

IT 19-0001-PLR 08/14/2019 SALES FACTOR

Gross Receipts from Investment Advisory Services are Sourced to Billing Address of Customer

August 14, 2019

Re: Request for Private Letter Ruling
COMPANY
FEIN: ###

Dear Xxxx:

This is in response to your letter dated February 28, 2019 in which you request a Private Letter Ruling on behalf of TAXPAYER. 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 1200.110 is contained in your request. This Private Letter Ruling will bind the Department only with respect to TAXPAYER. Issuance of this ruling is conditioned upon the understanding that TAXPAYER, and/or any related taxpayer(s) is not 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 states as follows:

We are writing to request a Private Letter Ruling under 2 Ill. Admin. Code § 1200.110, on behalf of our client, TAXPAYER. (hereinafter "Taxpayer"), in relation to its Illinois Corporation Income and Replacement Tax Return sales factor computation. Taxpayer requests your ruling with respect to the sourcing of receipts received from advisory services performed on behalf of investment funds under the newly amended (effective August 3, 2017) sales factor regulations (specifically 86 Ill. Admin. Code §100.3370(6)(D)(iii)). Taxpayer respectfully requests permission to source receipts received from advisory services performed on behalf of investment funds to the office of the fund to which the services are billed.

Taxpayer is not currently under audit and does not have litigation pending with the Illinois Department of Revenue ("Department"). Further, the issue addressed in this Private Letter Ruling is not an issue being examined as part of a Department audit or pending litigation.

Facts

Taxpayer is an investment advisor located in Illinois and is designated as a C Corporation for both Illinois and federal tax purposes. Taxpayer earns the

majority of its revenue for services it performs as the investment advisor for investment funds, which are Delaware Statutory Trusts. Taxpayer does not have an ownership interest in the investment funds, other than an investment in shares of certain mutual funds, in the same way that unaffiliated investors own shares of the funds. Taxpayer “sponsors” the funds, by setting up the funds, soliciting investors, and managing the funds. The investment funds (generally Regulated Investment Companies or “RICs) pay Management Fees, Transfer Agent Fees and 12b-1 fees to the Taxpayer. Historically, in states with market based sourcing or special industry-specific rules for mutual fund service providers, the Taxpayer uses the location of the underlying shareholders of the RICs to apportion income to each state. Since a large portion of the investing public invests in RICs through independent financial advisors (intermediaries with omnibus accounts), the individual underlying shareholder information is difficult, if not impossible, to obtain, and what information is obtained may not accurately reflect where the shareholders actually live. As such, the Taxpayer has concluded that using census information in order to source the service revenue provides a reasonable reflection of where the ultimate benefit of the services are received.

The investment funds have no fixed assets, physical presence or employees. As such, the funds do not have a physical presence in any state. The investment funds’ trustees (“Trustees”) are elected by the shareholders of the investment funds. Services provided to the investment funds are approved by the Board of Trustees, who do not maintain an office and as such have no physical presence. The Trustees meet several times throughout the year at various locations in the United States. The meetings are both telephonic and in-person. Of the at least four annual in-person meetings per year, typically one is held in the state of Illinois. The individual Trustees reside in various states. The books and records are maintained, and fund assets are held by a custodian located in STATE. Taxpayer’s address is used for tax return filing purposes. The Taxpayer sends its bills electronically to the custodian located in STATE, and the custodian transfers money from the funds to the Taxpayer.

Conclusion of the taxpayer

For the reasons stated below, Taxpayer respectfully requests the following ruling:

Taxpayer should source receipts related to advisory services performed on behalf of investment funds to the office of the fund to which the services are billed for purposes of computing its Illinois sales factor numerator.

Analysis

A tax is imposed on the net income of every individual, corporation, trust, and estate. In the case of a corporation, the tax is imposed on the base income which is allocated or apportioned to Illinois. Illinois apportioned income is determined by multiplying the taxpayer's base income by a ratio of sales sourced to Illinois over total sales everywhere. At issue in this request is the sourcing rules for the sales of advisory services performed on behalf of investment funds.

