

Taxpayer's request to change method of sourcing reinsurance premiums under IITA Section 304(b)(2) is granted. (This is a PLR.)

March 15, 2022

Re: Request for Private Letter Ruling
COMPANY (FEIN ##-#####)

Dear NAME:

This is in response to your letter dated September 4, 2020 in which you request a Private Letter Ruling, on behalf of COMPANY, for permission to change your apportionment computation method for reinsurance premiums effective for tax year ending DATE and subsequent tax years. Review of your request for a Private Letter Ruling indicates that all information described in paragraphs 1 through 8 of subsection (b) of 2 Ill. Admin. Code 1200.110 is contained in your request. This Private Letter Ruling will bind the Department only with respect to COMPANY. Issuance of this ruling is conditioned upon the understanding that COMPANY and/or any related taxpayer(s) is not currently under audit or involved in litigation concerning the issues that are the subject of this ruling request.

The facts and analysis as you have presented states as follows:

Private Letter Ruling Request

In accordance with the guidance in 86 Illinois Administrative Code §100.3420(e)(3)(A) and 2 Illinois Administrative Code §1200.110, COMPANY ("COMPANY" or "Taxpayer") respectfully requests that the Department grant this petition to change their election for apportionment methodology in respect to reinsurance premium effective retroactively to tax year ending DATE.

COMPANY is domiciled in STATE and has been fully licensed to conduct life, health and annuity insurance operations in Illinois by the Department of Insurance since DATE. COMPANY maintains its corporate offices at ADDRESS. Unlike a direct writer, COMPANY'S insurance operations consist solely of reinsurance activity and has no direct premium in Illinois or any other state. Consequently, COMPANY does not conduct associated standard insurance operations, such as insurance sales and claim processing. Based on the past five years, COMPANY has assumed approximately \$\$\$ million annually of life and annuity premium from multiple life insurance companies. COMPANY forecasts that the volume of premium and number of insurers it does business with will continue to increase for future years.

As COMPANY is licensed as an active insurer in Illinois, it is subject to both the Illinois Privilege Tax and the Illinois Corporate Income and Replacement Tax and has timely filed such returns since licensed. Based

on their insurance operations, COMPANY'S principal source of premium written consists of premium for reinsurance accepted and so must include reinsurance assumed in their apportionment factor per 86 IAC 100.3420(e). As established by the initial Illinois Corporate Income and Replacement Tax Return filed as prepared by their prior tax advisor, COMPANY "elected" to determine the amount of premium written for reinsurance accepted in Illinois based upon the proportion which the sum of the direct premium written for insurance upon property or risk in this State by each ceding company from which reinsurance is accepted bears to the sum of the total direct premium written by each such ceding company for the taxable year as permitted by 86 IAC 100.3420(e)(2)(B).

COMPANY is requesting to change their election for apportionment methodology in respect to reinsurance premium to determine the amount of premium written for reinsurance accepted in Illinois based upon the proportion which premium written for reinsurance accepted from companies commercially domiciled in Illinois bears to premium written for reinsurance accepted from all sources as permitted by 86 IAC 100.3420(e)(2)(A). Based on a review of COMPANY'S business operations and their state tax filings, COMPANY believes this method streamlines the tax return process and more accurately attributes their revenues to the states where they do business. Per the discussion in Illinois Income Tax Info. Bulletin No. 1970-4, the Department has been long aware of the issues involved in identifying Illinois property or risk related to reinsurance premium. Obtaining premium distribution information for ceding insurance companies is time consuming and obviously compounded by the volume of reinsurance transactions. Due to financial reporting requirements (or lack thereof) for the ceding insurance companies, this information is not always readily or publicly available, and so may require additional expense to obtain. Further, due to potential differences in permitted reporting methodologies by the National Alliance of Insurance Commissioners, the premium distribution data obtained for ceding insurance companies may differ by company and skew the accuracy of the resulting apportionment. Further, COMPANY believes that sourcing revenue to their actual customer location (i.e. the domicile of the ceding insurance companies) more accurately reflects the economic reality of their business operations. The ceding insurance companies are COMPANY'S actual customer base, with income and expenses directly attributable to their home states. Under the current "look-through" sourcing method, COMPANY is inaccurately attributing revenue to the policyholder locations of the ceding insurance companies. However, COMPANY has no interaction with or contractual responsibility to these policyholders. Sales of services are in Illinois if the services are received in Illinois. Note that sourcing revenue to the domicile of the ceding insurance companies also more closely follows the general sourcing of services for general

corporations to the location where the services are received per 35 ILCS §5/304(a)(3)(C-5)(iv).

