

Private Letter Ruling: No withholding is required from compensation paid to a nonresident employee whose base of operations is outside Illinois.

August 25, 2009

Dear:

This letter is in response to your letter dated June 11, 2009, in which you request a Private Letter Ruling on behalf of Company. Your request for a Private Letter Ruling includes the information required under paragraphs 1 through 8 of subsection (b) of 2 Ill. Adm. Code 1200.110. The Private Letter Ruling will bind the Department only with respect to Company for the issues presented in this ruling. Issuance of this ruling is conditioned upon the understanding that Company and/or any related taxpayer(s) is not currently under audit or involved in litigation concerning the issues that are the subject of this ruling request.

The facts and analysis as you have presented them are as follows:

We respectfully request a private letter ruling from the Illinois Department of Revenue ("Department") on behalf of our client, Company, pursuant to 2 Ill. Adm. Code 1200.110. The tax period at issue is from January 1, 2009 on. A Power of Attorney (Form IL-2848) from Company is enclosed.

STATEMENT OF FACTS

The interested parties with respect to this private letter ruling request are Company ("Employer") and its Employee.

Employer is based in Illinois and is the operating subsidiary of a holding company ("Parent"). Employee also serves as the Secretary of Parent; however, Employee does not receive any additional compensation for these services. Employee is a resident of, and is domiciled in, XXXX, StateA, and as described below, conducts almost all of his duties from StateA.

Employee's duties are to manage and oversee the Employer's XXX Department, which has a staff of xx people. These employees are located in Employer's offices throughout the country. The vast majority of these employees provide services to customers. Until December 31, 2008, Employee also sat on Employer's Executive Management Committee, which generally met ten times per year in Illinois. However, that Committee disbanded. This largely eliminated any need for Employee to travel to Illinois. The modification of Employee's duties commencing in 2009 is part of a series of changes implemented at Employer with respect to both company strategy and company leadership.

Employee performs his duties almost entirely in StateA. In 2009 and thereafter, Employee will spend only five or six days working in Illinois. Employee's duties in Illinois will be limited to attending Parent's quarterly board meetings and meetings of Parent's audit committee. These board and audit committee meetings together last about four hours and are predominantly concerned with financial reporting topics and operating reports. At the board meetings, Employee provides an update on Employer's and Parent's matters which typically lasts fifteen minutes. Other than the update, Employee

has no speaking role at board or audit committee meetings, except for mechanical items performed in his role as Parent's Secretary such as the adoption of minutes from prior meetings. Board and audit committee meetings are generally held in Illinois, but are also occasionally held in StateA. For example, two out of the last three meetings were held in StateA. It is noteworthy that Parent is XX% owned by Corporation, which is headquartered in StateA.

Employee reports directly to Employer's CEO. The CEO works primarily out of the Employer's Illinois office but travels a large amount of the time, including regular trips to StateA. Employee reports to the CEO from StateA and interacts with him largely by telephone and email. In person contact between them is occasional and has not taken place in Illinois.

All of Employee's official mail is sent to Employer's office in Illinois and is immediately forwarded to appropriate staff for handling except for correspondence requiring Employee's personal attention, such as correspondence marked personal and confidential, which is forwarded to Employee in StateA. Employee has an Illinois-based phone number, but all of his incoming calls are automatically routed from the Illinois number directly to StateA. Because most of Employee's files are kept electronically, he has access to all of his files from StateA. Hard copy files containing official correspondence, signed agreements, and the like are maintained in Illinois. The Employee also has a secretary who works in Employer's Illinois office, whose primary role is to intake the physical mail and distribute it to the appropriate personnel within the Department for handling. She also forwards to Employee in StateA on a regular basis any physical mail that requires Employee's personal attention.

Employer currently withholds Illinois income tax from the taxable compensation paid to Employee. Employer seeks this private letter ruling to clarify its withholding obligations resulting from the change in Employee's Illinois activities since January 1, 2009. It should be noted that Employer also pays Illinois unemployment insurance tax with respect to the taxable compensation paid to Employee and Employer intends to continue to treat Employee consistently for Illinois income tax withholding and unemployment insurance tax purposes. See 820 ILCS 405/207; 86 Ill. Adm. Code 100.7010(a)(1).

RULING REQUESTED

1. Employer is not required to withhold Illinois income tax from the compensation paid to Employee because Employee's services are localized in StateA and any services performed outside of StateA are only "incidental" to the services performed in StateA.
2. Even if it is determined that Employee's services are not localized in one particular state, Employer is not required to withhold Illinois income tax from the compensation paid to employee because Employee's "base of operations" is in StateA.

