

General Information Letter: Business use of tangible personal property in Illinois is generally sufficient to create nexus.

December 31, 2008

Dear:

This is in response to your letter dated November 26, 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 website at www.Iltax.com. The following information relates to Illinois income tax. 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:

I am a New York State licensed Certified Public Accountant representing a New York based company that maintains an internet computer server farm in the City of Chicago. Other than the equipment being physically located in the jurisdiction, there are no other assets, employees or bank accounts maintained in Chicago. Maintenance of the equipment is conducted by a New York based employee visiting the site once or twice a year for a period of less than eight hours per day.

My client does not currently file business tax returns in your State nor does the company pay sales tax to your State for the equipment situated there. All equipment purchased is taxed at the New York State rate. Simply stated, does the company have to file a Franchise or a Business or Administrative Tax Return based on the above? Additionally, is it necessary to obtain a license to operate the internet computer server farm?

RULING

In general, 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. However, owning property that is located in Illinois and is used in the conduct of a business almost certainly results in your client being subject to Illinois income tax jurisdiction. For information regarding nexus, see Department of Revenue Regulations Section 100.9720, which may be accessed from the Department's website. In addition, the following general information may be provided.

Section 502(a) of the Illinois Income Tax Act ("IITA" ; 35 ILCS 5/502(a)) states:

In general. A return with respect to the taxes imposed by this Act shall be made by every person for any taxable year:

- (1) For which such person is liable for a tax imposed by this Act, or
- (2) In the case of a resident or in the case of a corporation which is qualified to do business in this State, for which such person is required to make a federal income tax return, regardless of

whether such person is liable for a tax imposed by this Act. However, this paragraph shall not require a resident to make a return if such person has an Illinois base income of the basic amount in Section 204(b) or less and is either claimed as a dependent on another person's tax return under the Internal Revenue Code of 1986, or is claimed as a dependent on another person's tax return under this Act.

Under this section, a nonresident must file an Illinois income tax return with respect to any taxable year in which the nonresident incurs an Illinois income tax liability, or, in the case of a corporation qualified to do business in Illinois, with respect to any taxable year in which the taxpayer is required to file a federal income tax return, regardless of whether the corporation is liable for Illinois income tax.

Section 201 of the IITA imposes the Illinois income tax upon every individual, corporation, trust and estate for each taxable year on the privilege of earning or receiving income in or as a resident of Illinois. A nonresident is liable for Illinois income tax under Section 201 of the IITA upon deriving "net income" 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 website. 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.

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 gives rise to the receipts is performed wholly in Illinois, or the income producing activity is performed in Illinois based on costs of performance. Department Regulations Section 100.3370(c)(3)(A) defines the term income producing activity.

Income producing activity defined. The term "income producing activity" applies to each separate item of income and means 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 profit. 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. The mere holding of intangible personal property is not, of itself, an income producing activity. Accordingly, the income producing activity includes but is not limited to the following:

- i) The rendering of personal services by employees or the utilization of tangible and intangible property by the person in performing a service.
- ii) The sale, rental, leasing, licensing or other use of real property.
- iii) The rental, leasing, licensing or other use of tangible personal

property.

iv) The sale, licensing or other use of intangible personal property.

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). Section 304(a)(3)(C-5)(iv) states:

Sales of services are in [Illinois] if the services are received in [Illinois]. For the purposes of this section, gross receipts from the performance of services provided to a corporation, partnership, or trust may only be attributed to a state where that corporation, partnership, or trust has a fixed place of business. If the state where the services are received is not readily determinable or is a state where the corporation, partnership, or trust receiving the service does not have a fixed place of business, the services shall be deemed to be received at the location of the office of the customer from which the services were ordered in the regular course of the customer's trade or business. If the ordering office cannot be determined, the services shall be deemed to be received at the office of the customer to which the services are billed. If the taxpayer is not taxable in the state in which the services are received, the sale must be excluded from both the numerator and denominator of the sales factor. The Department shall adopt rules prescribing where specific types of service are received, including, but not limited to, broadcast, cable, advertising, publishing, and utility service.

Based solely on the information you have provided, it is apparent that your client engages in income producing activity in Illinois. The use of tangible personal property in Illinois is income producing activity within the State. Accordingly, for taxable years ending prior to December 31, 2008, your client may be liable for Illinois income tax. For taxable years ending on and after December 31, 2008, whether or not any of your client's business income is apportioned to Illinois depends on whether the services it provides are received in Illinois, and whether the services are provided to a corporation, partnership, or trust with a fixed place of business in Illinois.

Finally, note that Section 3-10(c) of the Uniform Penalty and Interest Act ("UPIA" ; 35 ILCS 735/3-10) provides that in the case of a failure to file a return that is voluntarily disclosed, in accordance with regulations promulgated by the Department for receiving the voluntary disclosure, tax may be assessed no more than 4 years after the original due date of each return required to have been filed. Department regulations require that to be eligible for the 4-year limitations period, a taxpayer must voluntarily come forward and disclose its tax liability to the Board of Appeals. 86 Ill. Adm. Code § 210.126(b). In order to satisfy such disclosure requirement, a taxpayer must file with the Board returns for the tax being disclosed for the last four years and pay all tax, penalty and interest due within 30 days from the date the taxpayer's disclosure application is accepted. In addition, a taxpayer's determination of its tax liability, including the methodology used to compute such liability, must be documented in a manner reviewable by the Department. 86 Ill. Adm. Code § 210.126(b)(2). Lastly, a taxpayer will not be eligible for the relief provided under voluntary disclosure where the Department determines that the taxpayer has understated its tax liability to the Board by 10% or more and has failed to make a good faith effort to accurately report its liability for the voluntary disclosure period. The Department maintains the right to audit all open years within the voluntary disclosure period. 86 Ill. Adm. Code § 210.126(e).

Both the regulations referred to above, as well as Form BOA-2 Application for Voluntary Disclosure,

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may be accessed from the Department's website.

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. If you have further questions regarding this GIL, please call (217) 782-7055. If you have additional questions regarding Illinois income tax laws, please visit the Department's website at www.ILtax.com.

Sincerely,

Brian L. Stocker
Associate Counsel (Income Tax)