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**Allocation/Apportionment**

In the past 18 months, Illinois has adopted new legislation that has revised the state's apportionment regime for banks and other financial organizations. In this article, author George J. Barry, of Deloitte Tax LLP, analyzes the new apportionment rules and concludes that these changes will likely result in major increases in tax liability for many banks and financial organizations. The author provides an overview of the major changes to the law and flags those revisions most likely to impact taxpayers.

## **An Analysis of Illinois' New Bank Apportionment Regime: Expansion of Data Requirements and Potential Tax Liability**

By GEORGE J. BARRY

### **SCOPE AND INTRODUCTION**

**T**his article summarizes significant legislative changes that have occurred during the last 18 months concerning the apportionment provisions related to the Illinois income taxation of banks and

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other financial organizations.<sup>1</sup> There is more intricacy in the potential application of these new provisions than an article of this length could hope to cover. Therefore, the focus here is on those applications that are believed by the author to be of the most general importance to affected members of the bank and financial organization taxpayer community, as well as those issues that most effectively illustrate broader matters of tax policy.

By way of a general comment on the impact of the new apportionment provisions, it would seem that overall these changes should result in a major increase in tax liability for the bank and financial organization taxpayer group. While changes in apportionment methodology often result in almost equal numbers of winners and losers, in this case, the losers will almost certainly outnumber the winners. It is true, of course, that most

<sup>1</sup> The legislation in question is Ill. P.A. 95-233 and Ill. P.A. 95-707. As a matter of scope, the entire discussion in this article focuses on how the new apportionment provisions will apply in the context of banks. However, there are 16 other statutory categories of financial organization for Illinois income tax purposes. It should be noted that the new apportionment provisions do not differentiate between banks and these other categories of financial organization, so the new provisions would also apply in varying contexts to those other financial organizations.

large banks are already subject to apportionment in Illinois and other states. However, the new apportionment provisions are going to place far greater demands on taxpayers at three points of the compliance cycle:

- Data collection—more detailed apportionment data must be collected and retained.

- Transaction analysis—more detailed analyses of transactions and customers must be performed in support of apportionment computations that are reported on tax returns.

- Audit defense—potentially, an increased effort will be needed to defend far more factually detailed issues when the Illinois Department of Revenue<sup>2</sup> audits these returns.

The new legislation did not alter the definition of “financial organization,” which has been an important issue at various times during the history of the Illinois income tax,<sup>3</sup> so that subject is not discussed in this article. Moreover, though there are other aspects of this same legislative package that did affect tax base issues for this taxpayer group, such as captive REIT provisions and provisions related to inter-company transactions between financial organizations and affiliated nonfinancials, these matters are also generally beyond the scope of this article.

From the first enactment of the Illinois Income Tax Act (IITA) in 1969, banks, bank holding companies, savings and loans, sales finance companies and the other 13 categories of financial organization enumerated in IITA § 1501(a)(8)<sup>4</sup> have always had their own one factor apportionment formula.<sup>5</sup> Dramatic statutory changes

<sup>2</sup> The Illinois Department of Revenue is the agency of state government in Illinois that administers the Illinois Income Tax Act. Throughout this article, it will sometimes be referred to simply as the “Department of Revenue” or the “department.”

<sup>3</sup> The controversy over the years around qualification as a financial organization for Illinois income tax purposes has not generally been focused on banks or bank holding companies or savings and loans, all of which are either federal or state chartered financial institutions. The controversy has generally revolved around whether definitional terms used in § 1501(a)(8) of the Illinois Income Tax Act (IITA), such as “investment company” and “sales finance company,” could encompass entities that were not government regulated and that were affiliated with nonfinancial operating companies. The importance of the question for the Illinois income tax has usually been the result of the Illinois unitary business group provision that precludes financial organizations from being included in the same unitary business group as nonfinancial organizations (e.g., companies using sales factor apportionment), even if the two affiliates were otherwise in a unitary relationship. The resolution of this long-contested universe of issues about how narrowly the definition of financial organization should be read (the usual point of view of the Department of Revenue) or how broadly it should be read (the usual point of view of the taxpayer community) was largely resolved by a comprehensive regulation on the subject in 2001. Ill. Admin. Code tit. 86, § 100.9710.

<sup>4</sup> The IITA is found at 35 ILCS 5/101 through 5/1701. Throughout this article, it will be cited in text and footnotes as IITA § 101 through IITA § 1701.

<sup>5</sup> Similarly, insurance companies and companies providing transportation services have also had their own one factor apportionment formulas from the first enactment of the IITA. All other taxpayers, not coming within one of the three special classifications of financial organization, insurance company, or company providing transportation services, were originally required with the first enactment of the IITA to utilize a three-

were made to that formula over the last 18 months by the enactment of two pieces of legislation, Ill. P.A. 95-233 and Ill. P.A. 95-707. The changes that were made collectively by these two legislative enactments were effective for tax years ending on or after Dec. 31, 2008.<sup>6</sup> Taxpayers and their advisers will be dealing with these changes on returns first coming due in March 2009, and it is these changes that are the primary subject of this article.

The discussion in this article is based in large part on a straightforward reading of the new statutory provisions.<sup>7</sup> However, as is often the case with tax statutes in Illinois and other jurisdictions, not every application of the new statutory provisions is clear cut. Therefore, some of what is discussed below necessarily represents the author’s interpretation of the new statute. As such, it may or may not withstand the test of time as issues

factor apportionment formula based on property, payroll, and sales. Over the years that followed, the weight given to the sales factor was increased at various points in time with a corresponding decrease in the weight given to the property and payroll factors. Ultimately, beginning with the year 2000, the property and payroll factors were completely eliminated from the apportionment formula leaving a single sales factor for all taxpayers that do not qualify as financial organizations, insurance companies, or companies providing transportation services. The sales factor and the one factor formula for financial organizations are statutorily entirely separate apportionment formulas that apply to mutually exclusive groups of taxpayers, though they do have some provisions in common, most notably for 2008 forward, the sourcing of service receipts.