Sales of service are sourced to Illinois using a tiered market-based "waterfall" methodology.

Sales of services are in this State if the services are received in this State. For the purposes of this section, gross receipts from the performance of services provided to a corporation, partnership, or trust may only be attributed to a state where that corporation, partnership or trust has a fixed place of business. If the state where the services are received is not readily determinable or is a state where the corporation, partnership, or trust receiving the service does not have a fixed place of business the services shall be deemed to be received at the location of the office of the customer from which the services were ordered in the regular course of the customer's trade or business. If the ordering office cannot be determined, the services shall be deemed to be received at the office of the customer which the services are billed. 35 ILCS §5/304(a)(3)(C-5)(iv)

The term "fixed place of business" has the same meaning as that term is given in Section 864 of the Internal Revenue Code and the related Treasury regulations. (See 35 ILCS §5/1501(a)(9.5).)

A) As a general rule, a fixed place of business is a fixed facility, that is, a place, site, structure or other similar facility through which the taxpayer engages in a trade or business. (See 26 CFR 1.864-7(b)(1).)

B) A taxpayer is not considered to have a fixed place of business merely because the taxpayer uses another person's fixed place of business, whether or not the other person and the taxpayer are related persons, through which to transact a trade or business, if the trade or business activities of the taxpayer in that fixed place of business are relatively sporadic or infrequent, taking into account the overall needs and conduct of that trade or business. (See 26 CFR 1.864-7(b)(2).)

C) A fixed place of business of an agent of the taxpayer who is not an independent agent is not a fixed place of business of the taxpayer unless the agent has the authority to negotiate and conclude contracts in the name of the taxpayer, and regularly exercises that authority. (See 26 CFR 1.864-7(d)(1)(i).)

D) A fixed place of business of an independent agent of the taxpayer shall not be treated as the office or other fixed place of business of the taxpayer, irrespective of whether the agent has authority to negotiate and conclude contracts in the name of the principal and regularly exercises that authority.

E) For purposes of this subsection (b)(1), "independent agent" means a general commission agent, broker or other agent of an independent status acting in the ordinary course of his or her business in that capacity.

Here, the funds have no tangible property, payroll or physical presence anywhere. Furthermore, both Illinois and federal law hold that the office of an agent operating independently and in the ordinary course of its business shall not be attributed to the principal irrespective of whether the agent has authority to negotiate and conclude contracts in the name of the principal, and regularly exercises that authority. Taxpayer is retained as an investment advisor in its ordinary course of business for multiple investment funds owned by shareholders across the country. Taxpayer is in the business of providing investment advice and managing the funds for the benefit of each fund's shareholders. Taxpayer does not "own" the funds as in a subsidiary relationship, in fact the funds are a client of the taxpayer. The custodian is in the business of performing back office functions for the investment funds and handles the custody of the assets, money movements, and accounting of the investment funds. The custodian operates in its ordinary course of business and performs similar services for thousands of investment funds as an independent agent. As such, the investment funds should not be deemed to have a fixed place of business under Illinois law.

Under 35 ILCS § 5-304(a)(3)(C-5)(iv), Taxpayer has historically taken the position that the benefit of the investment services are received by the investment funds' ultimate owners.

On August 3rd, 2017, the Department adopted revised sourcing regulations. Relevant to Taxpayer and the stimulus for this private letter ruling request, the adopted regulations added the following example:

Example 5. Services performed by an investment fund on behalf of an investor are received in this State if the investor resides in this State (in the case of an individual) or has its ordering or billing address in this State (for other investors). In the case of services provided by Taxpayer to or on behalf of the investment fund that are directly connected with services provided separately to the investors, such as preparation of communications and statements to investors, and allocations of earnings and distributions to investors, the service is also received in this State to the extent the investors reside (or have their ordering or billing address) in this State. Accordingly, receipts of Taxpayer for these services are allocated to this State on the basis of the ratio of: the average of the outstanding shares in the fund owned by shareholders, partners or other investors residing (or having their ordering or billing address) within this State at

the beginning and end of each taxable year of the taxpayer; and the average of the total number of outstanding shares in the fund at the beginning and end of each year. Residence or ordering or billing address of the shareholder, partner, or other investor is determined by the mailing address in the records of the investment fund or the taxpayer. Services provided to an investment fund that are not directly connected to or in support of services provided separately to investors, such as brokerage services or investment advising, are not received by the customer at the location of its investors. 86 Ill. Admin. Code §100.3370(6)(D)(3).

