Questions and Answers for 2006/2007
Illinois Department of Revenue Practitioners' Meetings

1. Income tax: Does the Department have any position on how an Illinois series LLC will be treated for income tax purposes? The series provision is in Section 37-40 of the Illinois LLC Act, 805 ILCS 180/37-40. The latest issue [January 2007?] of the Journal of Multistate Taxation and Incentives has an article by Michael W. McLoughlin and Bruce Ely titled "The Series LLC Raises Serious State Tax Questions But Few Answers are Yet Available."

Answer:

The Illinois income tax treatment of a series LLC follows the federal income tax treatment.

For federal income tax purposes, an LLC is classified as either a corporation or a partnership, or its existence separate from its owner is disregarded, and all of its income is taxed to the owner as if received directly by the owner. IITA Section 1501(a)(4) says every entity treated as a corporation for federal purposes is a corporation for purposes of the IITA. Similarly, IITA Section 1501(a)(16) provides that every entity treated as a partnership for federal purposes is a partnership for Illinois purposes. Regulation Section 100.9750 provides additional guidance.

If an LLC is disregarded, its income is included in the federal taxable income or adjusted gross income of its owner, and so is automatically included in the Illinois base income of the owner unless a specific provision of IITA Section 203 allows a modification.

2. Real Estate Transfer Tax: The Department has taken the position that the creation of a lease is not taxable. See the end ~~of the Department's February 23, 2006 mem~~o at the Lake County Recorder's website: http://www.co.lake.il.us/recorder/forms.asp [PDF copy attached] What is the basis for this position? Will it be published in a regulation or information bulletin?

Which counties have enacted ordinances pursuant to Public Act 93-1099, which authorizes counties to follow the state-level transfer tax on ground leases and controlling interests?

Several counties do not publish their ordinances, which makes it difficult for practitioners. Would it be possible for the Department to provide this information at its own website?

What other types of issues are pending regarding the Real Estate Transfer Tax?

Answer:

The Illinois Department of Revenue has been receiving an increasing number of questions regarding the applicability of the Illinois Real Estate Transfer Tax, 35 ILCS 200/31 to ground leases of a term of 30 or more years. Plans to place a Notice on the Department's website are underway. If an Information Bulletin or rule is needed these will be considered.

The Department is not aware of any local ordinances that have been recently passed that address the issue. The Department is aware that the City of Chicago intends to take a different approach in interpreting its transfer tax ordinance.

In examining the law, previous guidance from the Department, and current practices of various counties, it is apparent that taxpayers are receiving inconsistent and conflicting interpretations of the statute as it applies to the ground lease issue.

The Illinois Real Estate Transfer Tax Law, 35 ILCS 200/31-10 provides that the tax is imposed "on the privilege of transferring a beneficial interest in real property located in Illinois..."

Section 31-5 (2) defines "beneficial interest as "the lessee interest in a ground lease (including any interest of the lessee in the related improvements) that provides for a term of 30 or more years when all options to renew or extend are included, whether or not any portion of the term has expired.""

Reading these provisions together the Department concludes that the tax applies to the transfer of a ground lease--not to the issuance or creation of a ground lease.

The Department has not found any indication from the legislative history of the Law indicating any intention to expand the scope of the transfer tax to include lease payments.

This interpretation of the Law makes applying the tax in its intended way straightforward and easy to administer. The tax rate is applied to the consideration paid by the new lessee to the prior lessee. In contrast, taxing the consideration to be paid over the lease term by a lessee at the time it enters into a 30-year ground lease is virtually impossible since in many cases the future lease payments are not known because the rent is subject to adjustments or other formulae. Any interpretation of the Law to include the creation of ground leases raises the additional question of whether the stream of payments, even if knowable, should be discounted to reflect the time value of money and if so how to determine the appropriate discount factor.

Based on the reasoning stated above, the Department hereby advises that the Illinois Real Estate Transfer Tax does not apply to the issuance or creation of ground leases.

The Department is considering holding forums on the state Real Estate Transfer tax in late 2007. The purpose of such meetings would be to receive input from county officials and practitioners about issues that need rules or clarifying interpretations. The only other issue that seems to generate a reasonable number of inquiries relates to situations where the "controlling interest" needs to be determined. The existing rules contain several examples but there are factual situations that sometimes do not perfectly fit the examples.

3. Aircraft Use Tax: In the responses to last year's Practitioners Meeting, the Department stated that the transfer of an airplane which occurred through a merger was exempt from Aircraft Use Tax. Will the Department publish this position in a regulation or information bulletin? There could be some confusion on this issue because it is not directly addressed in ST 05-0106-GIL, which involves a merger of LLCs. Several earlier letter rulings state that the Motor Vehicle Use Tax [which is very similar to the Aircraft Use Tax] is triggered by a merger. See, e.g., ST 99-0001-PLR, ST 96-0556-GIL and ST 91-0251.

Answer:

The Department does not plan on amending its rules or issuing a bulletin regarding the position articulated in response to last year's practitioner meeting question. As discussed last year, the transfer of ownership between two separate legal entities triggers tax under the Aircraft Use Tax. However, the form of the transfer may affect taxability. As explained last year, if the transfer results from a transfer or merger under the provisions of Section 11.50 of the Business Corporation Act of 1983, 805 ILCS 5/11.50, no tax is due. Under these provisions, when corporations are merged or consolidated, the new corporation takes over the prior corporation's liabilities and benefits as if it were the prior corporation. The assumption of the assets and liabilities to the surviving or new company takes place as a matter of law and is not considered to be a transfer.