<sup>6</sup> Ill. P.A. 95-0233 was passed by the General Assembly in May 2007 and signed by the governor in August 2007. Its financial organization apportionment provisions were scheduled to take effect for years ending on or after Dec. 31, 2008. Ill. P.A. 95-707 was passed by the General Assembly in November 2007 and signed by the governor in January 2008. P.A. 95-707 repealed and revised certain of the provisions of P.A. 95-233 related to financial organizations before those provisions had a chance to be implemented on any actual tax returns. All of the amendments by P.A. 95-707 to bank and financial organization apportionment provisions in the IITA, like those of P.A. 95-233, were to be operative for tax years ending on or after Dec. 31, 2008. With that history now established for the reader, from this point forward, this article will discuss the newly legislated bank and financial organization apportionment provisions for tax years ending on or after Dec. 31, 2008, as they emerged after the enactment of the latter of these two bills, which was P.A. 95-707. The article will not specifically discuss provisions that were enacted in P.A. 95-233 only to be revised in P.A. 95-707.

<sup>7</sup> The new bank and financial organization apportionment provisions that are the subject of this article were codified at IITA § 304(c)(3). The bank and financial organization apportionment provisions applicable to tax years ending prior to Dec. 31, 2008 (“pre-2008 provisions”) continue to be codified at IITA § 304(c)(1) and (2).

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are raised and resolved in the future with the Department of Revenue through administrative and litigation processes. From this point forward, the reader will also observe that there are some interpretive issues on which the author has felt it prudent to present potential opposing arguments without expressing an opinion about the ultimate resolution of the question.

In addition to the statute itself, as of the date of this article, the department has started the administrative rulemaking process by circulating a draft set of regulations for informal comment in the tax community. The department has not yet formally proposed any regulations. Given the fact that this regulatory process is still in its earliest stages and that the present draft regulations could be abandoned, revised, or advanced by the department at any time at its own sole discretion, all discussion of the draft regulations in this article will be confined to the footnotes.

## OVERVIEW OF NEW APPORTIONMENT PROVISIONS

### Themes Emerge

To establish a good background for dealing with the details of the bank and financial organization apportionment revisions that are going into effect starting with calendar 2008 liabilities, it is helpful to begin with a review of the major themes of the legislation. These appear to be five in number.

**A Shift to a Market Approach.** The new provisions generally reflect a tax policy shift toward the “market approach” for sourcing. The statute, as amended, recites generally that the numerator of the bank and financial organization apportionment formula is to be “gross receipts from sources in this State or otherwise attributable to this State’s marketplace. . . .”<sup>8</sup> All of the detailed statutory apportionment rules that follow are said to be “illustrative” of this general mandate.<sup>9</sup> Of course, as close scrutiny of some of the detailed rules later in this article will suggest, it is not always very clear what constitutes the “market approach.” For example, if there is a receipt from a secured loan or from the rental of tangible personal property, is the “market” defined by where the property is located or by where the borrower or lessee is located? The new service receipt sourcing rule, which will be discussed in some detail below, is more of a market approach than the income-producing activity and cost-of-performance rule,<sup>10</sup> but in the details of the new rule, it certainly could be argued that there are other approaches that would be more market driven.

**Throwout Rule.** Two of the most important new sourcing provisions—services and unsecured commercial loans—include a “throwout rule,” in other words,

<sup>8</sup> IITA §304(c)(3).

<sup>9</sup> *Id.*

<sup>10</sup> In Illinois apportionment pre-2008, the income-producing activity and cost-of-performance rule is an approach that sourced certain receipts to the Illinois numerator if the greater proportion of the income-producing activity related to the particular receipt was in Illinois, based on costs of performance.

the exclusion of a gross receipt item from the denominator of the apportionment factor. In this way, the apportionment process is tightened in these key places, making it less likely that revenue that may be beyond any state’s income tax reach will be allowed to reduce the Illinois liability of the taxpayer.

**‘Laddered’ Numerator Sourcing Tests.** Three of the new provisions utilize “laddered” numerator sourcing tests—services, unsecured commercial loans, and investment and trading receipts. As revised, these apportionment provisions prescribe a series of sourcing tests that are to be applied in a specified sequence, until one of the sourcing criteria is satisfied either as to Illinois or hypothetically as to some other state. This is another mechanism for tightening the Illinois apportionment process in an apparent effort to ensure that whatever sourcing rule is ultimately applied, every dollar of gross receipts in each particular category would be sourced to Illinois or somewhere else.

**Sourcing Criteria That Cannot Be Determined.** Three of the new provisions establish certain factual criteria for apportionment sourcing and then acknowledge that there may be instances in which these criteria “cannot be determined.” This implies that taxpayers that are diligent in marshalling necessary sourcing information as transactions are being consummated may be able to develop a more favorable apportionment outcome than those that choose not to make the effort.

**Transaction-Level Analysis.** Finally, another theme that permeates the new statutory provisions is that the analysis for apportionment purposes is to occur, quite often, at a transaction-by-transaction, customer-by-customer level. These new sourcing provisions do not lend themselves as easily as the pre-2008 apportionment provisions to the broad grouping of transactions for purposes of apportionment analysis. As seen in the detailed discussion later in this article, under the new provisions, each loan has to be tested against the relevant sourcing criteria (including ladders for unsecured commercial loans), as opposed to the more macro-level process under the pre-2008 provisions of sorting out the Illinois customer loans from the non-Illinois customer loans. Likewise, each service transaction will require analysis with due regard being given to the identity and geographic footprint of the service customer.

Potentially, the most daunting of all are the prescribed sourcing tests for receipts from investment and trading activities. At least some bank taxpayers will have substantive contacts<sup>11</sup> for their investment or trading assets or activities with fixed places of business in Illinois and in other states. This will trigger the need to determine where the preponderance of the contacts related to each asset or activity exists and the amount of gross receipts related to each asset or activity.

### Single Factor With Multiple Elements

The new apportionment formula for banks and financial organizations, as with its predecessors since

<sup>11</sup> IITA §304(c)(3)(viii)(2)(D). Under this provision, proper assignment of the gross receipts from an investment or trading asset or activity is to a particular fixed place of business if that fixed place of business has the preponderance of substantive contacts with that asset or activity.

1969, continues to be comprised of a single apportionment factor. However, this superficial appearance of simplicity is belied by the fact that the typical bank taxpayer is likely to have several different types of revenue streams, and what the new statute does is to prescribe in considerable detail separate tests for treatment of these various revenue streams in the denominator and numerator of the apportionment factor.

To quantify how many separate aspects there might be to the sourcing analysis, consider that there are eight numerator sourcing provisions in the new statute, and five of them are compound in that they deal with multiple transaction categories related to loans, credit card accounts, and investment and trading assets and activities.<sup>12</sup> Accordingly, for any particular bank or financial organization taxpayer, there can easily be 12 or more categories into which gross receipts must be sorted in order to align with the statutory rules for determining whether particular gross receipts are or are not in the Illinois numerator or perhaps excluded from the denominator under an application of the throwout rule.

