

General Information Letter: Nexus issues are not a proper subject for letter ruling.

October 8, 2008

Dear:

This is in response to your letter dated September 2, 2008 in which you request a letter ruling. The nature of your request and the information provided requires that we respond with a General Information Letter (GIL). A GIL is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code § 1200.120(b) and (c), which may be accessed from the Department's web site at www.Iltax.com. The following information relates to Illinois income tax. Your request in regard to Illinois sales tax has been forwarded to the Sales and Excise Tax Division and will be addressed by a separate ruling. For questions regarding Illinois franchise tax, contact the Illinois Secretary of State, 501 S. 2nd St., Rm 328, Springfield, IL 62756.

Your letter states as follows:

Please be advised that I represent an entity that is currently being formed.

At this time it is anticipated that the entity and its server will be located in the State of STATE.

This entity will provide poker gaming lesson via the internet.

Individuals will be offered four (4) levels of training as follows: Basic – This level will provide basic poker training. Individuals will be charged \$19.95 annually. Silver – The level will provide additional training above the basic level. Individuals will be charged \$49.95 annually. Gold- This level will provide advanced training. Individuals will be charged \$49.95 annually. Platinum – This level will provide the highest level of training. Individuals will be charged \$299.00 annually.

In addition, individuals will be able to purchase a "starter kit" for \$24.95 which can be downloaded from the website.

Platinum level individuals will be able to refer other individuals to this site and will receive a payment for these referrals.

Rulings Requested

Are the fees subject to sales tax by your state?

Is the downloadable starter kit subject to sales tax by your state?

Is the company subject to any business activity taxes by your state? Business activity taxes would be income, franchise, business and occupational, gross receipts etc.

RULING

The determination whether a taxpayer has nexus with Illinois is extremely fact-specific. Therefore, the Department does not issue rulings regarding whether a taxpayer has nexus with the State. For information regarding nexus, see Department of Revenue Regulations Section 100.9720 (accessible

from the Department's web site). In addition, the following general information may be provided.

The United States Constitution limits a state's power to subject to income tax foreign corporations and other nonresidents. The Due Process Clause requires that there exist some minimum connection between a state and the person, property, or transaction the state seeks to tax. (Quill Corp. v. N. Dakota, 504 U.S. 298 (1992)) The Commerce Clause requires that a state's tax be applied only to activities with a substantial nexus to the taxing state. (Id.) In the case of foreign corporations, Illinois may assert nexus to tax unless the corporation falls under the protection conferred by Public Law 86-272. (15 U.S.C. § 381) Public Law 86-272 precludes a state from subjecting a nondomiciliary corporation to a net income tax where such corporation's only activities within the state for the taxable year consist of solicitation activities for sales of tangible personal property.

Aside from the question of nexus is the issue of whether or not there is any income tax liability imposed under the Illinois Income Tax Act ("IITA" ; 35 ILCS 5/101 *et seq.*). A nonresident is liable for Illinois income tax under Section 201 of the IITA if it derives "net income" as defined under IITA Section 202. IITA Section 202 defines net income as that portion of the taxpayer's "base income," as defined in Section 203, which is allocated or apportioned to Illinois under the provisions of Article 3 of the IITA, less certain deductions. The above provisions may be accessed from the Department's web site.

Base income that constitutes nonbusiness income is allocated to Illinois under IITA Sections 301(c)(2) and 303. Base income that constitutes business income is apportioned to Illinois under IITA Section 304. IITA Section 304(a) provides for taxable years ending on or after December 31, 2000 that the apportionment factor for a nonresident deriving business income from Illinois and one or more other states (other than an insurance company, financial organization, or transportation company) shall be equal to its sales factor. Section 304(a)(3)(A) defines the sales factor as a fraction, the numerator of which is the total sales of the person in Illinois during the taxable year, and the denominator of which is the total sales of the person everywhere. IITA Section 1501(a)(21) defines the term "sales" to mean all gross receipts of the taxpayer that are part of the taxpayer's business income.

In the case of sales of tangible personal property, in general, sales are in Illinois if the property is delivered or shipped to a purchaser in Illinois. Sales of "canned" computer software are considered sales of tangible personal property. See IT 93-0042 (GIL). With respect to sales other than sales of tangible personal property, for taxable years ending before December 31, 2008, such sales are assigned to Illinois for sales factor purposes if the income-producing activity that gave rise to the receipts is performed wholly in Illinois, or the income-producing activity is performed in Illinois based on costs of performance.