Unless a tax act specifies use of a different test to determine imposition of tax during business transfers, the Department's policy is to analyze the taxation of such transfers under the provisions of the Business Corporation Act of 1983 cited above (or similar provisions for other types of legal entities in that act). For instance, Section 130.1701 (g) of the Department's regulations provides examples of situations in which bulk sales reporting is not required. The examples in subsection (g)(2) provides that no bulk sales reporting requirements are triggered when a corporation is merged into another corporation pursuant to the Business Corporation Act (subsection (g)(2) provides an example where consolidations are involved). This policy can also be seen in administration of the Manufacturer's Purchase Credit. Although the Use Tax provides that the credit is not transferable, the Department authorizes the transfer of MPC when made as part of merger/consolidations pursuant to Section 11.50 of the Business Corporation Act of 1983.

This approach can be contrasted with the provisions of the Vehicle Use Tax, 625 ILCS 5/3-1001 et seq., which provides that a reduced tax of $15 is incurred when "a motor vehicle which has once been subjected to the Illinois retailers' occupation tax or use tax is transferred in connection with the organization, reorganization, dissolution or partial liquidation of an incorporated or unincorporated business wherein the beneficial ownership is not changed." This specific provision, which is broadly written and which includes mergers and consolidations (a type of reorganization with no change in beneficial ownership), provides for a reduced tax. This type of specific language takes precedence over the general policy set forth in the Business Corporation Act.

4. **GILs vs. PLRs:** In recent years, I have been led to believe the Department is reluctant to respond to Private Letter Ruling ("PLR") requests, in favor of creating General Information Letters ("GIL"). I am aware of the requirements for private letter ruling requests, in submission instructions published by the Department. What factors determine whether the department issues a PLR vs. a GIL when the requestor submits all specific details as required in your submission instructions? Does the department have a general policy to create GIL's versus PLR's? It is my understanding that an entity may not rely on guidance in a general information letter as it pertains to their circumstances, although the entity is seeking clarity for their specific tax situation. Please provide any background information on your processes regarding private letter rulings and general information letters.

Answer:

IDOR is receptive to requests for PLRs but we necessarily reserve the right to deny a request and to satisfy ourselves that the request contains all the factual representations prerequisite to preparing a PLR or converting the request to a GIL.

In assessing requests, we consider the following issues:

a. Is there clear and adequate information already provided, such as a GIL or administrative rule?
b. Is the PLR request so factually intensive that it would be unwise to spend the time to prepare a response because a minor change in facts would likely lead to a different legal result? For example, many sales tax nexus questions fall into this category.
c. Is the requested ruling one which likely is sufficiently common such that a GIL would better serve the tax community?
d. Do we suspect that the PLR is a precursor to a tax avoidance scheme? Complex, multi-layered related corporate activities may well fall into this category.

It may be helpful to explain how we review and respond to such requests. In June of 2005 we established a PLR Committee which consists of over a dozen members of our Legal and Audit staffs. The participants on any specific discussion may change based upon the subject matter. Thus, specialists in Sales Tax are likely to be in the majority for a Sales Tax matter. The same approach is used in Income Tax matters.

The request is assigned to a single lawyer, but as the PLR is developed other lawyers and auditors are consulted. The drafter is very likely to contact the requestor to obtain additional information. Once a draft is complete, it is circulated to the Committee members for review and ultimately for discussion at a Committee meeting. The discussions tend to be quite robust. They result in approval, modification, disapproval or directions for further investigation, analysis and redrafting.

Terry Charlton, (217) 782-2844, chairs our PLR Committee. Please feel free to contact him for more information regarding the PLR process.

5. Ohio CAT: Now that the state of Ohio imposes a Commercial Activity Tax ("CAT"), is an Illinois-based taxpayer required to include Ohio sales in the Illinois sales factor numerator when preparing its Illinois income tax return? To clarify, if an Illinois taxpayer is subject to and paying the Ohio CAT tax, can the Ohio sales subject to the CAT be excluded from the taxpayer's Illinois sales numerator because the Ohio CAT is based on the privilege of doing business in OH?

Answer:

Regulation Section 100.3200(a)(1) provides that, for purposes of the sales factor, a taxpayer is "taxable in another state" if it is subject to a "franchise tax on the privilege of doing business" in that state. The Ohio Commercial Activity Tax is imposed on "the privilege of doing business in this state." Ohio Code Ann. Section 5751.02(A). Accordingly, sales to Ohio are not thrown back if the taxpayer is paying Commercial Activity Tax.

6. Federal Credit for Excise Tax: In regard to the federal credit for excise tax claimed on federal Form 8913 or on an individual's federal 1040 for 2006, will the Illinois treatment be the same as the federal treatment for 2007 taxes? For federal purposes, an individual who claims the standard amount does not have to include the credit or refund in income for any tax year. For taxpayers claiming the actual amount paid or business and nonprofit estimation method, any part of the credit or refund attributable to tax payments that were deducted as ordinary and necessary business expense must be included in income for the taxable year in which the refund is received or accrued, to the extent that the tax payments reduced the amount of federal income tax imposed. The part of the credit or refund attributable to interest must also be reported as interest income in the year received or accrued.

Answer:

Under IITA Section 203, base income is computed by starting with the taxpayer's federal taxable income (or adjusted gross income, in the case of an individual). Section 203(h) provides that only those modifications expressly provided in Section 203 may be made. Illinois has no modification related to the Credit for Federal Telephone Excise Tax Paid. Therefore, Illinois will tax the credit, refund and related interest only to the extent that it is included in federal taxable income or adjusted gross income.