IT 09-0023-GIL 07/30/2009 PUBLIC LAW 86-272/NEXUS

General Information Letter: Missionary sales activities by employees of the taxpayer for which the taxpayer is paid by its customer are sales of service by the taxpayer and are not protected by Public Law 86-272.

July 30, 2009

Dear:

This is in response to your letter dated April 16, 2009 in which you state the following:

> We are requesting a general information letter on our findings from the Illinois Department of Revenue ("Department") on the determination of whether our client, Company X, has nexus for purposes of the Illinois Income and Replacement Tax and, if so, how the apportionment percentage should be determined as discussed below. We recognize that the information contained within a general information letter is not binding on the Illinois Department of Revenue.
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> Facts
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> Company X is a STATE corporation with its commercial domicile in a state outside of Illinois. Company X is in the business of research and development of pharmaceutical products. As a result of Company X's development efforts, it owns various pharmaceutical intangibles (i.e., patents and related intangibles). Company X does not manufacture or distribute the pharmaceuticals in which it owns the underlying intangibles. Instead, Company X licenses the use of the intangibles to other parties. Company X has a licensing agreement with a drug company ("Company Y") which gives Company Y the right to "…co-develop, use, sell, promote, offer for sale, import and distribute…", within the United States, one of the pharmaceutical drugs ("Drug A") in which Company X owns the underlying intangible assets. The only intangibles that are being licensed from Company X to Company Y are the non-production intangibles related to Drug A ("Intangibles") (i.e., the Drug A patents and manufacturing know-how are not being licensed to Company Y). Company Y is unrelated to Company X. The licensing agreement is between Company X, a STATE Corporation with its commercial domicile in a state outside of Illinois, and Company Y, an entity organized in a country outside of the United States with its commercial domicile outside of the United States. Company Y does not directly operate within North America. Wholly owned affiliates of Company Y have operations in North America and the licensing agreement allows Company Y to use these affiliates to distribute Drug A within the United States. Company Y's United States affiliate has operations within Illinois and is commercially domiciled within Illinois. Employees of Company X occasionally visit the Illinois location of Company Y's U.S. affiliate in an effort to advise Company Y's affiliate on issues related to the distribution, marketing and sale of Drug A.
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> Various payments are outlined within the licensing agreement between Company X and Company Y for the use of the Intangibles. The licensing agreement outlines three main payments related to the distribution of Drug A: a royalty, commercial milestone payments and development milestone payments. The licensing agreement provides for a royalty which is calculated as a percentage of the net sales revenue of Company Y's sales of Drug A (which would include any sales by Company Y and any of its affiliates). In addition to the percentage royalty, the licensing agreement between Company X and Company Y also provides for several "commercial milestone" payments from Company Y to Company X contingent on

Company Y reaching certain annual sales thresholds of Drug A within the geography covered by the licensing agreement (i.e., the 50 states in which Company Y has the right to market/distribute Drug A). As an example, the licensing agreement provides for a $30 million "commercial milestone" payment from Company Y to Company X in the first calendar year in which Company Y's sales of Drug A reach $700 million. The $30 million "commercial milestone" payment is in addition to the percentage royalty that would be payable from Company Y to Company X on the $700 million in sales. Company Y has the legal right to sell Drug A in all 50 states and expects that Drug A will be sold in all 50 states. Drug A is available only by prescription.

The final type of payment outlined in the licensing agreement for the right to distribute Drug A are the development milestone payments. Company X and Company Y had executed the licensing agreement in advance of when Drug A received approval from the Food & Drug Administration (FDA). There are six development milestone payments outlined within the licensing agreement. The various development milestones are met either when Drug A achieves certain approval stages for prescription use within the United States or if Drug A secures approval from the FDA for the treatment of other health conditions. An example of one of the development milestone payments in the licensing agreement calls for a payment of $10 million from Company Y to Company X when Company X files a new drug application with the FDA related to the primary use of Drug A. Company Y does not receive anything in exchange for the development milestone payments other than the right to "…co-develop, use, sell, promote, offer for sale, import and distribute…" Drug A (i.e., the development milestone payments are not contract research payments nor are they payments that give Company Y either partial or full title to the Drug A intangibles). The royalty, commercial milestone and development milestone payments constitute a group of payments based on different metrics related to Drug A and at various times during the licensing agreement giving Company Y the right to distribute Drug A.