An additional complexity in the new apportionment statute is that it prescribes for denominator purposes a mix of gross receipt items on the one hand and what might be characterized as gross income items on the other. Gross receipt items in the denominator include all interest on customer loans, all interest on credit cards, and all receipts from the performance of services. However, on certain types of investment transactions, such as federal funds transactions, the only amount that goes to the denominator is *the excess* of interest received on federal funds sold over interest paid on federal funds purchased. The same netting of revenue-generating transactions against expense- or loss-generating transactions is prescribed for trading activities.

The provisions under discussion in this article, while new to Illinois, were not all the original work of Illinois tax policy writers. In this regard, the reader should be aware of the Multistate Tax Commission's "Recommended Formula for the Apportionment and Allocation of Net Income of Financial Institutions." The MTC Recommended Formula was adopted by the Multistate Tax Commission in 1994. It prescribes a property, payroll, and receipts factor for financial institutions, leaving it entirely to each state to define which type of organization would be subject to those apportionment and allocation provisions for purposes of the state's own taxes. The receipts factor of the MTC Recommended Formula includes specific sourcing rules for receipts from loans, services, credit cards, investment and trading, and leasing. The sourcing rules within the new Illinois provisions are in some respects similar to certain aspects of the receipts provisions of the MTC Recommended Formula. However, it is probably fair to conclude that there are more important differences than there are similarities. In any event, this article is not intended to be a comparative study of the new Illinois provisions and

<sup>12</sup> IITA §304(c)(3)(i) through (viii). Note that clauses (i) through (viii) are said to be illustrative of the application of a general rule that the numerator should include "gross receipts from sources in this State or otherwise attributable to this State's marketplace."

provisions in other jurisdictions or the provisions of the MTC Recommended Formula.<sup>13</sup>

## OUT WITH THE OLD

### Loss of Two Tax Advantages

Looking at the new apportionment provisions from taxpayers' partisan point of view, taxpayers lost two very significant tax advantages that were built in to the pre-2008 apportionment rules. These are the so-called "lock-box rule" and the related preferential treatment of interest and dividends from investment activity.

The lock-box rule had the effect of minimizing the amount of interest from loans of all types that a bank or other financial organization would have to include in the numerator of the Illinois apportionment factor. The rule had its foundation in IITA §304(c)(1)(C), which sourced interest to the numerator of the Illinois financial organization apportionment formula only if the interest was "from Illinois customers. . . received within this State." Over the years since this statutory sourcing provision was first enacted,<sup>14</sup> the concept of what constituted "receiving interest" came to be understood very narrowly as referring to the place where the payment first came within the taxpayer's control, even if the taxpayer did no processing whatsoever of the payment at that location.<sup>15</sup> Hence, the establishment of a lock box outside Illinois to which loan payments could be made would suffice to keep the interest out of the Illinois numerator, even if the payor was an Illinois customer. In addition, if the interest payment was made by a customer from another state, as opposed to an Illinois customer, the interest would not be included in the numerator, even if it was received in Illinois.

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**Two very advantageous sourcing provisions that had been available to banks and financial organizations under the pre-2008 statute are now no longer available.**

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Moreover—and here is where the preferential treatment of investment income developed—there was no provision that affirmatively called for the sourcing to the Illinois numerator of interest, unless the interest was from an Illinois customer. Therefore, interest from a bond or other investment security could not be

<sup>13</sup> Illinois was formerly a member of the MTC. However the state withdrew from membership in 1975. In more recent years, Illinois has been an "associate" nonvoting member.

<sup>14</sup> The language sourcing to Illinois only interest received in the state from an Illinois customer was first enacted into the statute by Ill. P.A. 87-478, effective for taxable years ending after Dec. 31, 1991.

<sup>15</sup> The Department of Revenue's acceptance of the "lock-box" rule became very clear with the promulgation in June 2002 of its regulation discussing the lock-box rule and other aspects of financial organization apportionment. Ill. Admin. Code tit. 86, §100.3400(c)(3)

sourced to the Illinois numerator.<sup>16</sup> As for dividends from investment securities, while their sourcing did not depend on the identification of the payor with Illinois, as in the case of “an Illinois customer,” they were only sourced to the numerator if received in Illinois, again understood to be a very narrow mechanical concept of receipt.

The overall effect of these pre-2008 provisions was to create the potential for placing large pools of bank and financial organization receipts beyond the reach of Illinois’ numerator sourcing test, even though these receipts were fully included in the denominator of the factor.

While there are some uncertainties as to how the new apportionment provisions will operate in various situations, it is clear that these two very advantageous sourcing provisions that had been available to banks and financial organizations under the pre-2008 statute are now no longer available.

## IN WITH THE NEW

### Customer, Transaction Specific Rules

#### *Consumer and Commercial Loans*

The new sourcing provisions do not look generally at whether the borrower is an Illinois customer or where the payment of interest on a loan is received. Instead, the new sourcing provisions categorize loans as either “commercial” or “consumer” and as “secured” or “unsecured” and set out the sourcing rules separately for the different categories.

Interest on a commercial or consumer loan that is secured by real or tangible personal property is sourced to Illinois if the collateral is located in Illinois. If the collateral is located outside the state, the interest is excluded from the Illinois numerator.<sup>17</sup> This is a very straightforward rule on its face, easy to understand and easy (enough) to apply, as long as the collateral is stationary.<sup>18</sup>

Interest on an unsecured consumer loan is sourced to Illinois if the borrower is resident in Illinois.<sup>19</sup> By definition, the concept of “resident” in Illinois income tax law does not apply to business entities, whether corporations or partnerships, but only to individuals,

<sup>16</sup> Ill. Admin. Code tit. 86, § 100.3400(c)(3).

<sup>17</sup> IITA § 304(c)(3)(ii).

<sup>18</sup> The statute does not specify how to handle the sourcing of interest on a secured commercial or consumer loan for which the collateral is tangible personal property that is mobile in nature and sometimes in Illinois and sometimes outside Illinois. There are provisions in the current draft regulations of the Department of Revenue that would simplify the determination of where property is located based on where its title is registered, or, for nontitled property, based on where the borrower is resident or has its commercial domicile. If these regulations are finally promulgated, they would appear to obviate the need for dealing with property that is mobile and sometimes in Illinois and sometimes outside the state. This draft regulation has been designated by the department as Ill. Admin. Code tit. 86, § 100.3405(c)(2).

