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Representative Curtis J. Tarver, II, Chair
Illinois House Revenue and Finance Committee
Senator Celina Villanueva, Chair
Illinois Senate Revenue Committee
Illinois General Assemby

Re: COST Opposes Removal of "Subject to Tax" Exception and Limited Allocation of IRC 163(j) Interest Expense in S.B. 1956

Dear Chair Tarver, Chair Villanueva, and Members of the House Revenue and Finance and Senate Revenue Committees:

On behalf of the Council On State Taxation (COST), we respectfully "oppose" S.B. 1956, which would eliminate a necessary safe harbor to the State's current income tax interest and intangible expenses addback provisions. The current provisions, 35 ILCS 5/203(b) (E-12) (i) and E-(13) (i), prevent the double taxation of income when the related entity receiving the interest or intangible income is also subject to another state or foreign income tax. This potential for double taxation raises serious constitutional issues and will lead to protracted litigation. Additionally, we are concerned with the provision allocating the reduction of interest expense under IRC 163(j). The proposed change is unclear as to how the allocation would be implemented, and it could unfairly limit full consideration of the federal interest expense limitations to all members of an Illinois unitary group (which could include both U.S. and foreign based entities).

About COST

COST is a nonprofit trade association based in Washington, DC. COST was formed in 1969 as an advisory committee to the Council of State Chambers of Commerce and today has an independent membership of approximately 500 major corporations engaged in interstate and international business. COST's objective is to preserve and promote the equitable and nondiscriminatory state and local taxation of multijurisdictional business entities. Many COST members have significant operations in Illinois and would be negatively impacted by the proposed changes in S.B. 1956.

COST Opposes Unfair Expense Disallowance Provisions

The COST Board of Directors has adopted the following formal policy position addressing states' related member expense disallowance legislation:

Legislation seeking to disallow deductions between related corporations must be carefully crafted to avoid unintended negative consequences on legitimate business practices.[1]

The proposed removal of the addback safe harbor provision for interest and intangible expenses made to related members that are subject to tax in another state or foreign country is grossly unfair. It would result in double taxation of the same income in another state or foreign country when the interest and/or intangible income is subject to tax in those locations. Absent such a safe harbor, a taxpayer would be required to go through the grueling process of establishing, by "clear and convincing" evidence the addback of the interest or intangible expense is unreasonable. Alternatively, both the taxpayer and the Illinois Department of Revenue (DOR) must agree to use alternative apportionment. This is concerning because the guidelines on what constitutes "clear and convincing" evidence of "unreasonableness" in this area is unknown and has not been addressed by the DOR. This will lead to protracted litigation over what is reasonable and raises serious constitutional issues under the U.S. Supreme Court's requirement that state and local taxes be internally consistent.[2] It also sends a negative signal to Illinois businesses and those seeking to do business in the state—it would significantly hamper Illinois's economic development activity.

Problematic Allocation of IRC 163(j) Interest Expense Limitation

The language used in S.B. 1956 is unclear with respect to how the interest expense limitation under IRC 163(j), which at the federal level is calculated on a federal consolidated return basis and includes both third-party and related party interest expenses, would "be treated as allocable first to persons who are not foreign persons … and then to those foreign persons." It appears the allocation language is attempting to restrict the application of IRC 163(j) to U.S.-based members of an Illinois unitary group, which is contrary to how the IRC 163(j) limitation is calculated on those taxpayers filing federal consolidated returns. This potentially limits the amount of interest expenses that may be deducted on the Illinois unitary group return. The ambiguities resulting from the proposed statutory language are likely to result in protracted litigation.

Conclusion

For the foregoing reasons, COST strongly urges members of the House and Senate Committee to reject the above provisions in S.B. 1956.

Respectfully,

Marilyn A. Wethekam Fredrick J. Nicely

cc: COST Board of Directors
Patrick J. Reynolds, COST President & Executive Director

[1] This policy position, "Related Company Expense Disallowance," is available at: www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-policy-positions/relatedcompanyexpensedisallowance.pdf.

[2] See *Comptroller of the Treasury of Maryland v. Wynne*, 575 U.S. 542 (2015) which held Maryland's income tax was not internally consistent – that is if every state imposed the same tax would it result in duplicative taxation.