

**Illinois Department of Revenue
Regulations**

**Title 86 Part 100 Section 2430 ADDITION AND SUBTRACTION MODIFICATIONS FOR
TRANSACTIONS WITH 80/20 AND NONCOMBINATION RULE COMPANIES**

**TITLE 86: REVENUE
CHAPTER I: DEPARTMENT OF REVENUE**

**PART 100
INCOME TAX**

Section 100.2430 Addition and Subtraction Modifications for Transactions with 80/20 and Noncombination Rule Companies

- a) For taxable years ending on or after December 31, 2004, IITA Section 203 requires a taxpayer, in computing base income, to add back deductions allowed in computing federal taxable income or adjusted gross income for interest expenses and intangible expenses incurred in transactions with a person who would be a member of a unitary business group with the taxpayer, if not for the 80/20 test. These provisions were expanded by Public Act 95-233 and Public Act 95-707 to also require the add-back of deductions for interest expenses, intangible expenses and insurance premium expenses when incurred in taxable years ending on or after December 31, 2008, in transactions with a person who would be a member of a unitary business group with a taxpayer if not for the prohibition in IITA Section 1501(a)(27) against including in a single unitary business group taxpayers who use different apportionment formulas under IITA Section 304 (the "noncombination rule"). The noncombination rule was repealed by Public Act 100-22, so that the expansions of the add-back provisions in Public Act 95-233 and Public Act 95-707 have no application for taxable years ending on or after December 31, 2017. Taxpayers are also allowed subtraction modifications that would ensure that the addition modifications do not result in double taxation. Exceptions are provided for instances in which requiring the addition modifications would not be appropriate.
- b) Definitions
- 1) Dividend Included in Base Income. "Dividend" means any item defined as a dividend under 26 USC 316 and any other item of income characterized or treated as a dividend under the Internal Revenue Code, and includes any item *included in gross income under Sections 951 through 964 of the Internal Revenue Code and amounts included in gross income under Section 78 of the Internal Revenue Code.* (IITA Section 203(a)(2)(D-17), (D-18) and (D-19), (b)(2)(E-12), (E-13) and (E-14), (c)(2)(G-12), (G-13) and (G-14), and (d)(2)(D-7), (D-8) and (D-9)) A dividend is included in base income of a taxpayer only to the extent the dividend is neither deducted in computing the federal taxable or adjusted gross income of the taxpayer nor subtracted from federal taxable income or adjusted gross income under IITA Section 203.
 - 2) Foreign Person. A "foreign person" is any person who would be included in a unitary business group with the taxpayer if not for the fact that *80% or more of that person's business activities are conducted outside the United States.* (IITA Section 1501(a)(30))

- 3) Interest. "Interest" means "compensation for the use or forbearance of money". (See *Deputy v. du Pont*, 308 U.S. 488, 498 (1940).) Interest includes the amortization of any discount at which an obligation is purchased and is net of the amortization of any premium at which an obligation is purchased.
- 4) Intangible Expense. "Intangible expense" includes *expenses, losses, and costs for, or related to, the direct or indirect acquisition, use, maintenance or management, ownership, sale, exchange, or any other disposition of intangible property; losses incurred, directly or indirectly, from factoring transactions or discounting transactions; royalty, patent, technical, and copyright fees; licensing fees; and other similar expenses and costs.* (IITA Section 203(a)(2)(D-18), (b)(2)(E-13), (c)(2)(G-13) and (d)(2)(D-8))
- 5) Intangible Income. "Intangible income" means the income received or accrued by a person from a transaction that generates intangible expense for the other party to the transaction.
- 6) Intangible Property. "Intangible property" includes *patents, patent applications, trade names, trademarks, service marks, copyrights, mask works, trade secrets, and similar types of intangible assets.* (IITA Section 203(a)(2)(D-18), (b)(2)(E-13), (c)(2)(G-13) and (d)(2)(D-8))
- 7) Related Party. "Related parties" means persons disallowed a deduction for losses by section 267(b), (c) and (f) of the Internal Revenue Code, as well as a partner and its partnership and each of the other partners in that partnership.
- 8) Noncombination Rule Company. "Noncombination rule company" means any person who would be a member of a unitary business group with a taxpayer if not for the prohibition in IITA Section 1501(a)(27) against including in a single unitary business group persons who use different apportionment formulas under IITA Section 304.
- 9) Insurance Premiums. "Insurance premiums" means the total amount paid or accrued during the taxable year, net of refunds or abatements, for coverage against any risk under a policy issued by an entity that is required to apportion its business income under the provisions of IITA Section 304(b) or that would be required to do so if it were subject to Illinois income taxation.
- 10) Federal Deduction Allowed for Interest Paid to a Foreign Person
 - A) Under 26 USC 163(j), for taxable years beginning after December 31, 2017, a taxpayer's federal income tax deduction for business interest paid is limited to an amount equal to the sum of the taxpayer's business interest income plus 30% of its adjusted taxable income plus its floor plan financing interest. Business interest in excess of that limitation is carried forward under 26 USC 163(j)(2) and treated as interest paid in the following taxable year. For purposes of this Section, in the case of a taxpayer whose federal income tax deduction for business interest expense for a taxable year beginning after December 31, 2017 is subject to limitation by 26 USC 163(j):