Company X's gross receipts from the Drug A royalties and milestone payments are expected to constitute greater than 50% of its gross receipts included in gross income during the current tax year and during each of the two immediately preceding and future tax years.

Company Y is a multi-national pharmaceutical company that conducts operations within the United States through a subsidiary. Company Y and its subsidiaries market and distribute both Drug A and other pharmaceuticals in which it owns the underlying intangibles. Company Y's subsidiary uses its own sales force to advocate for the use of the various pharmaceuticals that it sells across the United Sates. Company Y's subsidiary uses Company Z to assist in the physical distribution of Drug A to pharmacies across the United States. Company Y and Company Z are unrelated (Company X and Z are also unrelated). Company Z has various distribution centers across the United States that are used for the distribution of Drug A. Company Y's subsidiary sells Drug A to Company Z (i.e., legal title passes from the subsidiary to Company Z). Company Y's subsidiary ships Drug A to the various distribution centers across the United States that are owned/operated by Company Z. Company Z subsequently sells/distributes Drug A to the thousands of pharmacies across the United States. The unrelated pharmacies across the United States then fill prescriptions of Drug A for patients across the United States.

Company Y's subsidiary advocates for the use of Drug A across the United States through the efforts of its sales force. The subsidiary's sales force meets with doctors and other medical practitioners across the United States to explain how Drug A can be used and its benefits. Company Y also allows Company X to advocate for the use of Drug A to a certain segment of medical professionals. Company X employs a group of Account Executives (AEs) across the United States for the purpose of encouraging the sale of Drug A. Company X's AEs meet with doctors and/or decision makers at institutional facilities (e.g., hospitals/Veterans Administration facilities/long-term care facilities) to promote the use of Drug A. The AEs do not deliver product, nor do they take any product orders. Similar to the sales force of Company Y, the sole purpose of the advocacy/education of the medical community on the uses and benefits of Drug A is to generate "pull through" sales. The "pull through" sales generate sales for Company Y's subsidiary of Drug A and also generate a corresponding "pull through" royalty for Company X.

To encourage Company X to assist in this solicitation/advocacy activity related to Drug A, Company Y has agreed (within the licensing agreement) to reimburse Company X for a portion of its costs related to its employment of the AEs that advocate for the use of Drug A. Under the terms of the agreement, Company Y has agreed to pay Company X $592.11 per AE, up to the first 38 AEs, per day for the sales activities. Under no circumstance will the reimbursement exceed $450,000 per month nor will it exceed $4,500,000 per twelve month period following the first date that Company X deploys AEs in the field. Company X may increase the number of AEs beyond 38 upon approval from Company Y. Upon approval from Company Y of such expansion, the additional AEs will be reimbursed at a rate of $422.50 per actual working day in the field. The total reimbursement for the additional sales force may not exceed $3,500,000 per twelve month period. The cost reimbursement is in addition to the royalty and milestone payments that are due to Company X from the "pull through" sales that may be generated as a result of the qualified contacts with medical professionals.

Currently, Company X does not employ a resident of the state of Illinois as an AE. However, AE's that reside in other states may travel into Illinois to solicit/advocate for the use of Drug A. The AEs receive incentive compensation partially based on the sales volume of Drug A in his/her respective geographic territory. Company X does not provide office space to the AEs. Similar to the other Company X AEs, the AE assigned to the Illinois territory does not take orders or make any sales of Drug A. The AEs sole responsibility is to advocate for the use of Drug A in Illinois.

Company X believes it has access to two different sources of data related to Drug A sales. One source of data available to Company X is the sales by state information of Company Y's subsidiary's sales of Drug A to Company Z. This information is constructed by identifying the destination of the sales of Drug A shipped by the subsidiary (i.e., the destination sales of the subsidiary related to its wholesale sales to each state including its sales to each of Company Z's distribution centers). Company X believes it may be able to obtain a second source of data related to Drug A sales. The other source of data is the sales by state information of Drug A by the thousands of pharmacies to consumers/patients across the country. Company X believes this sales data may be obtained through a third-party data source for a fee. Company Y's subsidiary sales information is heavily influenced by its choices on how it physically distributes Drug A whereas the pharmacy sale data represents the actual volume of sales occurring in each state which mirrors the extent that each marketplace is penetrated by Company Y's advertising and from the activities of both Company X and Company Y's AEs.