The quoted language above divides investment fund services into two categories. The first category is comprised of services provided separately to investors. This first category is sourced to the location of the investors. The second category is comprised of services not directly provided separately to the investors. This second category is not sourced to the location of the investors and expressly includes investment advisory services. Because the majority of Taxpayer's services fall into the second category, under the amended regulations, these services should not be sourced to the location of the investors.

Illinois law states that gross receipts from the performance of services provided to a corporation, partnership, or trust may only be attributed to a state where that corporation, partnership, or trust has a fixed place of business. When the corporation, partnership, or trust has no fixed place of business, Taxpayer would apply the statutorily-provided tiered methodology for sourcing to where the services are received that has a fixed place of business, ordering office, or billing office of the investment funds. Here, the state where the services are received is not readily determinable, thus the services shall be deemed to be received at the location of the office of the customer from which the services were ordered in the regular course of the customer's trade or business. If the ordering office cannot be determined, the services shall be deemed to be received at the office of the customer which the services are billed. The investment funds do not have an ordering office. Because the location of an ordering office cannot be determined, the services would ultimately be sourced to the office of the customer which the services are billed. Considering that the investments of the funds are held by the custodian and the books and records of the investment funds are maintained by the custodian in STATE, and all bills of the investment funds are serviced by the custodian in STATE, it appears the billing office is located in STATE. As such, by following the Department's adopted revised sourcing regulations and applying the statutorily-provided tiered methodology for sourcing to where the services are received, the Taxpayer ultimately will source 100% of their advisory services to the location of the custodian's billing office, which is in STATE.

Summary

The revised regulations adopted on August 3rd, 2017, state that services provided to an investment fund that are not directly connected to or provided separately to investors should not be sourced to the state in which the ultimate investor resides. Taxpayer has historically sourced a portion of their investment advisory services to Illinois by looking through to the ultimate investor and is seeking confirmation to begin using the location of the office of the customer which the services are billed to source the investment advisory services going forward.

Statement of Authorities Contrary to the Taxpayer's View

Neither the Taxpayer nor the Taxpayer's representatives are aware of any contrary rulings, cases, statutes or regulations to the position requested in this letter.

RULING

Section 304(a)(3)(A) of the Illinois Income Tax Act ("IITA" ; 35 ILCS 5/304(a)(3)(A)) defines the sales factor for taxpayers other than insurance companies, financial organizations, federally regulated exchanges, and transportation companies, as follows:

The sales factor is a fraction, the numerator of which is the total sales of the person in this State during the taxable year, and the denominator of which is the total sales of the person everywhere during the taxable year.

IITA Section 304(a)(3)(C-5) provides, in part, for taxable years ending on or after December 31, 2008, sales, other than sales governed by paragraphs (B), (B-1), (B-2), (B-5) and (B-7), are in this State if any of the following criteria are met:

...

(iv) Sales of services are in this State if the services are received in this State. For the purposes of this section, gross receipts from the performance of services provided to a corporation, partnership, or trust may only be attributed to a state where that corporation, partnership, or trust has a fixed place of business. If the state where the services are received is not readily determinable or is a state where the corporation, partnership, or trust receiving the service does not have a fixed place of business, the services shall be deemed to be received at the location of the office of the customer from which the services were ordered in the regular course of the customer's trade or business. If the ordering office cannot be determined, the services shall be deemed to be received at the office of the customer to which the services are billed. If the taxpayer is not taxable in the state in which the services are received, the sale must be excluded from both the numerator and the denominator of the sales factor. The Department shall adopt

rules prescribing where specific types of services are received, including, but not limited to, publishing, and utility service.

