ILLINOIS STATE TAX DEVELOPMENTS
(Updated as of September 30, 2021)

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I. LEGISLATION

A. Public Act 102-0016, S.B. 2017, FY2022 Budget Implementation Bill (the Governor's tax "loophole" closing proposals) (eff. June 17, 2020).

A number of important tax changes are made under this public act, including, among other measures:

- Elimination of the phase-out of the Illinois franchise tax. The new law retains the phase-out of the first $1,000 of franchise tax liability, which became effective on January 1, 2021, but eliminates subsequent annual phase-outs, which would have repealed the franchise tax for all taxpayers by January 1, 2024.

- Limits the use of corporate net operating losses to $100,000 per year for any taxable year ending on or after December 31, 2021 and prior to December 31, 2024. If a corporate taxpayer is subject to the $100,000 NOL cap in a given year, that tax year will not be counted for purposes of Illinois' 12-year carryforward period in which NOLs must be used.

- Illinois previously conformed to the concept of global intangible low-taxed income (GILTI) as includible in taxable income, but allowed for a 100% deduction as a foreign dividend. Public Act 102-0016 requires C corporations to addback for taxable years ending on or after June 30, 2021 the 50% GILTI deduction (the deduction allowed under IRC Section 250(a)(1)(B)(i))), and an amount equal to the deduction allowed under IRC Section 243(e) (certain dividends received from foreign corporations), and IRC Section 245A (deduction for foreign source-portion of dividends received by domestic corporations from specified 10% owned foreign corporations).

- Modifies the foreign dividend subtraction to provide that for taxable years ending on or after June 30, 2021, "the term 'dividend' does not include any

amount treated as a dividend under Section 1248 of the Internal Revenue Code" (gain from certain sales or exchanges of stock in certain foreign corporations). *See* Illinois Department of Revenue Information Bulletin, FY 2021-27, June 2021 for the Department's summary of foreign dividend reporting changes for tax years ending on or after June 30, 2021

- Decouples from federal 100% bonus depreciation for tax years on or after December 31, 2021.

B. Public Act 102-0040, S.B. 2279, Changes Statute of Limitations for Deficiency Notices (eff. June. 25, 2021).

This act amends a number of Illinois tax acts to provide that if a taxpayer files a claim for refund or credit with less than 6 months left on the statute of limitation for the Department to issue an assessment (*e.g*., notice of deficiency, notice of tax liability, etc.), then the statute of limitation for issuing an assessment is automatically extended for 6 months from the date the statute of limitation would have otherwise expired.

C. Public Act 102-0634, S.B. 2066, General Clean Up Legislation (eff. Aug. 27, 2021).

This act, among other things, provides that:

- beginning January 1, 2020 and through December 31, 2020, sales of tangible personal property made by a marketplace seller over a marketplace for which tax is due but for which use tax has been collected and remitted to the Department of Revenue by a marketplace facilitator are exempt from Illinois Retailers' Occupation Tax (sales tax).
- the term "marketplace facilitator" does not include any person licensed under the Auction License Act. The exemption does not apply to any person who is an Internet auction listing service, as defined by the Auction License Act.
- certified service providers (CSP) filing returns on behalf of retailers may claim the retailers' discount of 1.75% with respect to those taxes paid to the state. A remote retailer using a CSP to file a return on its behalf, is not eligible for the discount.

D. Public Act 102-0288, S.B. 0338, Unclaimed Property Changes (eff. Aug. 6, 2021).

This act amends Illinois' unclaimed property laws to include "cryptocurrency" within the definition of "virtual currency." The act also provides that the period for reporting and delivering unclaimed virtual currency to the state is 5 years, and that the virtual currency must be liquidated by the holder before remitting the unclaimed proceeds to the state. The act further provides that the State Treasurer may, at reasonable times and upon reasonable notice: (1) examine the records of specified types of financial organizations under certain conditions; (2) issue an administrative

subpoena requiring the financial organization to make records available for examination; and (3) bring an action seeking judicial enforcement of the subpoena. Other changes to Illinois' unclaimed property laws include, in part, that the presumed abandonment period for money orders is now 5 (rather than 7) years after issuance, and that any instrument on which a financial organization or business association is directly liable, other than a money order, is presumed abandoned if it is unclaimed after 3 years after issuance.

E. Public Act 102-0658, S.B. 2531, SALT Cap Workaround (eff. Aug. 27, 2021).

This act, like similar acts passed by many other states this year, allows pass-through entities (partnerships and S corporations) to elect to pay income tax at the entity-level, and for their respective partners or members to claim a credit for the taxes paid by the pass-through entity. The intent is to allow individuals to deduct, for federal income tax purposes, the Illinois income taxes paid by the entity and therefore exceed the $10,000 SALT deduction cap. The entity-level tax applies for taxable years ending on or after December 31, 2021 and beginning prior to January 1, 2026. The act also provides that the entity-level tax shall be in an amount equal to 4.95% of the taxpayer's net income for the taxable year, and defines "net income." The past-through entity must make estimated payments if the estimated tax exceeds $500.