Issues

1) Does Company X have nexus and thus a filing requirement for Illinois's Income and Replacement Tax as a result of the licensing of its Intangibles to Company Y for use in Illinois and/or from the meetings in Illinois between employees of Company X and personnel from Company Y's subsidiary?

2) If Company X is subject to the Illinois Income and Replacement Tax, how should Company X determine the portion of the Drug A licensing agreement payments to source to the state of Illinois for sales factor apportionment purposes? Specifically:
a) Is the right (i.e., the right to "…co-develop, use, sell, promote, offer for sale, import and distribute…") granted to Company Y within the Drug A licensing agreement a "similar item of intangible personal property" as outlined in ILCS § 5/304(a)(3)(B-1) and thus should be sourced based on ILCS § 5/304(a)(3)(B-1)(i)?
b) If the sourcing rule in ILCS § 5/304(a)(3)(B-1)(i) is applicable, then will any of the payments under the Drug A licensing agreement (i.e., the royalty, commercial milestone payments and development milestone payments) be sourced to Illinois?
c) If the sourcing rule in ILCS § 5/304(a)(3)(B-1)(i) is not applicable, then should Company X use either the Illinois sales percentage of Company Y's subsidiary or the Illinois pharmacy sale percentage as the proxy for the portion of the Drug A licensing agreement payments to source to Illinois?

Conclusions

1) Yes, although Company X did not enter into its licensing agreement within the state of Illinois, it does send employees of the Company to meet with Company Y representatives to coordinate efforts related to the sale of Drug A with personnel from Company Y's subsidiary. Therefore, Company X should have Illinois Income and Replacement Tax nexus as a result of its activities within the state of Illinois.
2) We are not sure what apportionment sourcing methodology should be used by Company X because we are unsure if the distribution right that Company X has granted to Company Y is a "similar item of intangible personal property" as outlined in ILCS § 5/304(a)(3)(B-1). If it is, then it would appear that none of the payments received in connection with the Drug A licensing agreement would be sourced to Illinois because the "similar item of intangible personal property" is not being "utilized" within Illinois because the licensee, Company Y, is not commercially domiciled within Illinois.

Analysis

Illinois Income and Replacement Tax

<u>Tax Imposed</u>

The State of Illinois imposes an income tax at a rate of 4.8% upon the net income of corporations on the privilege of earning or receiving income in the state.[1] The State of Illinois also imposes a replacement tax of 2.5% upon the net income of every corporation on the privilege of earning or receiving income in the state.[2] "Net income" is defined by the state as the "portion of base income for such year which is allocable to this State under the provisions of Article 3, less the standard exemption allowed by Section 204 and the deduction allowed by Section 207."[3] Base income is calculated by taking the taxpayer's federal taxable income plus/minus certain state modifications.[4]

Net income may be comprised of two classes of income: business and/or nonbusiness income. The State of Illinois defines "business income" as "all income that may be treated as apportionable business income under the Constitution of the United States."[5] A person having taxable business activities both inside and outside of the state is then entitled to apportion his business income by multiplying the income by a fraction.[6] The fraction is calculated by dividing the person's Illinois sales by the person's sales everywhere.[7] Royalty income is included in apportionable income if the intangible property was held or created in the regular course of the taxpayer's trade or business operations.[8]

The second classification, nonbusiness income, is defined as "all income other than business income or compensation."[9] In general, a person's income is classified as business income unless clearly classifiable as nonbusiness income.[10] Nonbusiness income is generally allocated to the State of Illinois if the income producing property is located within the state or utilized within the state.[11]

Nexus

Income Tax Nexus in General

Currently, federal protection exists for activities directly associated with the solicitation of sales of tangible personal property under Public Law 86-272, 15 U.S.C. 381-384 (herein P.L. 86-272). P.L. 86-272 restricts a state from imposing a net income tax on income derived within its borders from interstate commerce if the sole business activity of the company consists of the solicitation of orders for sales of tangible personal property. In addition, orders must be sent outside of the state for acceptance or rejection, and, if accepted, must be shipped from a point outside of the state.