Relevant Supporting Documents

The following documents relevant to the request are attached:

- Copies of COMPANY'S Annual Statement, Schedule S, Part 1, Section 1, Reinsurance Assumed Life Insurance, Annuities and Deposit Funds, for calendar years YEAR1- YEAR2
- Copies of each ceding insurance company's Annual Statement, Schedule T, Premiums and Annuity Considerations Allocated by States and Territories, for calendar years YEAR1 – YEAR2
- Copy of Form IL-872, Consent to Extend the Time to Assess of Refund Income Tax, extending the statute of limitations for tax year YEAR1 until DATE.

Please let us know if you believe there are additional documents or information you need to process this request.

Identification of Tax Period and Audit/Litigation

COMPANY requests that this election change be effective for tax year ending DATE and future years.

While COMPANY is currently under audit for Corporate Income and Replacement Tax for tax years ending DATE through DATE, COMPANY does not believe that the apportionment methodology for assumed reinsurance premium will be an audit issue. Additionally, COMPANY does not believe this audit will impact apportionment methodology for tax years ending YEAR and YEAR.

Further, COMPANY has no litigation pending with the Department for any period or tax type.

Prior Rulings

To the best of COMPANY'S knowledge, the Department has not previously ruled on the same or a similar issue for the Taxpayer or a predecessor. Further, neither COMPANY nor any representative of COMPANY has previously submitted the same or a similar issue to the Department but withdrew it before a letter ruling was issued.

Statement of Authority

Illinois Compiled Statutes, Chapter 35/Revenue, Illinois Income Tax Act, and associated Administrative Code, Title 86/Revenue, Part 100/Income Tax, state:

35 ILCS §5/304(b)(1) / In general

Except as otherwise provided by paragraph (2), business income of an insurance company for a taxable year shall be apportioned to this State by multiplying such income by a fraction, the numerator of which is the direct premiums written for insurance upon property or risk in this State, and the denominator of which is the direct premiums written for insurance upon property or risk everywhere. For purposes of this subsection, the term "direct premiums written" means the total amount of direct premiums written, assessments and annuity considerations as reported for the taxable year on the annual statement filed by the company with the Illinois Director of Insurance in the form approved by the National Convention of Insurance Commissioners or such other form as may be prescribed in lieu thereof.

35 ILCS §5/304(b)(2) / Reinsurance

If the principal source of premiums written by an insurance company consists of premiums for reinsurance accepted by it, the business income of such company shall be apportioned to this State by multiplying such income by a fraction, the numerator of which is the sum of (i) direct premiums written for insurance upon property or risk in this State, plus (ii) premiums written for reinsurance accepted in respect of property or risk in this State, and the denominator of which is the sum of (iii) direct premiums written for insurance upon property or risk everywhere, plus (iv) premiums written for reinsurance accepted in respect of property or risk everywhere. For purposes of this paragraph, premiums written for reinsurance accepted in respect of property or risk in this State, whether or not otherwise determinable, may, at the election of the company, be determined on the basis of the proportion which premiums written for reinsurance accepted from companies commercially domiciled in Illinois bears to premiums written for reinsurance accepted from all sources, or, alternatively, in the proportion which the sum of the direct premiums written for insurance upon property or risk in this State by each ceding company from which reinsurance is accepted bears to the sum of the total direct premiums written by each such ceding company for the taxable year. The election made by a company under this paragraph for its first taxable year ending on or after December 31, 2011, shall be binding for that company for that taxable year and for all subsequent taxable years, and may be altered only with the written permission of the Department, which shall not be unreasonably withheld.