II. NOTEWORTHY NEW REGULATIONS / ADMINISTRATIVE GUIDANCE

A. Sales Tax (Remote Sellers & Marketplace Facilitators)—Ill. Admin. Code tit. 86, 131.101 et al.; 45 Ill. Reg. 931 (eff. Dec. 31, 2021).

These regulations implement the new requirements for remote retailers and marketplace facilitators, and explain the requirements for certified service providers and for the certified automated systems used by remote retailers pursuant to Public Acts 101-31 and 101-604. These two Public Acts provide, among other things, that as of January 1, 2021, state and local retailers' occupation taxes on sales made by remote retailers and marketplace facilitators on behalf of marketplace sellers are incurred based on the rate in effect at the location to which the tangible personal property is shipped or delivered or at which possession is taken by the purchaser ("destination sourcing"). State and local retailers' occupation taxes for a marketplace facilitator's own marketplace sales are incurred, depending on the nature of the transaction, either at the rate in effect at the location of Illinois inventory from which a sale is fulfilled or the Illinois location where selling activities otherwise occur ("origin sourcing"), or by using destination sourcing. The Department's regulation explains the sourcing rules for these different types of retailers.

B. EMERGENCY REGULATION: Retailers' Occupation Tax (Leveling the Playing Field), Ill. Admin. Code tit. 86, 131 *et al.*; 45 Ill. Reg. 9625 (eff. July 13, 2021).

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The Department filed emergency regulations to, among other things, amend the current regulations to provide that the Metropolitan Pier and Exposition Authority Retailers' Occupation Tax ("MPEA") and the Chicago Home Rule Municipal Soft Drink Tax ("Soft Drink Tax") are required to be collected and remitted by food delivery services that are considered marketplace facilitators meeting a tax remittance threshold. This amendment reverses provisions of Compliance Alert 2021-01 issued by the Department with regard to collection of these taxes. In connection with this change, provisions are added to emphasize that food delivery services that are considered marketplace facilitators under the Act must provide food service establishments with a certification that the food delivery service assumes the rights and duties of a retailer under the Retailers' Occupation Tax Act and all applicable local taxes administered by the Department for sales made by the food service establishment on the marketplace, and that it will remit all such taxes for such sales. The rules specify additional requirements for this certification, and clarify that food service establishments that have received this certification are generally relieved of liability for tax on such sales. Section 131.110 is being amended to provide that remote retailers exclusively making tax exempt sales (*i.e.*, 100% of their sales are nontaxable) are not subject to the provisions of the Act. In addition, Section 131.120 is being amended to specify that, for remote retailers, occasional sales are excluded from consideration when calculating tax remittance thresholds. However, Section 131.140, governing marketplace facilitators, is amended to provide that occasional sales must be included when calculating tax remittance thresholds. Throughout the regulations, provisions are being amended to specify that retailers incurring Retailers' Occupation Tax based on origin sourcing must consult the provisions of 86 Ill. Adm. Code 270.115 (c) and (d) to determine the location at which selling activities occur, and therefore, which local taxes will be incurred. Section 131.145 is being amended to clarify books and records requirements for marketplace facilitators, including the manner in which sales made by marketplace sellers that possess active exemption identification numbers ("E" numbers) must be documented.

NOTE: The Joint Committee on Administrative Rules (JCAR) suspended the Department's emergency regulation (86 Ill. Admin. Code 131; 45 Ill. reg. 9625), finding that there was insufficient basis for submitting the regulations as "emergency" regulations. *See* 45 Ill. Reg. 10883 (Sept. 3, 2021). On September 14, 2021, JCAR lifted its suspension based on the Department's agreement to make certain changes to its emergency rules.

REED SMITH OBSERVATIONS

For 2021, and subsequent tax years, Illinois has made a number of substantive changes to its income tax laws, including decoupling from 100% bonus depreciation, limiting Illinois NOLs, and modifying its treatment of the deduction for GILTI and other foreign dividend subtractions. As a result of these material changes to the Illinois Income Tax Act, it is a good time to review whether the proper members are in your Illinois unitary business group, how sales are being sourced to Illinois, and general apportionment to the state.

In regard to indirect taxes, with Illinois' migration to destination sourcing as of January 1, 2021, taxpayers should review their tax software to make sure they are applying destination tax rates if they are "remote retailers" (*i.e*., retailers with no physical nexus with Illinois beyond "*Wayfair*" economic nexus). The Department has indicated that a number of remote retailers have not changed their tax software to come into compliance with the state's sales and use tax laws. The Department is also actively auditing the "*Wayfair*" gap period, which is the period in which an online retailer had tax nexus with Illinois under the state's economic nexus thresholds (annual sales of $100,000 or 200 transactions) as of October 1, 2018, and the date the taxpayer actually registered and starting collecting Illinois sales and use tax. If you receive a *Wayfair* gap period audit notice from the Department, please reach out to your Reed Smith contact for assistance with these audits.

