

General Information Letter: Nexus issues are not generally appropriate for resolution by letter ruling.

February 9, 2009

Dear:

This is in response to your letter dated January 15, 2009 in which you state the following:

Identification of all interested parties:

1. COMPANY, Inc., AVENUE, CITY, STATE ZIP CODE
2. One Illinois resident who is an employee and a shareholder of COMPANY
3. Over 70 shareholders of COMPANY who are all STATE residents.

State of the Facts:

COMPANY, Inc. (COMPANY) is a STATE S-Corporation with over seventy shareholders, all of whom are employees, with a 10/31 tax year end. COMPANY has only done business in STATE. They also do not foresee doing business in Illinois in the future. COMPANY has almost four hundred employees, all of whom were STATE residents. Recently, one of those employee/shareholders who is originally from Illinois decided to move back to Illinois and asked if she could keep her job with COMPANY and work remotely from her home in Illinois. COMPANY agreed to this arrangement.

This employee/shareholder performs accounts receivable duties. Specifically, she creates and sends invoices, applies payments, tracks, preliminary notices and releases, calls on late payments, creates and updates billing forms, and balances cash.

Request:

I would like to conclusively determine whether this one employee working from her home creates nexus for COMPANY, the S-Corp. The sales factor would be zero the property factor would be virtually zero, and the payroll factor would be incredibly nominal. The decision to allow the employee/taxpayer to stay on as an employee in another state was entirely for her convenience, in a time when companies are trying to provide good benefits and lifestyles to their hard workers.

The first tax period at issue would be for the period ending October 31, 2009.

According to the Department of Revenue ("Department") regulations, the Department may issue only two types of letter rulings: Private Letter Rulings ("PLR") and General Information Letters ("GIL"). The regulations explaining these two types of rulings issued by the Department can be found in 2 Ill.Adm.Code §1200, or on the website <http://www.tax.illinois.gov/LegallInformation/regs/part1200>.

Due to the nature of your inquiry and the information presented in your letter, we are required to respond with a GIL. GILs are designed to provide background information on specific topics. GILs, however, are not binding on the Department.

The determination whether a taxpayer has nexus to subject it to Illinois Income Tax is extremely fact-specific. Therefore, the Department does not issue rulings regarding whether a particular taxpayer has nexus with the State. However, general information regarding nexus with Illinois for income tax purposes may be provided.

Section 201 of the Illinois Income Tax Act ("IITA"), 35 ILCS 5/101 et seq, imposes a tax measured by

net income on taxpayers for the privilege of earning or receiving income in this State. The Due Process and Commerce Clauses of the Federal Constitution limit the power of Illinois to subject foreign taxpayers to Illinois tax. The Due Process Clause requires that there exist some minimum connection between a state and the person, property, or transaction it seeks to tax (Quill Corp. v. North Dakota, 504 U.S. 298, 112 S.Ct. 1904 (1992)). Similarly, the Commerce Clause requires that the tax be applied to an activity with a substantial nexus with the taxing state. Id. Where any part of a foreign corporation's income is allocable to Illinois in accordance with the provisions of Article 3 of the IITA, Illinois can demonstrate the connection, or nexus, necessary to subject a foreign corporation to tax. Therefore, unless protected by Public Law 86-272, a foreign corporation is liable for Illinois income tax where any portion of its income is allocated to Illinois.

IITA Section 304 provides for taxable years ending on or after December 31, 2000 that the apportionment factor for a foreign corporation deriving business income from Illinois and one or more other states 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. Department of Revenue Regulations 100.3700(c)(1) states that gross receipts from sales of tangible personal property are allocable to Illinois for sales factor purposes if the property is delivered or shipped to a purchaser within this state regardless of the f.o.b. point or other conditions of sale.

Because COMPANY, Inc. is involved primarily in providing services to its customers, the following is the statutory language for apportioning sales of services:

- (C) For taxable years ending before December 31, 2008, sales, other than sales governed by paragraphs (B), (B-1), and (B-2), 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.
- (C-5) For taxable years ending on or after December 31, 2008, sales, other than sales governed by paragraphs (B) [sales of tangible personal property], (B-1) [gross receipts from patents, copyrights, trademarks, and similar intangible property], (B-2) [same - gross receipts from patents, copyrights, trademarks, and similar intangible property], and (B-5) [sales of telecommunications service], are in this State if any of the following criteria are met:
  - ...
  - (iv) Sales of services are in this State if the services are received in this State. 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 the denominator of the sales factor.

Your letter indicates that COMPANY "has only done business in STATE" and that COMPANY does "not foresee doing business in Illinois in the future." Although your letter fails to provide details relating to COMPANY's business operations, your website makes it clear that COMPANY is in the business of earth moving and large equipment rental. Based on the fact that all earth moving operations and large equipment rentals take place in STATE, COMPANY will not have an Illinois sales factor. No portion of COMPANY's income will be allocated to Illinois even if COMPANY has nexus with Illinois based on one employee performing account receivables duties from her own home located in Illinois.

Please note, however, that as a result of an employee performing her duties entirely within the State of Illinois, COMPANY must withhold Illinois income tax on the entire amount of her compensation. IITA Section 701 states:

(a) In General. Every employer maintaining an office or transacting business within this State and required under the provisions of the Internal Revenue Code to withhold a tax on:

(1) compensation paid in this State (as determined under Section 304(a)(2)(B) to an individual): or

(2) payments described in subsection (b) shall deduct and withhold from such compensation for each payroll period (as defined in Section 3401 of the Internal Revenue Code) an amount equal to the amount by which such individual's compensation exceeds the proportionate part of this withholding exemption (computed as provided in Section 702) attributable to the payroll period for which such compensation is payable multiplied by a percentage equal to the percentage tax rate for individuals provided in subsection (b) of Section 201.

(b) Any payment (including compensation) to a resident by a payor maintaining an office or transacting business within this State (including any agency, officer, or employee of this State or of any political subdivision of this state) and on which withholding of tax is required under the provisions of the Internal Revenue Code shall be deemed to be compensation paid in this State by an employer to an employee for the purposes of Article 7 and Section 601(b)(1) to the extent such payment is included in the recipient's base income and not subjected to withholding by another state. ...

For more information, please view Publications 130 entitled "Who is Required to Withhold Illinois Income Tax" and 131 entitled "Withholding Income Tax Filing and Payment Requirements" at [www.tax.illinois.gov/Publications/Pubs](http://www.tax.illinois.gov/Publications/Pubs).

As stated above, this is a general information letter which does not constitute a statement of policy that either applies, interprets or prescribes tax law. It is not binding on the Department. Should you have additional questions, please do not hesitate to contact our office.

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Sincerely,

Heidi Scott  
Staff Attorney -- Income Tax