<sup>19</sup> IITA § 304(c)(3)(iii).

trusts, and estates.<sup>20</sup> Therefore, the concept of the “consumer” loan would almost always in practice involve a loan to a household unit. There could occasionally be situations in which borrowers on consumer loans will have addresses outside Illinois, which they provide to their banks and so ostensibly appear not to be Illinois residents, though closer examination of all of their relevant facts will show they are actually Illinois residents, and vice versa. Presumably, such second home situations are not likely to be material items that would create significant issues on audit with respect to the computation of any bank’s Illinois apportionment percentage.<sup>21</sup>

There is a laddered sourcing provision for interest on unsecured commercial loans.<sup>22</sup> On the first rung of the ladder, the interest on these loans is sourced to Illinois if the proceeds of the loan are applied in Illinois. If the proceeds are applied elsewhere, then the interest is excluded from the numerator. The second rung of the ladder deals with those unsecured commercial loans as to which it “cannot be determined” where the proceeds are applied by the borrower. The test on this rung is to source the interest to the state where the borrower’s office is located from which the loan was negotiated “in the regular course of business” of the borrower.<sup>23</sup> Finally, if neither the state where proceeds were applied nor the state where the borrower’s office is located from which the loan was negotiated can be determined, the statute excludes the interest from the denominator, that is, the throwout rule would be applied.

#### *Credit Card Receipts*

Interest on a credit-card loan is sourced to the Illinois numerator if the interest is regularly billed to a customer in Illinois.<sup>24</sup> The fact that payments are made to a lock box outside the state does not avoid this inclusion in the numerator. In practical application, while the credit-card rule is worded somewhat differently than the rule for unsecured consumer loans, which are

<sup>20</sup> The statutory definition of “resident” is found at IITA § 1501(a)(20).

<sup>21</sup> There are provisions in the current draft regulations of the Department of Revenue that would deal with this problem. These provisions indicate that a person’s billing address shall be deemed to be the person’s residence or commercial domicile, as the case may be, unless the financial organization has actual knowledge to the contrary. This draft regulation has been designated by the department as Ill. Admin. Code tit. 86, § 100.3405(b)(3).

<sup>22</sup> IITA § 304(c)(3)(iv).

<sup>23</sup> Like many statutory apportionment provisions, this one is not worded in quite such an even-handed manner as the text suggests. The language of the provision requires that if it cannot be determined where the loan proceeds are applied by the borrower, then the interest will be sourced to Illinois by the taxpayer bank or financial organization if the borrower’s office from which the loan was negotiated in the regular course of business was located in Illinois. The author believes that such provisions in apportionment statutes generally have to be read as implying that if the sourcing condition is satisfied in another state, then the taxpayer is entitled to exclude the receipt from the numerator of the apportionment factor. While state apportionment statutes often economize on words in this way, these statutes would make no sense and would probably not be constitutional if they were not read with the understanding described above.

<sup>24</sup> IITA § 304(c)(3)(v).

sourced based on residence of the borrower, the two rules do appear to grow out of the same market-based tax policy.

On the other hand, while market-based sourcing appears to be the operative tax policy for interest received from credit-card borrowers, there is a departure from market sourcing in the case of merchant-discount income that a bank might realize from this same credit-card business. A market approach to merchant-discount income would seem to focus on comparing discounts from the merchant population in Illinois to discounts from the merchant population everywhere else. In fact, under the new apportionment provisions, merchant-discount income is sourced not where the merchant is located, but rather where the credit-card customer is billed whose purchases generated the discount.<sup>25</sup> This will necessitate delivery of data to the tax-return preparation process that has not previously been required for Illinois purposes—namely, merchant-discount data by credit-card holder.

The change in the credit-card sourcing rules will clearly create higher liabilities for banks that are established Illinois income taxpayers and that will no longer have the right to exclude from their numerators credit-card interest received outside Illinois from Illinois customers. It may also create significant potential exposure for banks that have credit-card customers in Illinois, but believed in the past that they had no Illinois apportionment factors attributable to their credit-card activities. Banks in this latter category may need to re-examine whether they have nexus with Illinois and the effect of the credit-card receipts on their apportionment.<sup>26</sup>

### Service Receipts

The new bank and financial organization apportionment statute provides generally that receipts from services should be included or excluded from the numerator based on a determination of where the service was received.<sup>27</sup> This is completely different from the

income-producing activity and cost-of-performance criteria under the pre-2008 apportionment provisions.<sup>28</sup>

In business-to-business situations in which the service is being provided to a customer that is a corporation or partnership, the statute further provides that the receipt can only be sourced to a state in which the customer has a fixed place of business. In addition, if the state where the service is received is “not readily determinable” or the customer does not have a fixed place of business in that state, then the ladder of sourcing rules looks next at the state in which the customer’s office is located from which the service was ordered and, if that cannot be determined, then at the state in which the customer’s office is located to which the service is billed. Finally, whichever of the above three sourcing rules is ultimately satisfied, the sourcing will be overridden, and the gross receipt in question will be removed from the denominator (thrown out) if the taxpayer bank is not taxable in that particular state.<sup>29</sup> Many examples could be given to illustrate the various ways in which this provision operates. The following is one:

*Facts.* Bank A provides financial advisory services to a number of large business customers. One of those customers is Corp B. These services are performed by Bank A’s employees in Illinois, but the financial services relate in a broad and undifferentiated way to Corp B’s entire multistate business and not in any way that is specific to any particular geographic location. In Corp B’s case, the order for the services came from Corp B’s headquarters in Florida. Bank A does not have nexus in Florida and does not have to become taxable in Florida in order to perform its contract for Corp B.

*Apportionment Factor Treatment.* This gross receipt is going to be excluded from both the numerator and the denominator of Bank A’s Illinois apportionment factor.

*Rationale.* What constitutes receiving the service is not elaborated upon in the new statute. After a more in-depth analysis, it may be concluded in the circumstances described above that Corp B actually received the service of Bank A in Florida, its headquarters state. More likely, it would be concluded that because of the geographic scope of Corp B’s business and the nongeographically specific nature of the services of Bank A, it is “not readily determinable” where the service was received. Therefore, on that basis the location in Florida of the office from which Corp B made the order should control. In either event, since Corp B does clearly have a fixed place of business in Florida, the receipt would be sourced by Bank A to Florida for Illinois apportionment pur-

<sup>25</sup> IITA §304(c)(3)(v).