III. RECENT CASE LAW AND TAX TRIBUNAL DECISIONS

A. *State ex rel. Hurst v. Fanatics, Inc.,* 2021 IL App (1st) 192159, March 8, 2021.

In *Fanatics, Inc*. the court addressed whether an Illinois False Claims Act (740 ILCS 175/1 *et seq*.) (*qui tam*) action could be maintained by the plaintiffs-relators for the under-collection of Illinois sales tax on Internet sales shipped to Illinois customers, even though the Illinois Department of Revenue had initiated an audit of Fanatics, Inc. before the *qui tam* complaint was filed. The court denied the plaintiffs-relators claim for a portion of the sales tax collected by the Department during its audit, holding that the audit was not an "alternate remedy," which could have entitled the plaintiffs-relators to an award, but was rather an "original remedy," since the audit was initiated before the *qui tam* complaint was filed. Fanatics, Inc. also benefitted from voluntarily paying the audit liability during the audit and prior to the date the plaintiffs-relators' *qui tam* complaint was unsealed, and first made known to the public. (In Illinois, a *qui tam* complaint remains sealed from the public for at least 60 days to allow the state to investigate the alleged claim.)

B. *State ex rel. Thulis v. City of Chicago*, 2021 IL App (1st) 191675-U, March 31, 2021 (Rule 23 Order).

In *Thulis*, the court addressed whether an Illinois False Claim Act *qui tam* action could be maintained against the City of Chicago under the state's unclaimed property laws for the City's alleged failure to comply with the state's unclaimed property laws. The plaintiffs-relators alleged that the City had failed to turnover more than 22,000 uncashed checks with a total value in excess of $11 million. The state filed a motion to dismiss the plaintiffs-relators' *qui tam* complaint under its prosecutorial authority (740 ILCS 175/4(c)(2)(A)), which was granted by the circuit court. The appellate court affirmed the circuit court's decision dismissing the plaintiffs-relators' case, holding that the state had almost unfettered authority to dismiss plaintiffs-relators' *qui tam* compliant under the state's broad prosecutorial authority. Thus, according to the court, barring glaring evidence of bad faith or fraud on behalf of the state, it is the state's (acting through the Attorney General) decision to dismiss or otherwise pursue a *qui tam* action.

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C. *Texas Capitalization Resource Group. v. Ill. Dep't of Rev.,* No. 20 TT 93 (Ill. Indp. Tax Trib. July 6, 2021 (ALJ, Barov).

In *Texas Capitalization,* the Department audited and issued an assessment against Texas Capitalization Resource Group ("TCRG") for use of an aircraft purchased and owned by TCRG's subsidiary, a disregarded LLC. TCRG filed a petition challenging the assessment, claiming that the Department assessed the wrong entity. While this issue was pending, the Department issued a notice of proposed tax liability for use tax on the aircraft to the subsidiary. As a result of this proposed notice issued to the subsidiary, TCRG filed a motion for summary judgment arguing the assessment against TCRG was mooted by the Department's assessment issued to the correct entity.

In response to TCRG's motion for summary judgment, the Department argued that the taxpayer breached their "duty of consistency" and was therefore estopped from claiming that it was not the correct taxpayer. While the Tribunal recognized that the Department's position did not necessarily fall within the scope of "the duty of consistency" doctrine, because TCRG had not taken inconsistent positions in different tax periods, the Tribunal found the Department's equitable estoppel argument persuasive. Specifically, the Tribunal found that the Department provided enough facts to raise the issues of whether the taxpayer was improperly taking inconsistent positions regarding the aircraft's ownership and whether the Department reasonably relied on incorrect or incomplete representations by the taxpayer. To support their finding that the Department had sufficiently raised a quasi-estoppel argument, the Tribunal highlighted the fact that a representative from the subsidiary had originally responded to the TCRG's audit and that the tax return and stock exemption request filed by the subsidiary listed TCRG's FEIN. Accordingly, the Tribunal denied the taxpayer's motion for summary judgment and found that, based on the information provided, "it is not clear and free from doubt that [TCRG] can avoid possible use tax liability on the aircraft."

D. *PepsiCo Inc. & Affiliates v. Ill. Dep't of Rev.,* No. 16 TT 82 & 17 TT 16 (Ill. Indp. Tax Trib. May 4, 2021 (Chief ALJ, Conway).]

