

Common Problems and Simple Solutions

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This series of articles is intended to provide a deep dive into the Illinois State Franchise Tax (the "Franchise Tax") and should be read sequentially to be best understood. [The first](#) article covered the businesses and entities required to pay the Franchise Tax and the mechanics of the Franchise Tax system. [The second](#) defined the essential terms to understand the Franchise Tax and its calculation and covered some significant differences between the Franchise Tax and the state Income and Corporate Income Tax. [The third](#) provided specific resources and examples on correctly calculating your Allocation Factor for the Franchise Tax. For an overview of the Franchise Tax generally, please see our prior article on the topic [here](#).

At Kilpatrick, we see five common problems with franchise tax filings. These issues relate to improper Allocation Factor calculation, increases in Paid-In Capital, timely reporting to the Illinois Secretary of State, and so-called "push-down accounting" being used on reports following successful mergers and acquisitions. Each of these is discussed in more detail below.

Improper Allocation Factor Calculation:

The Franchise Tax Allocation Factor is broken into two figures—a numerator and a denominator. Much like the [apportionment factors used in calculating the state Income or Corporate Tax](#), the numerator represents what fraction of taxable activity is attributable to business or business activities derived from the State of Illinois. The denominator, by contrast, represents the business activity conducted everywhere in the United States and abroad. This function will produce a fraction which, when multiplied against the total taxable base, represents the fraction of that tax base attributable to the State of Illinois.

According to the Illinois State Tax Code, the Franchise Tax Allocation Factor is defined as the value of the sum of gross revenues and assets located within the State of Illinois divided by the *gross amount of business transacted* by the corporation everywhere.^[1] This formula is represented mathematically below:

$$\text{Allocation Factor} = \frac{\text{(Illinois Assets + Illinois Revenues)}}{\text{(Everywhere Assets + Everywhere Revenues)}}$$

If a corporation's Allocation Factor has been improperly calculated, it will necessarily result in the under or overpayment of Franchise Tax. Commonly, corporations will fail to correctly attribute assets and revenues to Illinois, distorting the numerator of the Allocation Factor. To avoid this mistake, it is vital to ensure that your corporation follows the directions on Form BCA 1.35 when determining what assets and revenues are attributable to Illinois. To view our previous article on determining whether property or income is attributable to Illinois for Allocation Factor purposes, please [click here](#).

Increases, Decreases, and Paid-In Capital "Lock-In":

A common problem we see corporations face involves changes to Paid-In Capital from prior tax years and how the corporation has elected to file its Illinois Annual Report. To quickly recap, Paid-In Capital is defined as the sum of two amounts detailed on a corporation's books and balance sheet. These are the "Capital Stock" line (listed in dollars at Par value) and the balance sheet account line of "Additional Paid-In Capital (consideration received/contributed over par value). Typically, these amounts are lifted straight from lines 22 and 23 in Schedule L of your federal Form 1120, and simply adding these two numbers together results in Paid-In Capital. This number can thus be increased or decreased in many ways. Please see our [second article](#) in this series for an example of how Paid-In Capital can increase and decrease from year to year.

Noting the increases and decreases in your corporation's Paid-In Capital is essential in correctly calculating your Franchise Tax. Your Illinois Form BCA 14.30, which provides a cumulative report of changes in your corporation-issued shares and Paid-In Capital, will generally be due at the same time as your Illinois Annual Report, provided there are year-over-year changes to the total number of shares or total Paid-In Capital. Changes in Paid-In Capital can benefit a corporation but can simultaneously complicate Franchise Tax calculation. These complications arise depending on your prior year's Allocation Factor and how your corporation filed its Illinois Annual Report.

When a corporation elects to file its Illinois Annual Report online or has elected a 100% Allocation Factor on Form BCA 14.05 for any period, these elections are often binding and cannot be amended following increases or decreases to Paid-In Capital. This rings especially true for Illinois Annual Reports, which have been filed online. However, we have recently seen the Illinois Secretary of State Office accept "Correction Statements" regarding the 100% Allocation Factor election on Form BCA 14.05, which are filed on paper. This is a change from the Office's historical policy of not accepting changes of these kinds regardless of how the Form was filed. Conversely, we have yet to see the Office accept Correction Statements for Allocation Factors elected on such forms that have been filed digitally.

This is important for several reasons. Most notably, if your corporation decides to file its Form BCA 14.05 or Illinois Annual Report online based on convenience, you may be stuck with that elected Allocation Factor despite significant increases to your Paid-In Capital the following year. This will usually result in the corporation being required to pay a larger, sometimes 100%, Allocation Factor on the significant increase in Paid-In Capital, thereby significantly increasing its Franchise Tax liability. This is a costly oversight in the name of convenience and warrants consideration before digitally submitting either of these documents.

Decreases of Shares and Paid-In Capital:

Another common issue occurs when the corporation has a decrease in its Paid-In Capital. This issue often appears when a corporation has issued a stock buy-back, redemption, share return, or some other action that reduces the number of shares issued or reported to the Illinois Secretary of State. As the corporation prepares its Form BCA 14.30 with its Illinois Annual Report, which would report the change in issued shares or Paid-In Capital, the corporation will incorrectly report the number of shares *outstanding*. The Illinois Secretary of State requires that the corporation instead report the number of *issued* shares, not *outstanding* shares.