- i) the deduction allowed in computing federal taxable income for business interest paid to a foreign person for that taxable year equals the business interest paid to that foreign person for that taxable year (including any amount of business interest paid to that foreign person in the preceding taxable year and carried forward from the preceding taxable year under 26 USC 163(j)(2)) times a fraction equal to the deduction allowed under 26 USC 163(j) in computing federal taxable income for business interest paid for that taxable year divided by the total business interest paid for that taxable year (including any amount of business interest paid in the preceding taxable year and carried forward from the preceding taxable year under 26 USC 163(j)(2)); and
- ii) the amount of business interest paid to a foreign person for a taxable year and carried forward to the next taxable year under 26 USC 163(j)(2) equals the business interest paid to that foreign person for that taxable year (including any amount of business interest carried forward from the preceding taxable year under 26 USC 163(j)(2)) times a fraction equal to the total amount of business interest to be carried forward to the next taxable year under 26 USC 163(j)(2) divided by the total business interest paid for that taxable year (including any amount of business interest carried forward from the preceding taxable year and carried forward to that taxable year under 26 USC 163(j)(2)).

B) EXAMPLE:

- i) In Year 1, Taxpayer paid \$100 in business interest to Foreign Person and \$1,000 in total business interest. There was no carryforward under 26 USC 163(j)(2) from the prior year. Under 26 USC 163(j), Taxpayer's federal income tax deduction for business interest in Year 1 was limited to \$800. In Year 2, Taxpayer paid \$130 in business interest to Foreign Person and \$1,800 in total business interest. Taxpayer's federal income tax deduction for business interest in Year 2 was limited under 26 USC 163(j) to \$1,200.
- ii) For purposes of this Section, the federal income tax deduction allowed to Taxpayer for interest paid to Foreign Person in Year 1 equals \$80: the \$100 actually paid multiplied by 80% (the \$800 federal income tax deduction allowed for business interest divided by the \$1,000 in total business interest paid). The carryforward of interest paid to Foreign Person in Year 1 to Year 2 equals \$20: the \$100 actually paid to Foreign Person multiplied by 20% (the \$200 carryforward to Year 2 divided by the \$1,000 in total business interest paid in Year 1).
- iii) For purposes of this Section, the federal income tax deduction allowed to Taxpayer for interest paid to Foreign Person in Year 2 equals \$90: the \$130 in interest actually paid to Foreign Person in Year 2 plus the \$20 paid to Foreign Person in Year 1 and carried forward to Year 2, or \$150, multiplied by 60% (the \$1,200 federal income tax deduction allowed for business interest divided by the

\$2,000 in total business interest for Year 2, which equals the \$1,800 actually paid plus the \$200 carryover from Year 1). The carryforward of interest paid to Foreign Person in Year 2 to Year 3 equals \$60: the \$150 paid to Foreign Person in Year 2 or carried forward from Year 1, multiplied by 40% (the \$800 carryforward to Year 3 divided by the \$2,000 in total business interest paid in Year 2 or carried forward from Year 1).

c) Addition Modifications

1) Interest. Except as otherwise provided in this subsection (c)(1), every taxpayer must add back to its base income any deduction otherwise allowed in the taxable year for interest paid to a foreign person or (for taxable years ending on or after December 31, 2008 and prior to December 31, 2017) to a noncombination rule company, to the extent the interest exceeds the amount of dividends received from the foreign person or noncombination rule company by the taxpayer and included in base income for the same taxable year. (See IITA Section 203(a)(2)(D-17), (b)(2)(E-12), (c)(2)(G-12) and (d)(2)(D-7).) This addition modification shall not apply to an item of interest expense if:

A) The foreign person or noncombination rule company is subject in a foreign country or state, other than a state that requires mandatory unitary reporting by the taxpayer and the foreign person or noncombination rule company, to a tax on or measured by net income with respect to the interest. The foreign person or noncombination rule company is subject to a tax on or measured by net income with respect to the interest if the interest is included in its tax base, even if the tax base is offset in whole or in part by deductions for expenses incurred in the production of income or by generally-applicable exemptions, or if the tax imposed by the foreign country or state is offset in whole or in part by credits that are not contingent on the receipt of the interest. If the foreign person or noncombination rule company is a partnership, subchapter S corporation or trust, the foreign person or noncombination rule company is subject to a tax on or measured by net income with respect to the interest to the extent that the interest is included in the tax base of a partner, shareholder or beneficiary who is subject to a tax on or measured by net income in a foreign country or state. For purposes of this subsection (c)(1)(A), it is irrelevant that, under the laws of the foreign country or state, the interest is included in the tax base in a period other than the taxable year in which the deduction is otherwise allowable.

