IT 99-0021-GIL 03/01/1999 UNITARY

General Information Letter: Taxpayers using different apportionment formulas under IITA Section 304 may not be members of the same unitary business group.

March 1, 1999

Dear:

This is in response to your letter to Director Glen Bower, dated February 16, 1999, which has been forwarded to me. The nature of your letter 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* 86 Ill. Adm. Code 1200.120(b) and (c), enclosed.

In your letter you have stated the following:

> Enclosed is a copy of the notice that I just received stating that we owe the Department $30 million in tax and penalties. As we are currently under audit, the auditor was kind enough to call and let me know that this was coming. The notice states that "the apportionment and allocation information is missing or incomplete" and that is why we are being assessed on 100% of our income along with interest and a 30% penalty. The auditor advises me that she was told this notice was issued because we filed our two unitary groups in one return, as opposed to two unitary returns. We have a pipeline transportation group that is apportioned using a single factor (per Sec. 304(d)) and a non-pipeline group that is apportioned using the three factor. Our returns have been prepared and filed with each group's apportioned income being determined using the appropriate factor and the results then being reported together on one Form IL-1120.
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> For many years now, the auditors have calculated separate returns for both our unitary groups. The losses of the common parent would be apportioned between the two groups. In creating separate returns for the two groups, the auditors have not allowed the income of the pipeline group to be offset by the losses from the non-pipeline group. When questioned as to why, the auditors have responded that Sec. 304(d) requires this treatment. I have always disagreed with this, as it is my belief that Sec. 304(d) merely requires the apportionment of the pipeline group to be made using the single factor. The auditors have conveniently ignored Section 100, Appendix A, Table B "Example of a unitary business apportionment for groups which include members using three factor and single-factor formulas" from the Illinois Administrative Code (copy attached). This table contains an example of a unitary group with two companies. One is a three factor manufacturing company and the other is a single factor financial services company. The everywhere amounts for sales, property and payroll for the manufacturing company include the sales, property, and payroll of the financial services company. The financial services company's sales are used to determine a factor amount for it alone. Each entity's factor is then multiplied by the combined income to arrive at an apportioned income amount. The individual entity apportioned income amounts are then added together to arrive at the total income apportioned to IL. Footnote 8 states that the same approach is to be followed where the unitary group includes an insurance company or a transportation company.

> In our prior audits, the difference between the auditors' position of two returns and my belief that the taxable incomes of the two groups should be added together, has never been large enough to pursue through administrative appeals to get clarification. I have not yet read the new regulations issued last October to see if they resolve the issue, so I don't know if Table B has been removed from the Administrative Code. Through my industry contacts and meetings, I do know other taxpayers have also questioned whether each unitary group should file its own IL-1120.
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> Mr. Bowers, this is a very serious situation. In the least, it is unacceptable abuse of a taxpayer by the Department. We are a xxxxxxx xxx enterprise with a substantial presence in Illinois. We are regularly audited and are currently under audit, so there is no jeopardy involved here. There was no outlandish position taken in the way we filed our return as the example in the regulations is completely opposite from the position taken by the Department's auditors, so there is no negligence involved here. Finally, the return in question clearly contained all the required apportionment data, so that the stated rationale supporting the assessment is false. (Attached is a copy of our 1996 return.) I would like to believe that it is the Department's policy to resolve disputes through proper audits and administrative appeals. Issuing an assessment notice such as this leads me to believe otherwise.

Response

Section 1501(a)(27) of the Illinois Income Tax Act (35 ILCS 5/101 *et. seq.*) contains the definition of "unitary business group." That section states:

> In no event, however, will any unitary business group include members which are ordinarily required to apportion business income under different subsections of Section 304.

This statutory prohibition against including in the same unitary business group transportation companies who apportion business income under Section 304(d) of the Illinois Income Tax Act and companies who use the three-factor formula of Section 304(a) has been in effect since 1982. It is repeated in the regulation expanding on the statutory definition of unitary business group (*see* 86 Ill. Admin. Code Section 100.9700(d)(1)) and in the instructions to Schedule UB of the Form IL-1120. Section 100, Appendix A, Table B, was promulgated prior to the enactment of the statutory prohibition and has not been repealed because guidance for pre-1982 years is still required for cases under audit or in dispute in the courts.

Because including both transportation and three-factor companies in the same unitary business group is clearly prohibited by statute, the apportionment method used in the 1996 return was a "mathematical error." *See* Section 1501(a)(12)(D) of the Illinois Income Tax Act, which states that a "mathematical error" includes "an attempt to . . . improperly report, in a manner directly contrary to the provisions of the Act and regulations thereunder any item of income . . ."

Section 903(a) of the Illinois Income Tax Act provides:

> In the event that the amount of tax is understated on the taxpayer's return due to a mathematical error, the Department shall notify the taxpayer that the amount of tax in excess of that shown on the return is due and has been assessed. Such notice of additional tax due shall be issued no later than 3 years after the date the return was

> filed. Such notice of additional tax due shall not be considered a notice of deficiency nor shall the taxpayer have any right of protest.

This statutory mandate prevents the Department from resolving your dispute "through proper audits and administrative appeals" procedures, which involve notices of deficiency issued under Section 904 of the Illinois Income Tax Act. The notice you received is required by statute, and its issuance is not a question of Department policy.

A review of the copy of the return you attached to your letter shows that it does not contain information necessary to compute the "everywhere" payroll, property and sales factors of the three-factor unitary business group. Instead, the schedules attached to the return show the Illinois factors of each three-factor company and "everywhere" factors that include the payroll, property and sales of the transportation companies. Accordingly, it was impossible for the returns processing personnel of the Department to compute the proper three-factor apportionment percentage for the nontransportation companies. While it may be reasonable to assume that the percentage will be less than 100%, the fact that the return does not contain the information necessary to compute the proper percentage, coupled with the fact that Section 903(a) does not permit gathering of such information by audit, compels the Department to apportion 100% of the nontransportation companies' income to Illinois in order to avoid understating the factor.

In order to allow the Department to assess tax using the proper apportionment percentage, you will have to file correct returns; one for the transportation companies and one for the nontransportation companies. Any resulting reduction in tax from the amount shown in the notice you received will automatically reduce the penalties and interest due on the deficiency. If any penalties remain after this recomputation, those penalties may be abated under Section 3-8 of the Uniform Penalties and Interest Act if you are able to show you had "reasonable cause" for your filing error. Requests for abatement of penalties should be made by petition to the Board of Appeals, on Form BOA-1.

As stated above, this is a general information letter which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Sincerely,

Paul S. Caselton
Associate Chief Counsel -- Income Tax