<sup>26</sup> The author is not offering any opinion in this article as to whether the U.S. Supreme Court ultimately will hold that the dormant Commerce Clause of the U.S. Constitution requires that a corporation be physically present in the state before income tax nexus can be asserted. The author recognizes that some corporations do take that position. There have been divergent holdings among state courts of last resort that have been called upon to decide the question. A decision favorable to the taxpayer point of view on this question is *J.C. Penney National Bank v. Johnson*, 19 S.W.3d 831 (Tenn. Ct. App. 1999). There is no reported case in the Illinois courts on the question of whether physical presence is required for income tax nexus. If the constitutional law issue happens to be definitively resolved by a U.S. Supreme Court opinion that accepts the view of most state tax administrators—that physical presence by the corporation is not required for income tax nexus—then there could be a more significant Illinois income tax liability for a bank under the new credit-card income sourcing provision and under some of the new loan interest provisions than there was under the pre-2008 sourcing provisions.

<sup>27</sup> IITA §§304(c)(3)(vi) and 304(a)(3)(C-5)(iv). It should be noted that the new bank and financial organization apportionment statute provides that the service-receipt sourcing rule for banks and financial organizations is to be the same sourcing rule that is specified for service receipts in the more generally applicable sales factor.

<sup>28</sup> Ill. Admin. Code tit. 86, §§100.3400(c)(1) and 100.3400(c)(5).

<sup>29</sup> The author is not offering any opinion in this article regarding whether the throwout rule might ultimately be held to violate the Commerce Clause of the U.S. Constitution, either facially or as applied in particular circumstances. The author does recognize that there are tax professionals who believe that the throwout rule is subject to attack on U.S. constitutional law grounds. Reference would be had in this regard to the position recently argued unsuccessfully in the New Jersey Tax Court on behalf of the taxpayer. *Pfizer Inc. v. New Jersey Director, Div. of Taxn.*, 24 N.J. Tax 116 (May 29, 2008), appeal granted, remanded to the Appellate Division, 196 N.J. 590 (Oct. 30, 2008).

poses, *except that Bank A is not taxable in Florida*. Since Florida on these facts satisfies the sourcing criteria, but Bank A is not taxable in the state, the gross receipt from this service transaction with Corp B would be removed from the denominator of Bank A's Illinois apportionment factor.

It should be noted that if there were income recognized by Bank A under this contract in 2007, the apportionment statute applicable to 2007 would have generated a very different result in that year than what is discussed above. On these facts the entire service receipt from the Corp B contract would have been included in the numerator of the Illinois apportionment factor in 2007. This would have been based on the fact that more than fifty percent of Bank A's income-producing activity and cost of performance in connection to the contract was in Illinois.<sup>30</sup>

It should also be noted that if the contract were entered into in 2007 for a two year period – 2007 and 2008 – then the very same transaction would have generated different apportionment factor results for Bank A in 2007 and 2008, as there is no grandfathering concept at work as to the choice of apportionment provisions.

### **Sourcing for Investment Assets, Activities**

Under the pre-2008 statute, interest from investment activities was included in the Illinois apportionment factor denominator, but was generally beyond inclusion in the Illinois numerator. This resulted in a built-in reduction of the apportionment factor. Dividends were also included in the denominator, but were only included in the numerator if the taxpayer arranged to actually receive them in Illinois from the dividend-paying company. By contrast, the new apportionment provisions prescribe a detailed series of tests that appear to have been designed to put every dollar of investment interest and dividends either in the Illinois numerator or hypothetically, from an Illinois apportionment viewpoint, in some other state's numerator. These are arguably the most complicated of the new bank and financial organization apportionment provisions.

The operative rule for sourcing receipts from investment assets and activity under the new statute is to determine whether the asset or activity is “properly assigned to a fixed place of business of the taxpayer within . . .” Illinois or to a fixed place of business of the taxpayer outside Illinois.<sup>31</sup> In turn, identifying the particular fixed place of business to which the activity or asset is properly assigned requires a determination of which fixed place of business has the “preponderance of substantive contacts” with the asset or activity.<sup>32</sup> There is a presumption in the new statute that can be invoked by a taxpayer in support of its assignment of an

investment or trading activity outside Illinois. The presumption is operative if the assignment of a particular investment or trading asset or activity outside Illinois is consistent with how the item was reported for federal or state regulatory purposes and consistent with how it was reported on state and local tax returns.<sup>33</sup> If the fixed place of business with the preponderance of substantive contacts to a particular investment or trading receipt cannot be determined, then that particular receipt is included in the Illinois numerator or excluded from the Illinois numerator based on taxpayer's commercial domicile.<sup>34</sup> For this purpose, the commercial domicile is presumed, subject to rebuttal, to be where the greatest number of the taxpayer's employees is regularly connected with the management of the investment or trading income.<sup>35</sup>

Under the heading “receipts from investment assets and activities and trading assets and activities,” the statute defines three pools for the denominator of the apportionment factor.

- One pool is interest received, dividends received, and gains from trading assets and activities *to the extent that those amounts exceed* the amounts paid in lieu of interest, the amounts paid in lieu of dividends, and the losses from such trading assets and activities.<sup>36</sup>

- A second pool is interest on federal funds sold and securities purchased subject to resale agreements *to the extent that those amounts exceed* the amounts of interest paid on federal funds purchased and on securities sold subject to re-purchase.<sup>37</sup>

- The third pool is a simple gross income pool of interest, dividends, net gains, and other income from investment assets and activities in the investment account (exclusive of federal funds transactions and re-purchase/re-sale agreement transactions).<sup>38</sup>

In computing the denominator of the financial organization apportionment formula, these three investment and trading pools are added to the loan receipt and credit-card receipt pools discussed above and to the various other denominator pools discussed below; for example, for rental and lease receipts.

Each of the three investment and trading pools is separately analyzed to determine a related entry for the numerator. The need for this separate analysis of the three investment and trading pools arises from the fact that while it is the gross trading receipts and gross receipts from federal funds transactions and gross receipts from security resale agreements that are attributed to a source, it is a net measure of federal funds income, trading income, and security resale agreement income that is included in the denominator of the apportionment factor. This subtle, but potentially signifi-

<sup>33</sup> *Id.*

<sup>34</sup> IITA § 304(c)(3)(viii)(2)(E).

