determining the business income of the partnership, transactions between the unitary partner (or members of its unitary business group) and the partnership shall not be eliminated. However, all transactions between the unitary business group and the partnership shall be eliminated for purposes of computing the apportionment factors of the partner and of any other member of the unitary business group.

EXAMPLE: Partner and Partnership are engaged in a unitary business. Partner owns a 20% interest in Partnership. Partnership has $10,000,000 in sales everywhere, $3,000,000 of which are to Partner, and $4,000,000 in Illinois sales, $1,000,000 of which are to Partner. In computing its apportionment factor, Partner will include $1,400,000 from Partnership in its everywhere sales (20% of Partnership's $10,000,000 in everywhere sales, after eliminating the $3,000,000 in sales to Partner) and $600,000 from Partnership in its Illinois sales (20% of Partnership's $4,000,000 in Illinois sales, after eliminating the $1,000,000 in sales to Partner). Also, Partner must eliminate any sales it made to Partnership.

B) If a partnership and one of its partners are engaged in a unitary business and the partnership is itself a partner in a second partnership:

i) If the partner is not engaged in a unitary business with the second partnership, the partner's share of the first partnership's share of the business income and apportionment factors of the second partnership shall not be included in the partner's business income and apportionment factors. Instead, the partner's share of the first partnership's share of the base income apportioned to Illinois by the second partnership will be included in the partner's Illinois net income.

ii) If the partner is engaged in a unitary business with the second partnership, the partner's share of the first partnership's share of the business income and apportionment factors of the second partnership shall be included in the partner's business income and apportionment factors.

3) This subsection (d) shall not apply to a partner's shares of business income and apportionment factors from any partnership that cannot be included in a unitary business group with that partner because:

A) the partner and the partnership are required to apportion their business income using different apportionment formulas under IITA Section 304, and therefore cannot be members of a unitary business group under IITA Section 1501(a)(27); or

B) the business activities of either the partner or the partnership outside the United States are equal to or greater than 80% of the total worldwide business activities of that partner or partnership, as determined under Section 1502(a)(27) of the IITA. In applying this 80-20 test to a taxpayer, no apportionment factors of any partnership shall be included in the apportionment factors of that taxpayer pursuant to this subsection (d).

If the partnership is itself a partner in a second partnership, and one of its partners is engaged in a unitary business with the second partnership and is not prohibited from being a member of a unitary business group that includes the second partnership under subsection (d)(3)(A) or (B), that partner shall include in its business income and apportionment factors its share of the partnership's share of the second partnership's business income and apportionment factors.

4) If substantially all of the interests in a partnership (other than a publicly-traded partnership under section 7704 of the Internal Revenue Code) are owned or controlled by members of the same unitary business group, 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 such 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 such person and the partnership apportion their business incomes under different subsections of IITA Section 304; or

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

5) EXAMPLE: Corporation A owns a 50% interest in P-1, a partnership. Corporation A and P-1 are engaged in a unitary business within the meaning of IITA Section 1501(a)(27). P-1 itself conducts no business activities in Illinois, and the Illinois numerator of its apportionment factor is zero. P-1 holds a 50% interest in P-2, a partnership doing business exclusively in Illinois. P-1 has $1.4 million of taxable business income, not including any income from P-2. P-2 has base income of $1 million, all of which is business income, and on a separate-entity basis, all of its business income would be apportioned to Illinois.

If Corporation A and P-2 are not members of the same unitary business group, Corporation A would compute its business income apportioned to Illinois by including $700,000 (50% of $1.4 million) of P-1's business income in Corporation A's business income, and 50% of P-1's apportionment factors in its apportionment factors. Corporation A also would include in its Illinois net income its 50% share of P-1's 50% share of the base of P-2 apportionable to Illinois, or $250,000 (50% of 50% of $1 million).

If Corporation A, P-1 and P-2 are members of the same unitary business group, P-1 will include 50% of P-2's business income and 50% of P-2's apportionment factors in its own business income and apportionment factors. Accordingly, P-1's business income will be $1.9 million (the $1.4 million it earned directly plus its 50% share of P-2's $1 million in business income). Corporation A will then compute its business income apportioned to Illinois by including its 50% share of P-1's business income, or $950,000 (50% of $1.9 million) with its business income and its 50% share of P-1's apportionment factors (which will include P-1's share of P-2's apportionment factors) in its apportionment factors.

If Corporation A, P-1 and P-2 are unitary, but P-1 cannot be included in a unitary business group with Corporation A and P-2 because those entities apportion their business income under IITA Section 304(a) and P-1 is a financial organization that apportions its business income under IITA Section 304(c), Corporation A will include in its business income and apportionment factors its 50% share of P-1's 50% share of the business income and apportionment factors of P-2. Also, Corporation A's Illinois net income will include 50% of the business income of P-1 apportioned to Illinois by P-1 using its own apportionment factors. Because, in this example, P-1 is not doing business in Illinois, none of its business income will be included in Corporation A's Illinois net income.

e) Apportionment of Business Income by Foreign Taxpayers.

1) Under 26 USCA 882, foreign corporations include only effectively-connected income in their federal taxable income. Foreign taxpayers may exclude other items of income from their federal taxable income if authorized under treaty, as provided in 26 USCA 894. Using a foreign taxpayer's worldwide apportionment factors to determine how much of its domestic business income should be apportioned to Illinois would not fairly represent that taxpayer's business activities within Illinois. Accordingly, a foreign taxpayer shall use only the apportionment factors related to its domestic business income when apportioning its business income to Illinois. Similarly, in determining whether 80% or more of a foreign taxpayer's total business activity is conducted outside the United States for purposes of IITA Section 1501(a)(27), that taxpayer must use only the apportionment factors related to the business income included in its federal taxable income (plus addition modifications), rather than use all of its worldwide factors.

2) Foreign Sales Corporations. Under 26 USC 921, "exempt foreign trade income" of a foreign sales corporation is treated as foreign source income excluded from gross income. "Exempt foreign trade income" is defined in 26 USC 923 to equal the sum of the amounts of income derived from various categories of transaction, with the income from each category multiplied by specific percentages. As a general rule, there is no systematic relationship between transactions qualifying for this treatment and any particular item of property or payroll of a foreign sales corporation. Accordingly, the provisions of subsection (e)(1) of this Section shall not apply to a foreign sales corporation and, in apportioning its business income and in determining whether 80% or more of its business activity is conducted outside the United States, a foreign sales corporation shall use all of its apportionment factors.

(Source: Amended at 32 Ill. Reg. 10170, effective June 30, 2008)