In addition to the protections provided to a taxpayer on its solicitation activities conducted towards its own customers, P.L. 86-272 also provides protections for a taxpayer's "missionary sales" activities. Missionary sales activities generally encompass the indirect solicitation activities by a taxpayer's employees or independent contractors that are intended to generate "pull through" sales for the taxpayer. As an example, a manufacturer of chewing gum may choose to directly solicit sales to the end consumers of the chewing gum or to the retail establishments that sell chewing gum in order to generate sales for the chewing gum manufacturer's distributors which then will generate "pull through" sales for the chewing gum manufacturer itself. This type of solicitation is also protected under P.L. 86-272. The relevant portion of P.L. 86-272 that pertains to this indirect solicitation activity reads as follows:

Sec. 381. (a) No State, or political subdivision thereof, shall have power to impose, for any taxable year…, a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person… are either, or both, of the following:

…..

(2) The solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1).[12]

Illinois Income and Replacement Tax Nexus

As mentioned above, the State of Illinois imposes an income tax and/or replacement tax on "the privilege of earning or receiving income in the state."[13] However, the State of Illinois recognizes the protections afforded to certain taxpayers under P.L. 86-272 and provides additional guidance concerning the applicability of P.L. 86-272. According to the state, the following business activities are considered to be "protected activities." Thus, a taxpayer that is otherwise protected under P.L. 86-272 will not lose his immunity if he engages in the following business activities:

- Soliciting orders for sales by any type of advertising;
- Soliciting orders for sales by an in-state resident employee or representative of the nonresident, so long as that person does not maintain or use any office or place of business in the State besides an "in-home" office;
- Carrying samples and promotional materials only for display or for distribution without charge or other consideration;
- Furnishing and setting up display racks and advising customers on the display of the nonresident's products without charge or other consideration;
- Providing automobiles to sales personnel for their use in conducting protected activities;
- Passing orders, inquiries and complaints on to the home office;
- Missionary sales activities; i.e., the solicitation of indirect customers for the nonresident's goods;
- Coordinating shipment or delivery without payment or other consideration and providing information relating to shipment or delivery either prior or subsequent to the placement of an order;
- Checking of customers' inventories without charge (for re-order, but not for other purposes such as quality control);
- Maintaining a sample or display room for two weeks (14 days) or less at any one location within the State during the tax year;
- Recruiting, training or evaluating sales personnel, including occasionally using homes, hotels or similar places for meetings with sales personnel;
- Mediating direct customer complaints when the purpose is solely for ingratiating the sales personnel with the customer and facilitating requests for orders;
- Owning, leasing, using or maintaining personal property for use in the employee's or representative's "in-home" office located within the residence of the employee or other representative that is not publicly attributed to the nonresident or to the employee or other representative of the nonresident in a representative capacity or automobile, when that use is solely limited to the conducting of protected activities;
- Shipping or delivering goods into this State by means of vehicles or other modes of transportation owned or leased by the nonresident taxpayer or by means of private carrier,

whether by motor vehicle, rail, water, air or other carrier and irrespective of whether a shipment or delivery fee or other charge is imposed, directly or indirectly, upon the purchaser.[14]

In addition, the State also provides a list of business activities that are not protected under P.L. 86-272. Engaging in the following business activities should create nexus for Illinois income and replacement tax purposes and subject a taxpayer to Illinois taxation:

- Making repairs or providing maintenance or service to the property sold or to be sold;
- Collecting current or delinquent accounts, whether directly or by third parties, through assignment or otherwise;
- Investigating credit worthiness;
- Installation or supervision of installation at or after shipment or delivery;
- Conducting training courses, seminars or lectures for personnel other than personnel involved only in solicitation of sales of tangible personal property;
- Providing any kind of technical assistance or services, including, but not limited to, engineering assistance or design service, when one of the purposes of the assistance or service is other than the facilitation of the solicitation of orders;
- Investigating, handling, or otherwise assisting in resolving customer complaints, other than mediating direct customer complaints when the sole purpose of such mediation is to ingratiate the sales personnel with the customer;
- Approving or accepting orders;
- Repossessing property;
- Securing deposits on sales;
- Picking up or replacing damaged or returned property;
- Hiring, training, or supervising personnel, other than personnel involved only in solicitation;
- Maintaining a sample or display room in excess of two weeks (14 days at any one location within the State during the tax year;
- Carrying samples for sale, exchange or distribution in any manner for consideration;
- Owning, leasing, or maintaining any of the following facilities or property in-state: repair shop; parts department; any kind of office other than an in-home office; warehouse; meeting place for directors, officers, or employees; stock of goods other than samples for sales personnel or that are used entirely ancillary to solicitation; telephone answering service; mobile stores; real property or fixtures to real property of any kind.
- Consigning stock of goods or other tangible personal property to any person, including an independent contractor, for sale;
- The maintenance of any office or other place of business in this State that does not strictly qualify as an “in-home” office;
- Entering into franchising or licensing agreements; selling or otherwise disposing of franchises and licenses; or selling or otherwise transferring tangible personal property pursuant to such franchise or license by the franchiser or licensor to its franchisee or licensee with the State.[15]

Application to Company X

<u>Licensing of Intangibles</u>

Entering into a licensing agreement outside the state of Illinois should not create nexus for purposes of the Illinois income and replacement tax. However, having employees of

Company X visit with representatives of Company Y's subsidiary in the state of Illinois to coordinate efforts related to the sale of Drug A likely creates nexus. P.L. 86-272 provides protections related to the sale of tangible personal property but does not provide the same protections related to the sale of intangible property such as activities related to a distribution right. Therefore, Company X likely has nexus for purposes of the Illinois income and replacement tax based on the activities of its employees.

Apportionment

Apportionment Formula

As stated above, a person having taxable business activities both inside and outside of the state is then entitled to apportion his business income by multiplying the income by a fraction.[16] The fraction is calculated by dividing the person's Illinois sales by the person's sales everywhere.[17]

Sales Factor

The state of Illinois defines "sales" as "all gross receipts derived by the person from transactions and activity in the regular course of such trade or business."[18] Sales of tangible personal property are in the state of Illinois if delivered or shipped to a purchaser other than the U.S. government within the state. For tax years ending on or after December 31, 2008, sales of services are in the state of Illinois if the services are received in the state.

Gross receipts from the sale, assignment or licensing of intangible personal property such as patents and copyrights are included in the Illinois' sales definition if gross receipts from licenses, sales, or other disposition of such items comprise more than 50% of the taxpayer's total gross receipts included in gross income during the tax year and during each of the two immediately preceding tax years.[19]

If the taxpayer's gross receipts from licenses, sales, or other disposition of intangible personal property exceed the 50% test, then the gross receipts are sourced to Illinois to the extent the intangible personal property is utilized in Illinois during the tax year.[20] The Illinois Statute provides specific situations as to when a patent or copyright is utilized in the state. A patent is used in the state to the extent that it is employed in production, fabrication, manufacturing or other processing in the state or to the extent that a patented product is produced in the state. The statute provides that if the patent is utilized in more than one state, the extent that it is utilized in any one state shall be a fraction equal to the gross receipts of the licensee or purchaser from sales or leases of items produced, fabricated, manufactured, or processed within that state using the patent and of patented items produced within that state, divided by the total of such gross receipts for all states in which the patent is utilized.[21] The copyright utilization rule is similar to the patent rule. However, the statute only provides that trademarks and other similar items of intangible personal property are utilized in the state in which the commercial domicile of the licensee or purchaser is located. The statute does not provide guidance on what constitutes "similar items of intangible personal property" and on how the sourcing should be applied in the event that the intangible is used in more than one state.

Application to Company X

> From the facts provided above, it was noted that greater than 50% of Company X's total gross receipts have been and are expected to be from the distribution right related to the Drug A licensing agreement. Since Company X meets the greater than 50% test, it appears that its sales from other intangible personal property should be sourced to the state in which the commercial domicile of the licensee is located. Within the facts it has been presented that Company Y's commercial domicile is in a Country outside the United States. Therefore, it appears that Company X should source the payments received from the Drug A licensing agreement outside of the state of Illinois.