<sup>35</sup> This presumption about the meaning of “commercial domicile” is stated in IITA § 304(c)(3)(viii)(2)(E). This is a much narrower meaning than that term otherwise has for Illinois income tax purposes. The term “commercial domicile” is actually defined in IITA § 1501(a)(2) as having a meaning that is focused on the entire executive function of a taxpayer's enterprise. That is clearly not the same as this special definition of “commercial domicile” that is central to the sourcing analysis required by the new law for each gross receipt generated by an investment or trading activity or asset.

<sup>36</sup> IITA § 304(c)(3)(viii)(1)(B).

<sup>37</sup> IITA § 304(c)(3)(viii)(1)(A).

<sup>38</sup> IITA § 304(c)(3)(viii)(1).

<sup>30</sup> IITA § 304(c)(1)(A) for financial services as elaborated upon by Illinois Department of Revenue regulation Ill. Admin. Code tit. 86, § 100.3400(c)(1) or IITA § 304(c)(1)(E) for other operation as a financial organization as elaborated upon by regulation Ill. Admin. Code § 100.3400(c)(5). Either set of provisions leads to the same income-producing activity and cost-of-performance sourcing rule.

<sup>31</sup> IITA § 304(c)(3)(viii)(2)(A), (B), (C).

<sup>32</sup> IITA § 304(c)(3)(viii)(2)(D).

cant concept is best illustrated by an example that focuses on a bank taxpayer that, for simplicity, has only one of these three types of transactions.

*Facts.* Bank C has been both a seller and a purchaser of federal funds at various times during the year. Overall, its gross amount of interest received from federal funds sold is \$300 million. This results from 30 different transactions each of which generated exactly \$10 million of interest receipts. Eighteen of these transactions had the preponderance of their substantive contacts at a fixed place of business outside Illinois and the other 12 had the preponderance of their substantive contacts at a fixed place of business inside Illinois. In addition to the federal funds sold transactions described above, Bank C also had transactions in which it purchased federal funds and incurred interest expense of \$200 million.

*Apportionment Factor Treatment.* Bank C would include \$100 million in the denominator of the apportionment factor and \$40 million in the numerator.

*Rationale.* The interest expense from federal funds purchased is netted out of the interest income from federal funds sold to compute the denominator element of the apportionment factor. The numerator element is then computed as a fraction of the denominator element. That fraction is defined as the gross interest received from federal funds (sold) transactions that have a preponderance of substantive contacts at fixed places of business in Illinois as a fraction of total gross interest received from federal funds (sold) transactions.

It is irrelevant which fixed places of business of Bank C had the preponderance of substantive contacts with the federal funds purchased transactions giving rise to the \$200 million interest expense.

### ***Sourcing for Lease or Rental Receipts***

Receipts from lease or rental of real or tangible personal property are sourced to Illinois, if the property is located in Illinois during the rental period, and excluded from the Illinois numerator, if the property is located outside the state during that period.<sup>39</sup> This is analogous to the test that is prescribed for interest on secured consumer or commercial loans. However, unlike the statutory sourcing provision for interest on secured consumer or commercial loans, this provision for receipts from lease or rental of tangible personal or real property actually has a specific clause that deals with mobile property. The receipts from “characteristically moving property” are sourced to Illinois “to the extent” that the property is used in this state. This requirement obviously necessitates detailed data sharing between the bank lessor and the customer lessee concerning the movement of the leased property in and out of Illinois during the rental period. This result is actually the same as generated under pre-2008 bank and financial organization apportionment provisions as those provisions had been clarified by the Department of Revenue’s regulations.<sup>40</sup>

<sup>39</sup> IITA §304(c)(3)(i)

<sup>40</sup> IITA §304(c)(1)(A) or (E) tracking to the income-producing activity and cost of performance tests in Ill. Admin. Code tit. 86, §3400(c)(1) or §3400(c)(5) and from those regula-

### ***Travelers Checks and Money Orders***

The one specific service for which a sourcing rule is established in the new apportionment provisions is the issuance of travelers checks and money orders. The receipts from these transactions are sourced to the numerator, if the travelers checks or money orders are issued from locations in Illinois.<sup>41</sup>

## **PRACTICAL IMPLICATIONS OF THE NEW SOURCING PROVISIONS**

### **Increased Tax Liabilities and Exposures**

There are provisions in this new legislation that put upward pressure on the apportionment factor of almost every bank filing Illinois income tax returns. In turn, this creates upward pressure on the potential tax exposure of those banks that are in a taxable income situation and that have customers in Illinois but do not file Illinois returns. It will be rare for any taxpayer in an income situation to have a smaller liability under the new apportionment provisions than it had under the old pre-2008 provisions. The investment receipt dilution feature and the lock box feature of the old law have both been lost to taxpayers. There are few taxpayers that were not benefited by at least one of these provisions, and many were benefited by both. Of course, banks and financial organizations that are in net operating loss situations in 2008 and later years can potentially benefit from higher Illinois apportionment levels to create larger Illinois net losses for carryforward to later years as net loss deductions.<sup>42</sup>

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**Provisions in this new legislation put upward pressure on the apportionment factor of almost every bank filing Illinois income tax returns.**

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Banks with commercial domicile or headquarters type activities in Illinois, or with investment or trading offices in the state, will have to deal with the prospect of investment receipts coming into the numerator of their apportionment factors. All banks, regardless of where they have commercial domicile or headquarters type activities, will have to deal with the prospect of loan interest and credit-card income, including interest and merchant discount, being sourced to Illinois based on criteria that are inherent in their respective customer and client bases. Depending upon the type of borrow-

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tions to Ill. Admin. Code tit. 86, §100.3370(c)(3)(D)(ii). That regulation reads into the income-producing activity and cost-of-performance test the ratio analysis for time that rented property is in Illinois versus time outside Illinois.

<sup>41</sup> IITA §304(c)(3)(vii).

<sup>42</sup> IITA §207 allows carryforward deductions of Illinois net losses for 12 years for losses incurred in calendar 2003 and later years. Carryback deductions are not allowed for losses incurred in calendar 2003 and later years. For net losses in years prior to calendar 2003, there were different carryforward and carryback periods under IITA §207.



ing, these sourcing criteria include location of collateral in the state, resident status of the borrower in the state, billing address of the card holder in the state, and use of the proceeds of the commercial loan in the state.