Department Regulations Section 100.3370(c)(6)(D)(iii) provides that services received in Illinois include, but are not limited to:

Services performed by a taxpayer that are directly connected to or in support of services received in this State are also services received in this State.

This rule is illustrated in Example 5 of the regulation, which provides:

Example 5. Services performed by an investment fund on behalf of an investor are received in this State if the investor resides in this State (in the case of an individual) or has its ordering or billing address in this State (for other investors). In the case of services provided by Taxpayer to or on behalf of the investment fund that are directly connected with services provided separately to the investors, such as preparation of communications and statements to investors, and allocations of earnings and distributions to investors, the service is also received in this State to the extent the investors reside (or have their ordering or billing address) in this State. Accordingly, receipts of Taxpayer for these services are allocated to this State on the basis of the ratio of: the average of the outstanding shares in the fund owned by shareholders, partners or other investors residing (or having their ordering or billing address) within this State at the beginning and end of each taxable year of the taxpayer; and the average of the total number of outstanding shares in the fund at the beginning and end of each year. Residence or ordering or billing address of the shareholder, partner or other investor is determined by the mailing address in the records of the investment fund of the taxpayer. Services provided to an investment fund that are not directly connected to or in support of services provided separately to investors, such as brokerage services or investment advising, are not received by the customer at the location of its investors.

In addition, Department Regulations Section 100.3370(c)(6)(D)(iv) provides the following special rule:

Under IITA Section 304(a)(3)(C-5)(iv), if the state where the services are received is not readily determinable, the services shall be deemed to be received at the location of the office of the customer from which the services were ordered in the regular course of the customer's trade or business, or, if the ordering office cannot be determined, at the office of the customer to which the services are billed. If the service is provided to an individual who provides a residential address as the place from which the services are ordered or to which the services are billed, rather than an office address, the residential address shall be used. For purposes of this provision, the state where services are received is not readily determinable if the facts necessary to make the determination are not

contained in the books and records of the taxpayer or any person related to the taxpayer within the meaning of 26 USC 267(b) or if the available facts would allow reasonable persons to reach different determinations of the state in which the services were received.

Your letter indicates that the receipts which are the subject of this ruling request consist of revenues for services the Taxpayer performs as investment advisor to investment funds. Under Department Regulations Section 100.3370(c)(6)(D)(iii)(Example 5), these services are not received by the Taxpayer's customer, the investment fund, at the location of its investors. Moreover, none of the rules in Section 100.3370(c)(6)(D)(iii) applies to determine where the Taxpayer's investment advisory services are received. Your letter indicates that Taxpayer's customers do not own any physical assets, nor do they have employees. The activities of the funds are controlled by boards of trustees, which meet several times throughout the year (sometimes remotely) at various locations in the United States, including Illinois. In addition, your letter indicates that the books and records of the funds, as well as custody of all funds' assets, are maintained by a custodian located in Massachusetts. Based on these facts, reasonable persons may disagree as to the state in which the Taxpayer's investment advisory services are received. Accordingly, under Regulations Section 100.3370(c)(6)(D)(iv), the Taxpayer's services shall be deemed to be received at the location of the office of the customer from which the services were ordered in the regular course of the customer's trade or business, or, if the ordering office cannot be determined, at the office of the customer to which the services are billed. Note that for purposes of determining the ordering office of the customer, the ordering office is not determinable if the facts necessary to make that determination are not contained in the books and records of the Taxpayer or any person related to the Taxpayer within the meaning of 26 USC 267(b). In this case, your letter represents that the ordering office cannot be determined. Accordingly, the Taxpayer's investment advisory services shall be deemed to be received at the office of the customer to which the services are billed.

This ruling shall bind the Department as provided herein. 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 shall bind the Department for all taxable years, except as limited pursuant to 2 Ill. Adm. Code 1200.110(d) and (e). 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,

Brian L. Stocker
Chairman, PLR Committee (Income Tax)