86 IAC §100.3420(a) / In general

Except as otherwise provided in this Section, business income of an insurance company for a taxable year shall be apportioned to this State by multiplying such income by a fraction, the numerator of which is the direct premiums written for insurance upon property or risk in this State, and the denominator of which is the direct premiums written for insurance upon property or risk everywhere. [IITA Section 304(b)(l)]

86 IAC §100.3420(b) / Insurance Company

For purposes of the IITA, an “insurance company” means any taxpayer properly treated as an insurance company for purposes of federal income taxation under subchapter L of the Internal Revenue Code (IRC sections 801 through 848). (See IITA Section 102.) No other taxpayer may be treated as an insurance company for purposes of the IITA.

86 IAC 100.3420(c) / Direct Premiums Written

“Direct premiums written” means the total amount of direct premiums written, assessments and annuity considerations as reported for the taxable year on the annual statement filed by the company with the Illinois Director of Insurance in the form approved by the National Convention of Insurance Commissioners (currently known as the National Association of Insurance Commissioners) or such other form as may be prescribed in lieu of the National Association of Insurance Commissioners form.

- 1) The apportionment factor shall take into account only those receipts that are included in either “gross premiums written” under IRC section 832(b)(4)(A) or “gross amount of premiums” under IRC section 803(a)(l)(A). Only receipts that are included in federal taxable income of the taxpayer, and that are not subtracted in the computation of base income under a provision of Section 203 of the IITA, may be included in the apportionment factor. (See *Continental Illinois National Bank and Trust Company of Chicago v. Lenckos*, 102 Ill.2d 210 (1984).)
- 2) Only direct premiums written for insurance, assessments against mutual policyholders and consideration for annuity contracts that include elements of insurance are included in the apportionment factor. Other receipts are excluded from the apportionment factor, even if included in net income.
- 3) Examples of receipts that are excluded from the apportionment factor include:
 - A. Interest, dividends and other income from investments.
 - B. Gains or losses from the adjustment of reserves, salvage or subrogation.

C. Deposit-type funds. This is due to the fact that deposit-type funds involve no insurance risk and are therefore reported separately from premiums, assessments and annuity considerations on the annual report.

D. Premiums on which State income taxes are prohibited by federal law.

- 4) Premiums rebated or repaid to policyholders and reported as negative amounts on the annual statement are treated as negative amounts in the computation of the apportionment factor. However, neither the numerator nor the denominator of the apportionment factor may be reduced below zero.

86 IAC §100.3420(d) / Insurance on Property or Risk in this State

A direct premium is written for insurance upon property or risk in this State and included in the numerator of the apportionment factor if it is allocated to this State in the annual statement filed by the insurance company with the Director of Insurance. If an insurance company does not file an annual statement with the Director of Insurance or if any direct premiums written by an insurance company are not allocated to a specific state on its annual statement, that insurance company shall include in the numerator of its apportionment factor the direct premiums written for insurance on property or risk in this State, determined in accordance with the determination of gross taxable premium written under Section 409(1) of the Illinois Insurance Code [215 ILCS 5/409(1)], provided that the determination shall be made without allowing the exceptions in that Section 409(1) for premiums on annuities, premiums on which State premium taxes are prohibited by federal law, premiums paid by the State for Medicaid eligible insureds, premiums paid for health care services included as an element of tuition charges at any university or college owned and operated by the State of Illinois, premiums on group insurance contracts under the State Employees Group Insurance Act of 1971 [5 ILCS 375], or premiums for deferred compensation plans for employees of the State, units of local government or school districts.

86 IAC §100.3420(e) / Reinsurance

If the principal source of premiums written by an insurance company consists of premiums for reinsurance accepted by it, the business income of such company shall be apportioned to this State by multiplying such income by a fraction, the numerator of which is the sum of direct premiums written for insurance upon property or risk in this State, plus premiums written for reinsurance accepted in respect of property or risk in this State, and the denominator of which is the sum of direct premiums written for insurance upon property or risk everywhere, plus premiums

written for reinsurance accepted in respect of property or risk everywhere.
(IITA Section 304(b)(2))