Should a corporation file their report with the outstanding shares and capital, the Illinois Secretary of State will typically deny or reject such filing. The Illinois Secretary of State has stated that once a share is "issued," it remains an issued share with its historical value until removed from the pool of authorized shares in the corporate charter (most commonly, the articles of incorporation). Simply put, buying back stock and treating it as treasury stock will not decrease Paid-In Capital. The shareholder must additionally cancel the stock and have such action reflected in board minutes and as an amendment in the corporation's articles of incorporation. This is even though the corporation may have "canceled" the same shares for financial reporting purposes.

If your corporation seeks to formally cancel these shares by amending your articles of incorporation, these amended articles must also be filed with the Illinois Secretary of State, along with Form BCA 14.30. Only then will the Illinois Secretary of State allow the reduced capital represented by those canceled authorized shares.^[2] Once this has been completed, the corporation's Paid-In Capital will be reduced by these amounts, thereby reducing your Franchise Tax liability for that taxable year.

Timely Reporting:

The complexities of a merger or acquisition can make the thought of Franchise Tax and reporting to the Illinois Secretary of State seem inconsequential. However, this could not be further from the truth, and paying attention to the deadlines presented by the Secretary's office is essential. Failure to do so could result in the stripping of your business's "good standing" with the State and the potential prohibition on conducting business within Illinois. Illinois law requires that Reports of Merger (Form BCA 14.35) be filed with the Illinois Secretary of State within 60 days of the merger, together with a "fresh" certified merger document.^[3]

One widespread misconception we have seen is when an Illinois-registered entity (foreign or domestic) is the "survivor" of the merger with an entity not registered or qualified in Illinois. Often, these deals are not reported to the Illinois Secretary of State because the non-surviving entity was not registered in Illinois. This is an incorrect interpretation of the Illinois Business Corporations Act. *Any* time an Illinois corporation is a party to a merger, such merger *must* be reported to the Illinois Secretary of State, with no exceptions. This report must be filed under Form BCA 14.35 and be accompanied by "fresh" merger documents. Similarly, this report must be filed within 60 days of the merger's occurrence.^[4]

This is important in the Franchise Tax context because the Illinois Secretary of State has been randomly reviewing the Delaware Secretary of State's filing record (and other Offices with public filing records) for entities registered with Illinois. If a corporation has merged and is found to be out of compliance with the reporting requirements of Illinois law, the Illinois Secretary of State has full authority to reject that corporation's Illinois Annual Report or any other document submission. There have been reported cases of the Illinois Secretary of State rejecting current pending submissions for failure to report mergers going as far back as fifty years.

As discussed in this series of articles, having an Illinois Annual Report rejected could potentially jeopardize your corporation's "good standing" with the State of Illinois. This means the Illinois Secretary of State could ultimately revoke your corporation's authority to do business within the State of Illinois until all unreported merger documents have been reported and perfected by the Illinois Secretary of State Office. This involves a severe amount of paperwork, taxes, fines, fees, and approval wait times. Unfortunately for the corporation, there is no statute of limitations on the fees, taxes, or reporting requirements associated with the change of paid-in capital. Finding the old financial records and merger documents can be further challenging for corporations whose mergers occurred long ago. The Illinois Secretary of State has yet to accept any current document, including Illinois Annual Reports, for entities subject to any unreported mergers until such an unreported merger has been submitted, paid for, and filed or accepted by the Illinois Secretary of State.

Push-Down & Purchase Accounting:

Push-down accounting is defined as a method of accounting for the purchase of another company at the price of the purchase rather than its historical cost. Thus, the "target" company's assets and liabilities are written down (or up) to reflect the purchase price.

^[5] Kilpatrick Townsend & Stockton LLP is often asked if this accounting style is included in the amounts used for the Franchise Tax. Our answer has been that all bookkeeping entries "pushed down" to the corporation's books and records of the entity are considered part of the corporation's Gross Assets and Total Paid-In Capital. However, to the extent these entries are not "pushed down" to the books of the corporation or not part of Gross Assets or Total Capital on the books, they are instead *not* considered part of the Gross Assets or Total Paid-In Capital of the entries by the Illinois Secretary of State. In other words, if the entries are held in "suspense" or consolidation, they will not be considered part of the corporation's Gross Assets or Total Paid-In Capital by the Illinois Secretary of State.

Wrapping Up and Conclusion:

The Illinois State Franchise Tax is an essential consideration for every corporation registered to do business within the State of Illinois and those seeking to conduct a merger or acquisition for such a corporation. Failure to carefully consider each of the implications mentioned throughout this series of articles could cost you and your corporation valuable time and money. Importantly, underpayment necessarily leads to the imposition of late penalties and interest.^[6] Such failure incurs a penalty of 10% of any delinquent amount due on the corporation's annual report.^[7] Interest rates will be applied at 2% each month that the liability remains unpaid.^[8]

We hope this series has helped you better understand the importance of these considerations and made the Franchise Tax a little bit easier to understand. Please contact the [State and Local Tax Group at Kilpatrick](#) if you have any questions or concerns regarding your corporation and your Franchise Tax liability.

Thank you for reading.

[1] 805 ILCS 5/14.05(h)(2)

[2] See 805 ILCS 5/9.20; See also

805 ILCS 5/9.05 & Form BCA 9.05.

[3] 805 ILCS 5/14.35

[4] 805 ILCS 5/14.35(a)

[5] [Pushdown Accounting: Definition, How It Works, Example](#)

([investopedia.com](#))

[6] 805 ILCS 5/16.05(a)

[7] 805 ILCS 5/16.05(a)

[8] 805 ILCS 5/16.05(c)