On service receipts, it is possible that repeal of the income-producing activity and cost-of-performance sourcing criteria could in some instances reduce the apportionment factor numerator for certain taxpayers providing services from Illinois service bureau operations to business customers in other states. However, the presence of the throwout rule could largely neutralize some of these potential apportionment gains.

## **Increased Planning, Compliance Requirements**

### ***More Apportionment Data to Be Gathered, Retained***

Taxpayers dealing with the new apportionment provisions will have to make significant adjustments in the database of information that they gather and retain to enable them to do the sourcing analyses. More than under the pre-2008 provisions, this will necessitate the establishment of procedures that marshal and organize data as transactions are occurring, particularly with respect to loans and service transactions. This data base of apportionment information will have to include characteristics of the transactions and characteristics of the customers that may or may not already be captured in the taxpayer's business records, but that almost certainly are not currently organized in a file that is designed for access and use by the tax function. To illustrate, the range of information that might have to be gathered could include any or all of the following items:

- where the customer's office was located from which services were ordered or unsecured commercial loans were negotiated;
- where the customer's office is located to which billing is made for particular services;
- whether a particular service is geographically specific to a particular state in terms of the customer's business and if so, to which state;
- whether the customer has a fixed place of business in particular states where they might be regarded as "receiving" specific services;
- which investment and trading assets and activities on a transaction-by-transaction basis generated interest, dividends, gains, and other income and at which of taxpayer's fixed places of business; and
- how much merchant fee income from around the world is associated with credit cards issued to customers with Illinois billing addresses.

Taxpayers with investment or trading offices, commercial domicile, or headquarters type operations in Illinois are going to have to consider certain threshold questions in designing their data-gathering procedures in response to the new Illinois apportionment provisions for investment and trading activities and assets. For example:

- To what degree will the preponderance of substantive contacts for any particular investment or trading transaction be centralized at one location along with the substantive contacts that support all other investment or trading transactions?
- Is that centralized location in Illinois or elsewhere?

■ If not centralized at one location, then how many such locations are there?

■ What will the procedures be and who will be responsible for coding the specific investment and trading transactions to reflect where the preponderance of substantive contacts exists for each transaction?

With respect to the last question above, the special problem at the time this article is being written is that there is no definition of "substantive contacts" in the new statute.<sup>43</sup> Therefore, data gathering at this time may have to focus on what the taxpayer concludes is likely to be considered as substantive contacts. This leaves open the possibility that the analysis of sourcing issues later in the compliance cycle when the return is being filed (October 2009, for example) may take a different direction. In other words, any coding in the data-gathering process as to where the preponderance of substantive contacts exists for a particular transaction may have to be treated as tentative and preliminary.

### ***More Detailed Transaction-by-Transaction Analysis Will Be Needed***

A daunting level of micro-analysis at the customer level and at the transaction level is going to be required to satisfy the new sourcing rules by comparison to the macro-analysis that sufficed under the pre-2008 apportionment rules. Three specific examples illustrate this point.

For contract service businesses, under the pre-2008 apportionment provision, a bank could simply review where its back room staff employees and equipment were located to provide the service. That information would often answer the income-producing activity and cost-of-performance test for all customers for whom that particular service was contracted. For service bureau type contracts, very little information that was specific to the customer or the transaction was required. This is definitely not the case for those same service receipts under the new apportionment rules. For example:

- Is it possible to conclude where the customer received the service? If so where is that?
- From which of the customer's offices was the service ordered?
- To which of the customer's offices is the service billed?
- Does the customer have a fixed place of business in the state in which it receives the service?
- Is the taxpayer taxable in the states to which the service receipt would be sourced under the above ladder?

For commercial and consumer loans, whether secured or unsecured, under the pre-2008 apportionment provisions, all that was required was to sort out from the whole universe of loans those that were made to Il-

<sup>43</sup> There are provisions in the current draft regulations of the Department of Revenue that would define "substantive contacts" for purposes of the apportionment sourcing provisions related to investment and trading assets and activities. The elements of substantive contacts, according to the draft regulations, would include research, approval, and administration. This draft regulation has been designated by the department as Ill. Admin. Code tit. 86, §100.3405(b)(4).

Illinois customers<sup>44</sup> and then to sort out from that group those for which payments were received in Illinois. Under the new statute, more details are required regarding the transaction and the customer, including whether the loan is secured or unsecured, commercial or consumer, if commercial and unsecured where the proceeds are applied by the borrower, and, if secured, where the collateral is located.

As discussed earlier, the need to analyze Illinois sourcing issues for investment and trading activity may at some time in the future be completely obviated by the development and implementation of a comprehensive data-gathering process. However, that data-gathering process will have to be extensive. This can only happen if the content of the term “substantive contacts” is sufficiently and definitively clarified.

### **Audit Issues Will Increase**

There are many more potential audit issues that taxpayers can expect the Department of Revenue to raise under the new apportionment provisions than under the old pre-2008 provisions. These could be extremely fact- and data-intensive and could focus on specific transactions and specific customers or borrowers. In this fact-intensive environment, taxpayers, as well as current nonfilers that could be pursued as taxpayers on audit, would obviously be well advised to go through the intellectual process of self audit on these potential issues.

The Illinois income tax return form, as applicable to banks and financial organizations, has been extremely summary on apportionment in the past, asking only for the numerator and the denominator of the apportionment factor. Assuming that the form will not change for 2008, it would of course be prudent at a minimum for taxpayers to go through the exercise of reviewing how the detailed schedules for denominator and numerator elements have been constructed to document the various revenue streams discussed in this article and other revenue streams as well.

It may be tempting for taxpayers in some situations to see the phrase that is used several times in the new apportionment provisions—“cannot be determined,”<sup>45</sup> or the phrase, “not readily determinable”<sup>46</sup>—as providing a way around having to do laborious and time-consuming data gathering and sourcing analysis. If the next rung on the ladder is one that generates a favorable sourcing outcome for the taxpayer, the taxpayer in self-audit mode should be cautious. How likely is it that the department will be inclined to accept that favorable outcome? What counter argument might the department interject as an alternative to permitting the taxpayer to move, to the taxpayer’s advantage, up the sourcing ladder?

<sup>44</sup> “Illinois customer” is defined in Ill. Admin. Code tit. 86, §3400(b)(5) as a customer who is resident of Illinois (this would be pertinent to individuals, trusts, and estates) and as a customer that has commercial domicile in Illinois (this would be pertinent to a corporation or partnership).