- 1) The principal source of premiums written by an insurance company consists of premiums for reinsurance accepted by the taxpayer for a taxable year if the premiums written for reinsurance accepted that would be includable in the denominator of the apportionment fraction for the taxable year under this subsection (e) exceed the direct premiums written for insurance that would be includable in the denominator of the apportionment fraction under this subsection (e).
- 2) An insurance company may determine the amount of premiums written for reinsurance accepted in respect of property or risk in this State by consideration of each premium written, or the premiums may, at the election of the company, be determined on the basis of:
 - A. the proportion which premiums written for reinsurance accepted from companies commercially domiciled in Illinois bears to premiums written for reinsurance accepted from all sources; or
 - B. the proportion which the sum of the direct premiums written for insurance upon property or risk in this State by each ceding company from which reinsurance is accepted bears to the sum of the total direct premiums written by each such ceding company for the taxable year.
- 3) The election to determine the portion of reinsurance premiums accepted in respect of property or risk in this State for a particular tax year, by consideration of each premium written or by either of the alternative methods outlined in subsection (e)(2), shall be made by using the chosen method on the taxpayer's return for the taxable year. For taxable years ending prior to December 31, 2011, the election may be made or changed at any time. The election made by a company for its first taxable year ending on or after December 31, 2011 is binding for that company for that taxable year and for all subsequent taxable years, and may be altered only with the written permission of the Department, which shall not be unreasonably withheld. (IITA Section 304(b)(2))

- A. A request for permission to alter an election shall be submitted to the Department as a request for a private letter ruling under 2 Ill. Adm. Code 1200.110, and permission to alter an election shall be granted by private letter ruling. Requests may be made for the change to take effect for a taxable year ending prior to the date the request is filed, provided that the request shall be granted only if the statute of limitations for assessment of additional tax is open for that taxable year and every subsequent taxable year as of the date the Department responds to the request. The taxpayer and the Department may agree in writing to extend the statute of limitations under IITA Section 905(f) in order to allow the Department time to process the request.

Illinois Income Tax Info. Bulletin, No. 1970-4, 09/28/1970

The problems of identifying Illinois property or risk related to reinsurance premiums may be difficult. This information is frequently unobtainable by reinsurance companies except at great expense. An election is provided which is intended to relieve reinsurers from the obligation of determining the state in which the risk or property which they have reinsured is located. Whether or not the facts with respect to location are otherwise determinable, the taxpayer may elect, for purposes of its apportionment factor, to determine reinsurance premiums accepted in respect of property or risk in Illinois by either of two alternatives:

- a) Reinsurance premiums in Illinois may be determined on the basis of the proportion which premiums written for reinsurance accepted from companies commercially domiciled in Illinois bears to premiums written for reinsurance accepted from all sources; or
- b) Alternatively, reinsurance premiums in Illinois may be determined on the basis of the proportion which the sum of the direct premiums written for insurance upon property or risk in Illinois by each ceding company from which reinsurance is accepted bears to the sum of the total direct premiums written by each ceding company for the taxable year.

COMPANY is requesting to change their election for apportionment methodology in respect to reinsurance premium to determine the amount of premium written for reinsurance accepted in Illinois based upon the proportion which premium written for reinsurance accepted from companies commercially domiciled in Illinois bears to premium written for reinsurance accepted from all sources as permitted by 86 IAC 100.3420(e)(2)(A). This is a request for an apportionment methodology

change as permitted by regulation from one permitted method to another permitted method. Further, COMPANY believes this request is also supported by the simplification of their tax return preparation and alignment of apportionment to their business operations as identified previously above.

As this is a request for an apportionment methodology change as permitted by regulation, COMPANY is unaware of any authority contrary to this request.

Identification of Impacted Trade Secrets

This request does not impact any specific trade secret information for COMPANY that would need to be deleted from the publicly disseminated version of the private letter ruling.

Taxpayer Signature

Please send all questions or requests for additional information to me via email, by phone, or by mail via the below contact information.

Under penalties of perjury, I declare that I have examined this request, including the accompanying documents, and to the best of my knowledge and belief the facts presented in support of the requested ruling are true, correct and complete.