In *PepsiCo Inc.,* the Tax Tribunal addressed whether PepsiCo could exclude a member of its combined group, Frito-Lay North America Inc., by classifying it as an 80/20 company (*i.e.*, an entity that conducts 80% or more of its business activities outside the U.S.). On consideration of PepsiCo's motion for summary judgment, the Tribunal held that PepsiCo must include Frito-Lay in its combined group because Frito-Lay did not qualify for the exclusion granted to companies that conduct most of their business internationally. Specifically, the Tribunal rejected PepsiCo's position that Frito-Lay's payroll factor should include compensation paid to employees working temporarily in other countries.

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PepsiCo had argued that Frito-Lay's payroll factor should include payroll costs reported by PepsiCo Global Mobility, LLC ("PGM"), a single-member LLC owned by Frito-Lay. However, the Tribunal found that, under the substance over form doctrine, PGM was "simply a shell corporation" and although PGM was formed to employ expatriates and administer the expatriate program previously administered by PepsiCo, the "negligible change" implemented was illusory in nature. The Tribunal highlighted the fact that PepsiCo swapped PGM's name onto some of the program documents, but that the same employees housed by PepsiCo still oversaw the majority of the program. Accordingly, finding that "PepsiCo [had] failed in its burden to show that PGM LLC was the true employer of the expatriates, and, by extension, [Frito-Lay] was the true employer of the expatriates", the Tribunal dismissed PepsiCo's motion for summary judgment.

IV. BULLETINS AND ANNOUNCEMENTS

A. Increased Estimated Tax Payments. Department bulletin~~g~~ FY 2022-01 (Sept. 2021), alerts taxpayers that because of the state's changes to its income tax laws starting in 2021 (*e.g.*, 100% bonus depreciation decoupling, capping net loss deductions, changes to foreign dividend reporting, and the entity-level SALT cap workaround, as discussed herein), taxpayers may need to make increased estimated tax payments to avoid penalties. This bulletin helps taxpayers navigate whether they may need to begin or increase their estimated tax payments, and what schedule to file to minimize or avoid late-payment penalties.

B. SALT Cap Workaround. Pursuant to IDOR Announcement September 10, 2021, the Department will not assess penalty for late estimated payments due for tax years ending before December 31, 2022, for partnerships and subchapter S corporations ~~who~~ that elect to pay the new pass-through entity-level tax. https://www2.illinois.gov/rev/research/news/Pages/IDOR-Waives-Late-Estimated-Payment-Penalty-for-Newly-Enacted-Entity-Level-Tax.aspx.

C. City of Chicago Nexus and Safe Harbor Information Bulletin (Jan. 21, 2021). Although the City of Chicago does not conform to Illinois' "*Wayfair* nexus" provisions (*e.g*., annual sales of $100,000 or 200 transactions), to promote certainty, the City has elected to employ its own nexus safe harbor. Under the City's safe harbor, an out-of-state entity that received under $100,000 in revenue from Chicago customers during the most recent consecutive four calendar quarters will not be expected to collect the following taxes from its Chicago customers during the current calendar quarter: (i) Chicago's amusement tax, Chapter 4-156 of the Municipal Code of Chicago ("Code") as applied to amusements that are delivered electronically, such as video streaming, audio streaming and on-line games; and (ii) Chicago's personal property lease transaction tax, Code Chapter 3-32, as applied to nonpossessory computer leases. The City's safe harbor contains the following conditions and qualifications to its safe harbor: (a) it will apply only to an entity that has no other significant contacts with Chicago; (b) it will apply on a prospective basis, beginning July 1, 2021; (c) If an out-of-state business initially qualified for the safe harbor but no longer does, it must (i) register with the City's Department of Finance within 60 days, (ii) begin collecting Chicago taxes within 90 days, and (iii) continue collecting Chicago taxes for at least twelve months, and (d) the safe harbor concerns only the issue of whether a provider has a duty to collect taxes from its customers; it does not affect the issue of whether a customer has a duty to pay those taxes.

BIOGRAPHIES

DAVID P. DORNER

David is a Partner in Reed Smith's State Tax Group. David's primary practice area is tax controversy, including federal and state tax audits, appeals, Illinois Independent Tax Tribunal disputes, administrative hearings, conciliation and mediation conferences and judicial litigation at all levels throughout the United States. Over the past 20 years, David has represented and counseled businesses and individuals on all forms of federal, state and local taxes, including corporate and individual income, franchise, federal excise, sales, use, personal and real property taxes, and he has defended numerous Illinois False Claims Act cases and employee misclassification audits. In addition to tax litigation, David also has substantial experience in the area of taxation of aircraft, railcars, and other transportation-related assets.

JACQUELINE T. NOYES

Jackie is an associate in Reed Smith's State Tax Group. Jackie focuses her practice on state and local tax issues, including sales and use tax, corporate income, and franchise tax. Jackie has worked with and advised clients in jurisdictions across the country.