<sup>45</sup> IITA §304(c)(3)(iv), related to sourcing for unsecured commercial loans; IITA §304(c)(3)(viii)(2)(E), related to sourcing gross receipts from investment or trading activities or assets; and IITA §304(a)(3)(C-5)(iv), related to sourcing of service receipts.

<sup>46</sup> IITA §304(c-5)(iv).

In the self audit, defensive thinking is of paramount importance concerning what direction the department’s audit might take in opposition to the return as filed. In this connection, the taxpayer should determine which revenue streams are going to be the most significant contributors to its overall apportionment as reported, as well as which revenue streams have the greatest potential to trigger an increase in the apportionment factor if the revenue stream were taken in its entirety into the numerator or if the revenue stream were excluded in its entirety from the denominator. Because of the throwout provisions potentially operating on the denominator, it can be a big mistake to focus the self audit exclusively on the numerator sourcing tests, as demonstrated by the example below:

*Facts.* Bank D is headquartered in State X, but also has offices in Illinois and credit card customers that have Illinois billing addresses. Bank D files Illinois income tax returns. Bank D does not have nexus in any states other than State X and Illinois.

Bank D does provide financial advisory services under contract to business customers located around the country. These are services that are provided by Bank D from its State X headquarters. Bank D has one such service contract in particular that it is analyzing for Illinois apportionment purposes for calendar year 2008. Under this contract, Customer T, a corporation, is headquartered in State Y, but it has fixed places of business in four other states as well. These are States Q, R, S, and Z. Customer T’s order to Bank D for the financial advisory services was from Customer T’s procurement office in State Z, and the billing from Bank D to Customer T for the service was also made to that same office in State Z. To repeat, Bank D is not taxable in States Q, R, S, Y, or Z.

*Apportionment Factor Treatment.* On its Illinois return for calendar year 2008, Bank D should include in the numerator of the apportionment factor the credit-card interest received from the cardholders who have Illinois addresses and all of the merchant discount received on those same cards, regardless of where the merchants are located. Bank D should exclude from the denominator the gross amount of the fee for services received from Customer T.

*Rationale.* The inclusion in the numerator of the credit-card interest from cardholders with Illinois billing addresses as well as merchant discount received on those cards is a straightforward application of credit card sourcing provision of IITA §304(c)(3)(v).

The exclusion from the denominator of the Customer T service fee results from an application of the throwout rule. The throwout rule is an element of the new sourcing provision for gross receipts from services under IITA §304(a)(3)(C-5). For Illinois income tax purposes, the service receipt sourcing provision requires that a laddered set of sourcing criteria must be applied to the particular service transaction until a state is identified, either Illinois or some other state, to which the service receipt would be sourced. At that point in the analysis, if the state to which the service receipt would be sourced is not Illinois, the additional question must be addressed whether the taxpayer (Bank D in this case) is jurisdictionally sub-

ject to tax in that other state. If the taxpayer is jurisdictionally subject to tax, then the taxpayer has the benefit of the dilution of its apportionment factor for Illinois income tax purposes in that the receipt is included in the denominator, but not in the Illinois numerator.<sup>47</sup> On the other hand, if the taxpayer is not jurisdictionally subject to tax in the other state, then the throwout rule requires that the service receipt would be excluded from the denominator of the apportionment factor for Illinois income tax purposes.<sup>48</sup>

In the present example, there are two possible analyses that could be asserted under the new service-receipt sourcing statute, and either one would result in the application of the throwout rule. First, if the facts permit, it could be argued that the Customer T service fee is for services actually received by Customer T in States Q, R, S, Y, and Z and that the service fee should therefore be divided in some way and sourced to those states. Under this analysis, the throwout rule would apply, because Bank D is not jurisdictionally subject to tax in any of those five states.

The second possibility is an argument that it is not “readily determinable” where the Customer T service fee is actually received by Bank D; this argument might be based on the notion that a service that benefits the customer’s business generally in multiple states does not fall into the “readily determinable” category. On this basis, the service fee would be sourced to the state from which Customer T made

the order for the service. This sourcing test would appear clearly to be satisfied as to State Z, where Customer T has its procurement office from which it ordered the service. Again, since Bank D is not jurisdictionally subject to income tax in State Z, the service fee would be excluded from the Bank D denominator (throwout rule) for Illinois income tax purposes.

Note the heavier Illinois income tax burden that falls on Bank D with respect to the Customer T service fee under the new apportionment provisions (excluded from both the numerator and the denominator, e.g., throwout) than under the old pre-2008 provisions (excluded from the numerator because income-producing activity and cost of performance is in State Y, but included in the denominator).

There should be similar attention given in the self-audit to throwout concerns for unsecured commercial loans.

In general, planning around the new apportionment provisions must be thought of as planning for audit defense. The taxpayer has to be aware of those rungs of the sourcing ladders on which it has the most precarious footing.

## CONCLUSION

The new bank and financial organization apportionment provisions dramatically alter the landscape for Illinois income taxation of this group of taxpayers. The effect will be seen both in the size of the liability that such taxpayers are likely to incur and in the compliance burden that they will now have to carry, including data gathering, sourcing analysis, and audit anticipation and preparation.

There are many questions that these new apportionment provisions invite, but that cannot be answered definitively at this time. Some of the answers will emerge in the future through observation of administrative practice by the Illinois Department of Revenue. Other answers will be developed more formally in regulations or judicial decisions or possibly in later remedial legislation. In the meantime, understanding what these questions are and the possible answers is likely to be an important aspect of the planning for this tax in the immediate future and for several years to come.

<sup>47</sup> Whether the receipt is actually included in the apportionment factor numerator on a return filed in the other state is a separate question that is resolved under the other state’s income tax apportionment law, not under Illinois law. An Illinois taxpayer can be jurisdictionally subject to tax (i.e., taxable) in another state for Illinois apportionment purposes, even if the other state does not impose a tax.

<sup>48</sup> In addition to defining taxability strictly in terms of contacts that would give a state the right to assert an income tax against the taxpayer, a long standing Department of Revenue regulation also provides that a taxpayer may not claim to be taxable for Illinois apportionment purposes, even if the taxpayer does have jurisdictional contacts, unless the taxpayer actually files the required returns and pays the indicated tax in the other state. Ill. Admin. Code tit. 86, §100.3200.

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