RULING

Section 304(b)(2) of the Illinois Income Tax Act ("IITA") (35 ILCS 5/304(b)(2)) provides:

Reinsurance. If the principal source of premiums written by an insurance company consists of premiums for reinsurance accepted by it, the business income of such company shall be apportioned to this State by multiplying such income by a fraction, the numerator of which is the sum of (i) direct premiums written for insurance upon property or risk in this State, plus (ii) premiums written for reinsurance accepted in respect of property or risk in this State, and the denominator of which is the sum of (iii) direct premiums written for insurance upon property or risk everywhere, plus (iv) premiums written for reinsurance accepted in respect of property or risk everywhere. For purposes of this paragraph, premiums written for reinsurance accepted in respect of property or risk in this State, whether or not otherwise determinable, may, at the election of the company, be determined on the basis of the proportion which premiums written for reinsurance accepted from

companies commercially domiciled in Illinois bears to premiums written for reinsurance accepted from all sources, or, alternatively, in the proportion which the sum of the direct premiums written for insurance upon property or risk in this State by each ceding company from which reinsurance is accepted bears to the sum of the total direct premiums written by each such ceding company for the taxable year. The election made by a company under this paragraph for its first taxable year ending on or after December 31, 2011, shall be binding for that company for that taxable year and for all subsequent taxable years, and may be altered only with the written permission of the Department, which shall not be unreasonably withheld.

Regarding this provision, the Instructions to Form IL-1120 provide:

You may determine your reinsurance premiums from Illinois sources using one of the following methods. You must use the same method for all future years unless you receive written permission from the Department to change methods.

Method A – Determine the reinsurance premiums assumed, relating to property or risk located in Illinois.

Method B – For each company from which reinsurance is accepted, determine the ceding insurance company's ratio of direct premiums on property or risk located in Illinois, to its total direct premiums. Apply this ratio to the reinsurance premiums assumed from that company. For example, reinsurer R assumes premiums of \$40,000 and \$50,000 from ceding companies A and B respectively. Company A's ratio of direct premiums on property or risk located in Illinois, to its total direct premiums, is 10 percent and Company B's ratio is 20 percent. Reinsurer R has \$14,000 of reinsurance premiums assumed on property or risk located in Illinois, consisting of \$4,000 from ceding Company A (10 percent of \$40,000) and \$10,000 from ceding Company B (20 percent of \$50,000).

Method C – Determine the amount of reinsurance premiums assumed from insurance companies commercially domiciled in Illinois. Include in reinsurance premiums assumed in Illinois, all premiums for reinsurance accepted from insurance companies commercially domiciled in Illinois.

IITA Section 304(b)(2) provides that an insurance company is allowed to make the election provided therein regardless of whether or not it may be determined that any particular reinsurance premiums are accepted in respect to property or risk located in Illinois. However, the section requires that an election made for the first taxable year ending on or after December 31, 2011, must apply to all future taxable years. The election is binding on the taxpayer for all subsequent taxable years unless the taxpayer receives written permission from the Department to

alter that election. The Department's permission must not be unreasonably withheld.

86 Ill. Admin. Code 100.3420(e)(3)(A) provides a request for permission to alter an election shall be submitted to the Department as a request for a private letter ruling and permission to alter an election shall be granted by private letter ruling. Requests may be made for the change to take effect for a taxable year ending prior to the date the request is filed, provided that the request shall be granted only if the statute of limitations for assessment of additional tax is open for that taxable year and every subsequent taxable year as of the date the Department responds to the request. The taxpayer and the Department may agree in writing to extend the statute of limitations under IITA Section 905(f) in order to allow the Department time to process the request.

COMPANY is hereby granted permission to alter its election in respect of its DATE taxable year. COMPANY may change its method from Method B, as described in the Instructions to Form IL-1120, to Method C, as so described, for its YEAR taxable year. The taxpayer must use Method C for its YEAR taxable year and all subsequent taxable years, unless it receives Department permission to alter that election.

Except as provided herein, this ruling shall bind the Department for the taxable year ending DATE and subsequent taxable years. The facts upon which this ruling is based are subject to review by the Department during the course of any audit, investigation or hearing and this ruling shall bind the Department only if the material facts as recited and incorporated in this ruling are correct and complete. This ruling shall bind the Department for the taxable years specified above, except as limited pursuant to 2 Ill. Admin. Code 1200.110(d) and (e). In addition, this ruling will cease to bind the Department if there is a pertinent change in statutory law, case law, rules or in the material facts recited in this ruling.

Sincerely,

Jennifer Uhles
Associate Counsel (Income Tax)