

General Information Letter: Response to questions regarding taxation of partners and partnerships investing in Illinois real estate for purposes of leasing.

January 22, 1998

Dear:

This is in response to your letter dated January 13, 1998 in which you request a General Information Letter. Department of Revenue ("Department") regulations require that the Department issue only two types of letter rulings, Private Letter Rulings ("PLRs") and General Information Letters ("GILs"). PLRs are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. GILs do not constitute statements of agency policy that apply, interpret or prescribe the tax laws and are not binding on the Department. For your general information we have enclosed a copy of 2 Ill. Adm. Code Part 1200 regarding rulings and other information issued by the Department.

Although you have not specifically requested either type of ruling, the information you have provided requires that we respond with a general information letter.

In your request you stated:

Partnership A is a limited partnership which has its office in the State of Illinois. The only activity of the partnership is the trading of securities for its own account. The general partner is responsible for the management of the portfolio on behalf of itself and the limited partners. All deductions of the partnership are shown as ordinary and necessary business deductions pursuant to IRC Section 162. The only income of the partnership is interest, dividends and capital gains from the holding and sale of securities. The partnership does not have customers and hence does not maintain an inventory of securities. Again, it merely trades securities for it's own account.

In light of the facts as so stated above, we recognize that there is a requirement to file a partnership return in the State of Illinois. The question however, is whether or not partners who are not residents of the State of Illinois are subject to income tax in the State of Illinois on their allocable share of the profits from Partnership A.

In addition, Partnership A is considering investing in a partnership that has Illinois rental income. Would this subject all of Partnership A's income to Illinois income tax or just the Illinois rental income?

Department Analysis

You are correct in determining that partnerships located in Illinois must file Illinois income tax returns. Section 205 of the Illinois Income Tax Act ("IITA") states:

(b) Partnerships. A partnership as such shall not be subject to the tax imposed by subsection 201 (a) and (b) of this Act, but shall be subject to the replacement tax imposed by subsection 201 (c) and (d) of this Act and shall compute its base income as described in subsection (d) of Section 203 of this Act. A partnership shall file such returns and other information at such time and in such manner as may be required under Article 5 of this Act. The partners in a partnership shall be liable for the replacement tax imposed by subsection 201 (c) and (d) of this Act on such partnership, to the extent such tax is not paid by the partnership, as provided under the laws of Illinois governing the liability of partners for the obligations of a partnership. Persons carrying on business as partners shall be liable for the tax imposed by subsection 201 (a) and (b) of this Act only in their separate or individual capacities.

Section 201(c) & (d) define the Replacement tax as:

Sec. 201(c) & (d). Tax Imposed.

(c) Beginning on July 1, 1979 and thereafter, in addition to such income tax, there is also hereby imposed the Personal Property Tax Replacement Income Tax measured by net income on every corporation (including Subchapter S corporations), partnership and trust, for each taxable year ending after June 30, 1979. Such taxes are imposed on the privilege of earning or receiving income in or as a resident of this State. The Personal Property Tax Replacement Income Tax shall be in addition to the income tax imposed by subsections (a) and (b) of this Section and in addition to all other occupation or privilege taxes imposed by this State or by any municipal corporation or political subdivision thereof.

(d) Additional Personal Property Tax Replacement Income Tax Rates. The personal property tax replacement income tax imposed by this subsection and subsection (c) of this Section in the case of a corporation, other than a Subchapter S corporation, shall be an additional amount equal to 2.85% of such taxpayer's net income for the taxable year, except that beginning on January 1, 1981, and thereafter, the rate of 2.85% specified in this subsection shall be reduced to 2.5%, and in the case of a partnership, trust or a Subchapter S corporation shall be an additional amount equal to 1.5% of such taxpayer's net income for the taxable year.

Accordingly, a partnership is subject to the Illinois Income Replacement Tax. Section 502(d) explains what records are necessary.

(d) Partnerships. Every partnership having any base income allocable to this State in accordance with section 305(c) shall retain information concerning all items of income, gain, loss and deduction; the names and addresses of all of the partners, or names and addresses of members of a limited liability company, or other persons who would be entitled to share

in the base income of the partnership if distributed; the amount of the distributive share of each; and such other pertinent information as the Department may by forms or regulations prescribe. The partnership shall make that information available to the Department when requested by the Department.

As regards your second question, whether non-resident partners must file Illinois income tax returns for income derived from an Illinois partnership, section 305 of the IITA states:

Sec. 305. Allocation Of Partnership Income By Partnerships And Partners Other Than Residents.

(a) Allocation of partnership business income by partners other than residents. The respective shares of partners other than residents in so much of the business income of the partnership as is allocated or apportioned to this State in the possession of the partnership shall be taken into account by such partners pro rata in accordance with their respective distributive shares of such partnership income for the partnership's taxable year and allocated to this State.

(b) Allocation of partnership nonbusiness income by partners other than residents. The respective shares of partners other than residents in the items of partnership income and deduction not taken into account in computing the business income of a partnership shall be taken into account by such partners pro rata in accordance with their respective distributive shares of such partnership income for the partnership's taxable year, and allocated as if such items had been paid, incurred or accrued directly to such partners in their separate capacities.

(c) Allocation or apportionment of base income by partnership. Base income of a partnership shall be allocated or apportioned to this State pursuant to Article 3, in the same manner as it is allocated or apportioned for any other nonresident.

(d) Cross reference. For allocation of partnership income or deductions by residents, see Section 301 (a). (Source: P.A. 84-550.)

As can be seen, non-resident partners must file Illinois income tax returns for all business and non-business partnership income received from an Illinois partnership. It should be noted, however, that individual partners are subject to the income tax, **not** the replacement tax. The status of Partnership A as a limited partnership does not affect the answer to this question, nor Partnership A's tax return.

Your third question is more complex. First of all, as a partnership doing business only in Illinois, Partnership A already has nexus with Illinois, and all of its income is currently attributable to Illinois. Secondly, if Partnership A invests in another partnership which has Illinois rental income, Partnership A would also be liable--as a partner-- for its portion of the second partnership's Illinois income. Such income would then flow through Partnership A to its partners, whether they are residents or non-residents of Illinois. These partners would then be taxable on their shares of Partnership A's own income and

on their shares of Partnership A's share of the second partnership's Illinois income.

If you have additional questions please feel free to contact me at the above address.

Sincerely,

Charles E. Matoesian
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Income Tax Division