B) The taxpayer can establish, based on a preponderance of the evidence, both of the following:

i) the foreign person or noncombination rule company (during the same taxable year in which the taxpayer paid the interest) paid, accrued, or incurred the interest to a person that is not a related party; and

ii) the transaction giving rise to the interest expense between the taxpayer and the foreign person or noncombination rule company did not have as a principal purpose the avoidance of Illinois income tax,

and interest is paid pursuant to a contract or agreement that reflects an arms-length interest rate and terms.

- C) The taxpayer can establish, based on clear and convincing evidence, that the item of interest relates to a contract or agreement entered into at arms-length rates and terms and the principal purpose for the payment is not federal or Illinois tax avoidance.
 - D) The taxpayer establishes by clear and convincing evidence that the adjustment would be unreasonable.
 - E) The taxpayer has received permission under Section 100.3390 to use an alternative method of apportionment allowing the deduction of the item.
- 2) Intangible Expenses. Except as otherwise provided in this subsection (c)(2), every taxpayer must add back to its base income any deduction otherwise allowed in the taxable year for intangible expenses incurred with respect to transactions with a foreign person or (for taxable years ending on or after December 31, 2008 and prior to December 31, 2017) with a noncombination rule company, to the extent the intangible expenses exceed the amount of dividends received from the foreign person or noncombination rule company by the taxpayer and included in base income for the same taxable year. If a taxpayer incurs both interest and intangible expenses with the same foreign person or noncombination rule company, any dividends received from that foreign person or noncombination rule company shall be applied first against interest under subsection (c)(1) and only the excess (if any) of the dividends over the interest expenses shall be applied against intangible expenses under this subsection (c)(2). (See IITA Section 203(a)(2)(D-18), (b)(2)(E-13), (c)(2)(G-13) and (d)(2)(D-8).) This addition modification shall not apply to an item of intangible expense if:
- A) The item arises from a transaction with a foreign person or noncombination rule company who is subject in a foreign country or state, other than a state that requires mandatory unitary reporting by the taxpayer and the foreign person or noncombination rule company, to a tax on or measured by net income with respect to the intangible income related to the item. The foreign person or noncombination rule company is subject to a tax on, or measured by net income with respect to, the intangible income if the intangible income is included in its tax base, even if the tax base is offset in whole or in part by deductions for expenses incurred in the production of income or by generally-applicable exemptions or if the tax imposed by the foreign country or state is offset in whole or in part by credits that are not contingent on the receipt of the intangible income. If the foreign person or noncombination rule company is a partnership, subchapter S corporation or trust, the foreign person or noncombination rule company is subject to a tax on or measured by net income with respect to the intangible income to the extent that the intangible income is included in the tax base of a partner, shareholder or beneficiary who is subject to a tax on or measured by net income in a foreign country or state. For purposes of this subsection (c)(2)(A), it is irrelevant that, under the laws of the foreign country or state, the intangible income is included in the tax base in a period other than the taxable year in which the deduction for the intangible expense is otherwise allowable.

- B) The taxpayer can establish, based on a preponderance of the evidence, both of the following:
 - i) the foreign person or noncombination rule company (during the same taxable year in which the taxpayer paid the intangible expense) paid, accrued, or incurred the intangible expense to a person that is not a related party; and
 - ii) the transaction giving rise to the intangible expense between the taxpayer and the foreign person or noncombination rule company did not have as a principal purpose the avoidance of Illinois income tax, and is paid pursuant to a contract or agreement that reflects arms-length terms.
 - C) If the taxpayer establishes, by clear and convincing evidence, that the adjustments are unreasonable.
 - D) The taxpayer has received permission under Section 100.3390 to use an alternative method of apportionment, allowing the deduction of the item.
- 3) Insurance Premiums. For taxable years ending on or after December 31, 2008 and prior to December 31, 2017, every taxpayer must add back to its base income any deduction otherwise allowed in the taxable year for insurance premiums paid to a noncombination rule company, to the extent the insurance premium expense exceeds the amount of dividends received from the noncombination rule company by the taxpayer and included in base income for the same taxable year. If a taxpayer incurs both interest or intangible expenses and insurance premium expenses with the same noncombination rule company, any dividends received from that noncombination rule company shall be applied first against interest under subsection (c)(1), then against intangibles expenses under subsection (c)(2), and only the excess (if any) of the dividends over the interest expenses and intangible expenses shall be applied against insurance premium expenses under this subsection (c)(3). (See IITA Section 203(a)(2)(D-19), (b)(2)(E-14), (c)(2)(G-14) and (d)(2)(D-9).)