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/LegalInformation/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.

Your letter states that your client, Company X, has employees that occasionally visit Illinois "in an effort to advise Company Y's affiliate on issues related to the distribution, marketing and sale of Drug A." Employees of Company X also visit Illinois to "meet with doctors and/or decision makers at institutional facilities, … the sole purpose of the advocacy/education of the medical community on the uses and benefits of Drug A is to generate 'pull through' sales. The 'pull through' sales generate sales for Company Y's subsidiary of Drug A and also generate a corresponding 'pull through' royalty for Company X." Generally such activities are not protected by public Law 86-272 and it is likely that Company X will have Illinois income tax consequences for services provided to Company Y by their "Account Executives."

Because Company X is involved in providing services to Company Y for a fee, 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:
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> > (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.
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> (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], (B-5) [sales of telecommunications service], and (B-7) [sale of broadcasting services] are in this State if any of the following criteria are met:
> …
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> > (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.

As mentioned above, the "Account Executive" services to Company Y at various locations throughout Illinois will most likely be viewed as "received in" Illinois. As a result, Company X may have Illinois income tax consequences for services provided to Company Y by their Account Executives and may be required to file an Illinois income tax return. Pursuant to Section 502(a), an Illinois income tax return is required in two situations. The first situation is when a taxpayer is liable for Illinois income tax. The second situation is, in the case of a corporation qualified to do business in Illinois, when the taxpayer is required to file a federal income tax return, regardless of whether such person is liable for Illinois income tax.

Should you believe Company X will be required to file an Illinois income tax return, Company X must register with the state of Illinois and the Illinois Department of Revenue. All inquiries regarding how to register as a foreign corporation should be directed to the Illinois Secretary of State at the following address:

Office of the Illinois Secretary of State

Department of Business Services
Howlett Building, Room 328
Springfield, Illinois 62756
(217) 782-7880

Enclosed please find a copy of Form REG-1, which is used to register businesses with the Illinois Department of Revenue.

The second inquiry in your letter is how to apportion the income derived from the licensing agreements entered into by Company X for Illinois income tax and replacement tax purposes. We are unable to provide an answer to your second inquiry because we do not have all the facts necessary to make such an apportionment determination. For example, what are the “related intangibles” referred to in your letter? Where does the manufacturer fit into the transactions discussed in your letter? Why is Company Y paying Company X a licensing fee when Company X “does not manufacture or distribute the pharmaceuticals in which it owns the underlying intangibles” especially when such “payments are expected to constitute greater than 50% of [Company X’s] gross receipts included in gross income during the current tax year and during each of the two immediately preceding and future tax years?” Until we have a better understanding of the sales arrangements and sources of income we simply cannot give advice regarding how to properly apportion Company X’s income to Illinois.

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.

Sincerely,

Heidi Scott
Staff Attorney -- Income Tax

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[1] ILCS § 5/201(a); ILCS § 5/201(b)(7)(ii)
[2] ILCS § 5/201(c)
[3] ILCS § 5/202
[4] ILCS § 5/203(b)(1)
[5] Illinois Admin. Code § 100.3010(a)(2)
[6] ILCS § 5/304(a)
[7] ILCS § 5/304(a)(3)(A)
[8] Illinois Admin. Code § 100.3010(c)(6)
[9] Illinois Admin. Code § 100.3010(a)(3)(B)
[10] Illinois Admin. Code § 100.3010(a)(3)(C)

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[11] ILCS § 5/303
[12] 15 U.S.C. §381(a)(2)
[13] ILCS § 5/201(a); ILCS § 5/201(c)
[14] Illinois Admin. Code § 100.9720(c)(5)
[15] Illinois Admin. Code § 100.9720(c)(4)
[16] ILCS § 5/304(a)
[17] ILCS § 5/304(a)(3)(A)
[18] Illinois Admin. Code § 100.3370(a)(1)
[19] ILCS § 5/304(a)(3)(B-2)
[20] ILCS § 5/304(a)(3)(B-1)(i)
[21] ILCS § 5/304(a)(3)(B-1)(ii)(I)