IT 98-0047-GIL 05/21/1998 PUBLIC LAW 86-272/NEXUS

General Information Letter: Conducting stock brokerage business through Illinois office.

May 21, 1998

Dear:

This is in response to your recent letter in which you request a General Information Letter. You letter contained questions involving a variety of tax fields. This letter will only contain an answer to the income tax question. The other questions will be answered by the corresponding areas of the department. 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:

> We request your assistance in resolving the income tax issues noted in the following two fact situations.
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> Situation #1:
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> FACTS - ABC Partnership, a calendar-year limited partnership, is a broker/dealer who buys and sells securities. The major source of ABC's income is the difference between the purchase price and sales price of the securities (referred to as trading revenue). One of the limited partners of ABC is an Illinois resident.
>
> Prior to December 1997, ABC had no nexus in Illinois. ABC had no property or employees in Illinois. It made sales of securities to Illinois residents through telephone solicitation from its main office in another state.
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> In December 1997, ABC opened an office in Illinois and has employees in Illinois. The Illinois employees are broker/dealers who primarily sell securities through telephone solicitation. The sales from the Illinois office are made to Illinois residents as well as residents of other states. Telephone sales from ABC's main office in another state are also made to Illinois residents.

QUESTION - It appears that nexus was established in Illinois when the office was opened and employees were hired. Therefore, we must make a determination of the amount of income to allocate or apportion to Illinois.

1. Should the following sales be shown as Illinois sales for purposes of the sales factor in apportioning income to Illinois?

a) Sales to Illinois customers from Illinois office?
b) Sales to non-Illinois customers from Illinois office?
c) Sales to Illinois customers from offices outside Illinois?

2. If the answer to question 1(c) is yes, should Illinois sales include only sales in December 1997 (since nexus was established in Illinois in that month) or should Illinois sales include sales for the entire calendar year?

Situation #2:

FACTS - XYZ corporation (an S corporation) is the general partner and majority owner of ABC partnership. XYZ is a calendar-year corporation. ABC partnership is the broker/dealer referred to in situation #1 above. XYZ's main source of income is from its general partnership interest in ABC. XYZ manages and operates ABC partnership. XYZ does not have and never has had property, employees or sales in Illinois (other than indirectly through its ownership of ABC partnership).

QUESTION - How should XYZ corporation determine its Illinois income?

- Should XYZ's share of the net income apportioned to Illinois by ABC partnership be shown as Illinois income?

- Should XYZ's share of the partnership's sales factor, payroll factor and property factor be included with XYZ's factors to determine Illinois income?

Department Analysis

Upon obtaining an office in Illinois nexus for taxing purposes was established with Illinois. I am unable to tell if nexus existed prior to the opening of the Illinois office. Section 201 of the Illinois Income Tax Act ("IITA"), which can be found at 35 Illinois 5/101 et seq., imposes a tax upon resident individuals and businesses as well as non-residents earning revenue in Illinois. However, §205(b) and (c) exempt partnerships and S corporations from the net income tax found in §201 (a) and (b) but do subject them to the personal property replacement tax found in §201 (c) and (d). Section 201 of the IITA states in pertinent part:

(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.

Section 301 provides the general rule for allocation and apportionment of base income to Illinois, and states in part:

(c) Other persons.

(1) In general. Any item of income or deduction which was taken into account in the computation of base income for the taxable year by any person other than a resident and which is referred to in Section 302, 303 or 304 (relating to compensation, nonbusiness income and business income, respectively) shall be allocated to this State only to the extent provided by such section.

(2) Unspecified items. Any item of income or deduction which was taken into account in the computation of base income for the taxable year by any person other than a resident and which is not otherwise specifically allocated or apportioned pursuant to Section 302, 303 or 304 (including, without limitation, interest, dividends, items of income taken into account under the provisions of Sections 401 through 425 of the Internal Revenue Code, and benefit payments received by a beneficiary of a supplemental unemployment benefit trust which is referred to in Section 501(c)(17) of the Internal Revenue Code):

(A) in the case of an individual, trust or estate, shall not be allocated to this State; and

(B) in the case of a corporation or a partnership, shall be allocated to this State if the taxpayer had its commercial domicile in this State at the time such item was paid, incurred or accrued. (Source: P.A. 82-609)

Reference must therefore be made to §304 of the IITA. Section 304 states in pertinent part:

:. 304. Business Income Of Persons Other Than Residents.

(a) In general. The business income of a person other than a resident shall be allocated to this State if such person's business income is derived solely from this State. If a person other than a resident derives business income from this State and one or more other states, then, except as otherwise provided by this Section, such

person's business income shall be apportioned to this State by multiplying the income by a fraction, the numerator of which is the sum of the property factor (if any), the payroll factor (if any) and 200% of the sales factor (if any), and the denominator of which is 4 reduced by the number of factors other than the sales factor which have a denominator of zero and by an additional 2 if the sales factor has a denominator of zero.

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(3) Sales Factor.

(A) The sales factor is a fraction, the numerator of which is the total sales of the person in this State during the taxable year, and the denominator of which is the total sales of the person everywhere during the taxable year.

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(C) Sales, other than sales of tangible personal property, are in this State if:

(i) The income-producing activity is performed in this State; or

(ii) The income-producing activity is performed both within and without this State and a greater proportion of the income-producing activity is performed within this State than without this State, based on performance costs.

(D) For taxable years ending on or after December 31, 1995 and excluding taxable years ending after December 31, 1997, the following items of income shall not be included in the numerator or denominator of the sales factor: dividends; amounts included under Section 78 of the Internal Revenue Code; and Subpart F income as defined in Section 952 of the Internal Revenue Code. No inference shall be drawn from the enactment of this paragraph (D) in construing this Section for taxable years ending before December 31, 1995.

For taxing purposes all corporations and partnerships are non-residents who determine income based upon the factors described in $304(a). Thus the question is where does the income producing activity occur? If it occurs in Illinois or within Illinois and without, but the portion in Illinois is greater (based upon performance costs) is greater than the portion without, the activity is considered to be within Illinois. If the corporate office is in Illinois, then the income-producing activity probably would be as well (although not necessarily). If the office is not in Illinois, then it depends upon the performance costs involved in the activity. Accordingly, the partnership must analyze its activities to answer the scenarios posed in the first situation.

Question 1(c) and 2 in the first situation are not related to the establishment of the Illinois office. Thus any tax burden would be based upon whether the income-producing activity was considered to be occurring predominantly in Illinois. The tax burden would not be based on when the Illinois office was opened.

The answer to the question in "Situation 2" is that, if XYZ and the partnership are engaged in a unitary business (as is likely the case if XYZ manages and operates the partnership, and most of its income is derived from the partnership then XYZ's share of the partnership's sales, payroll and property factors would be included with XYZ's factors to determine Illinois income. I have enclosed a copy of 86 Il. Administrative code Ch. 1, § 100.3380 which explains how the income of a corporate partner is determined. In particular, subsection (c) will contain the answer to your question. I have also included §3370 of the regulations for your further reference. If, on the other hand, XYZ and the partnership are not engaged in a unitary business, XYZ will include in its Illinois net income its partnership share of the income the partnership apportions to Illinois using the partnership's own apportionment factor. See §305 of the IITA which states in part:

> (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.

I hope that this has been helpful to you. If you have additional questions please feel free to contact me at the above address.

Sincerely,

Charles E. Matoesian
Associate Attorney (Income Tax)