d) Subtraction Modifications

- 1) Interest Income of a Foreign Person or Noncombination Rule Company. If interest paid to a foreign person or noncombination rule company is added back by a taxpayer under subsection (c)(1), the foreign person or noncombination rule company is allowed a subtraction for the amount of that interest included in its base income for the taxable year, net of deductions allocable to that income. The subtraction allowed under this subsection (d)(1) shall not exceed the amount of the corresponding addition under subsection (c)(1). (See IITA Section 203(a)(2)(CC), (b)(2)(V), (c)(2)(T) and (d)(2)(Q).)
- 2) Intangible Income of a Foreign Person or Noncombination Rule Company. If intangible expense incurred in a transaction with a foreign person or noncombination rule company is added back by a taxpayer under subsection (c)(2), the foreign person or noncombination rule company is allowed a subtraction for the amount of the intangible income from that transaction included in its base income for the taxable year, net of deductions allocable to that income. The

subtraction allowed under this subsection (d)(2) shall not exceed the amount of the corresponding addition under subsection (c)(2). (See IITA Section 203(a)(2)(CC), (b)(2)(V), (c)(2)(T) and (d)(2)(Q).)

- 3) Interest Income from a Foreign Person or Noncombination Rule Company. A taxpayer who receives interest income from a foreign person or noncombination rule company is allowed a subtraction for the amount of that interest income, net of deductions allocable to that income. The subtraction allowed in this subsection (d)(3) for a taxable year may not exceed the amount of the addition modification for the taxable year under subsection (c)(1) for interest paid by the taxpayer to the foreign person or noncombination rule company. (See IITA Section 203(a)(2)(DD), (b)(2)(W), (c)(2)(U) and (d)(2)(R).)
- 4) Intangible Income from a Foreign Person or Noncombination Rule Company. A taxpayer who receives intangible income from a transaction with a foreign person or noncombination rule company is allowed a subtraction for the amount of the intangible income, net of deductions allocable to that income. The subtraction allowed in this subsection (d)(4) for the taxable year may not exceed the amount of the addition modification for the taxable year under subsection (c)(2) for intangible expenses incurred by the taxpayer in transactions with the foreign person or noncombination rule company. (See IITA Section 203(a)(2)(EE), (b)(2)(X), (c)(2)(V) and (d)(2)(S).)
- 5) Insurance Premium Income of a Noncombination Rule Company. If insurance premium expense incurred in a transaction with a noncombination rule company is added back by a taxpayer under subsection (c)(3), the noncombination rule company is allowed a subtraction for the amount of the insurance premium income from that transaction included in its base income for the taxable year, net of deductions allocable to that income. The subtraction allowed under this subsection (d)(5) shall not exceed the amount of the corresponding addition under subsection (c)(3). (See IITA Section 203(b)(2)(V).)
- 6) Insurance Paid by a Noncombination Rule Company. For taxable years ending on or after December 31, 2011, in the case of a taxpayer who added back any insurance premiums under subsection (c)(3), the taxpayer may elect to subtract that part of a reimbursement received from the insurance company to which the premiums were paid equal to the amount of the expense or loss (including expenses incurred by the insurance company) that would have been taken into account as a deduction for federal income tax purposes if the expense or loss had not been insured by the policy for which the premiums were paid. If a taxpayer makes the election provided for by this subsection (d)(6), the insurer to which the premiums were paid must (if required to file an Illinois income tax return) add back to its taxable income the amount subtracted by the taxpayer under this subsection (d)(6). (See IITA Section 203(a)(2)(GG), (b)(2)(Y) (c)(2)(Y) and (d)(2)(T).)
- e) Unitary Business Groups. The provisions of this Section apply both to persons who are members of a unitary business group and to persons who are not members of a unitary business group because of the application of the 80/20 rule or (for taxable years ending on or after December 31, 2008 and prior to December 31, 2017) because of the prohibition in IITA Section 1501(a)(27) against including in a single unitary business group taxpayers using different apportionment formulas under IITA Section 304(a) through (d). In applying the provisions of this Section in the case of a unitary business group, any

reference to the "taxpayer" in this Section shall be deemed to refer to the unitary business group.

(Source: Amended at 44 Ill. Reg. 1097, effective June 10,2020)