For taxable years ending on and after December 31, 2008, the assignment of gross receipts from intangible personal property (other than patents, copyrights, trademarks, and similar items) depends on whether the taxpayer is a dealer with respect to the intangible property within the meaning of Section 475 of the Internal Revenue Code (IRC) 35 ILCS 5/304(a)(3)(C-5)(iii). A taxpayer is a dealer in an intangible if the taxpayer is actually a dealer with respect to the property under Section 475(c)(1) of the IRC, or would be a dealer under Section 475(c)(1) if the item were a security as defined in IRC Section 475(c)(2). If the taxpayer is a dealer, then gross receipts from the intangible personal property are assigned to Illinois for sales factor purposes if the receipts are received from an Illinois

customer. An individual is an Illinois customer if he or she is a resident of Illinois.

For taxable years ending on and after December 31, 2008, gross receipts from sales of services are assigned to Illinois to the extent that the receipts are from services received in Illinois. 35 ILCS 5/304(a)(3)(C-5)(iv). For this purpose, if services are performed for an individual and the subject matter of the service may not be identified as an item of tangible personal property, real property, or the individual's person, then the service is deemed to be received in the individual's state of residence. In such circumstances, if the services are provided to an Illinois resident, then the gross receipts would be assigned to Illinois. Unless the taxpayer has actual knowledge that the residence of an individual is different from the billing address of the individual at the time of the sale, the individual is deemed to be a resident of the state in which the billing address is located.

Applying the above to the facts provided, for taxable years ending before December 31, 2008, annual fees from poker training would not be assigned to Illinois. Nothing in your letter identifies any income-producing activity of the taxpayer that is performed in Illinois. Department regulations define the term "income-producing activity" to mean the transactions and activity directly engaged in by the person in the regular course of its trade or business for the ultimate purpose of obtaining gains or profits. However, such activity does not include transactions and activities performed on behalf of a person, such as those conducted on its behalf by an independent contractor. 86 Ill. Adm. Code 100.3370(c)(3)(A). Your letter indicates only that the taxpayer will be located and will maintain a server in STATE. In addition, activity conducted by Platinum level individuals would not be considered income-producing activity of the taxpayer. Therefore, annual fees from poker training would not be assigned to Illinois in computing the sales factor.

With respect to gross receipts from sales of "starter kits," sales factor treatment depends on whether a "starter kit" is tangible personal property. Your letter does not contain facts sufficient to determine the type of property that is comprised in a "starter kit." Assuming, however, that a starter kit is canned computer software, gross receipts from sales would be considered sales of tangible personal property, and therefore allocable to Illinois if downloaded by a purchaser in Illinois. 35 ILCS 5/304(a)(3)(B)(i). On the other hand, if a starter kit is not canned computer software, gross receipts from sales would not be assigned to Illinois. Again, no facts indicate that any income-producing activity with respect to such sales is performed in Illinois.

For taxable years ending on and after December 31, 2008, annual fees from poker training must be assigned to Illinois in computing the sales factor if the training is received in Illinois. Assuming the training is provided to individuals, the training is considered to be received in the individual's state of residence. Accordingly, annual fees from poker training must be assigned to Illinois to the extent that the fees are for training provided to Illinois residents. For this purpose, unless the taxpayer has actual knowledge that the residence of an individual is different from the billing address of the individual at the time of the sale, the individual is deemed to be a resident of the state in which the billing address is located.

With respect to gross receipts from sales of "starter kits" the analysis again depends on whether "starter kits" are canned computer software and therefore treated as tangible personal property. Assuming a "starter kit" is canned computer software, gross receipts from sales would be assigned to Illinois if downloaded by a purchaser in Illinois. 35 ILCS 5/304(a)(3)(B)(i). On the other hand, if a "starter kit" is an item of intangible personal property, gross receipts from sales are assigned under

IITA Section 304(a)(3)(C-5)(iii). The taxpayer in this case would be considered a dealer in “starter kits” under IRC Section 475(c)(1) if “starter kits” were considered securities under IRC Section 475(c)(2) because the taxpayer will sell “starter kits” to customers in the ordinary course of business. As a result, gross receipts from sales of “starter kits” are assigned to Illinois to the extent that sales are made to Illinois residents. Once again, unless the taxpayer has actual knowledge of the residence of a customer during the taxable year, the customer is deemed a resident of Illinois if the customer’s billing address is in Illinois.

If the taxpayer does incur an Illinois income tax liability, and is subject to the State’s tax jurisdiction, then income tax must be paid and a return must be filed as required under IITA Section 502(a). Also, if the taxpayer is a corporation and is qualified to do business in Illinois, a return must be filed even if the taxpayer does not incur an Illinois tax liability provided the taxpayer is required to file a federal income tax return.

As stated above, this is a GIL. A GIL does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department.

Sincerely,

Brian L. Stocker
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