STATEMENT OF AUTHORITIES

Section 701 of the Illinois Income Tax Act (the "IITA") provides that every employer maintaining an office or place of business in Illinois and required under the provisions of the Internal Revenue Code to withhold tax must deduct and withhold Illinois income tax on compensation "paid in this State" to an individual. IITA Section 701 incorporates the definition of "compensation paid in this State" set forth in IITA Section 304(a)(2)(B). 35 ILLS 5/701. The Department has adopted rules that further explain the term "compensation paid in this State" (86 Ill. Adm. Code 100.7010). Compensation is "paid in this State" if:

(A) the individual's service is localized in this State because it is performed entirely within this State; (B) the individual's service is localized in this State although it is performed both within and without this State, because the service performed without this State is incidental to the individual's service performed within this State; or (C) the individual's service is not localized in any state but some of the service is performed in this State and either; the base of operations, or if there is no base of operations, the place from which the service is directed or controlled is within this State, or the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in this State.

86 Ill. Adm. Code 100.7010(a)(1).

Section 100.7010(c) of the Department's rules sets forth the various "localization tests." Section 100.7010(c) restates the basic statutory test of localization and provides that an individual's service is localized in Illinois if it is performed entirely in Illinois, or if performed within and without Illinois and the service performed outside Illinois is "incidental" to the service performed within Illinois. The term "incidental" means "any service which is necessary to or supportive of the primary service performed by the employee or that is temporary or transitory in nature or consists of isolated transactions." 86 Ill. Adm. Code 100.7010(c)(2). The amount of time spent or amount of services performed in a particular state should not be regarded as decisive in determining whether the service is incidental. *Id.*

Section 100.7010(d) sets forth the Department's rules concerning the meaning of the term "base of operations." Section 100.7010(d) provides that "the localization tests are not applicable where an individual's employment normally or continually includes services within the State and also services without the State which are not 'incidental' to the services performed within this State." In such a case, the rule provides for an analysis of the base of operations for purposes of whether Illinois withholding is appropriate. "If the individual's base of operations is within this State, his entire compensation will be subject to withholding." 86 Ill. Adm. Code 100.7010(d)(1). The term "base of operations" refers to the "place or fixed center from which the individual works" and may be the individual's business office or home office or the place specified in the individual's contract of employment at which the employee is to receive his directions and instructions. 86 Ill. Adm. Code 100.7010(d)(2). The regulations state that "[i]n the absence of more controlling factors, an individual's base of operations may be the place to which he has his business mail, supplies, and equipment sent or the place

where he maintains his business records.” *Id.*

If the localization tests do not apply and it is impossible to determine an individual’s base of operations, the permanent place from which the employee’s service is directed or controlled is relevant for purposes of determining if Illinois withholding is required. 86 Ill. Adm. Code 100.7010(e)(1). “In such a case, if both the place from which the individual’s service is directed or controlled is within this State, and some of the service is performed within this State, then his entire compensation will be subject to withholding., but if not, none of his compensation will be subject to withholding.” *Id.*

The regulations state that the rules described above are to be applied in such a manner that if they were in effect in other states an item of compensation would constitute “compensation paid in” only one state. 86 Ill. Adm. Code 100.7010(a)(3). Thus, if an item of compensation would constitute compensation paid in a state other than Illinois after applying the rules set forth above, that same item of compensation could not also be compensation paid in Illinois. *Id.*

ANALYSIS

Employer is only required to withhold Illinois income taxes from the compensation paid to Employee if the compensation is “paid in this State.” 35 ILLS 5/701. Compensation is “paid in this State” if the individual’s services are localized in Illinois, either because the services are performed entirely within Illinois or because the services performed outside of Illinois are incidental to the services performed in Illinois, or if the base of operations is within Illinois or if there is no base of operations, the place from which the service is directed or controlled is within Illinois. 86 Ill. Adm. Code 100.7010(a)(1).

Employee performs services in both Illinois and StateA. The regulations state that the rules used to determine where compensation is paid for withholding purposes are to be applied in such a manner that if they were in effect in other states an item of compensation would constitute “compensation paid is” only one state. 86 Ill. Adm. Code 100.7010(a)(3). Thus, if an item of compensation would constitute compensation paid in StateA after applying the localization or base of operations tests, that same item of compensation could not also be compensation paid in Illinois. *Id.*

As the following paragraphs will demonstrate, the compensation paid to Employee should not be subject to Illinois income tax withholding because the services performed by Employee in Illinois are merely “incidental” to the services performed by Employee in StateA and, therefore, Employee’s services are localized in StateA. Further, even if Employee’s services are not deemed to be localized in any particular state, the compensation paid to Employee should not be subject to Illinois income tax withholding because the Employee’s base of operations is in StateA.

- A. The services performed by Employee in Illinois are merely “incidental” to the services performed in StateA and, therefore, Employee’s services are localized in StateA and compensation for such services is not subject to Illinois income tax withholding.

Employee performs services for Employer both in StateA and Illinois but almost all of them are performed in StateA. Under the localization tests, the services will be localized in one particular state if all of the services performed outside of that state are merely “incidental” to the services performed within the state. 86 Ill. Adm. Code 100.7010(c)

The term “incidental” means any services that are necessary to or supportive of the primary services performed by the Employee or that are temporary or transitory in nature or that consist of isolated transactions. 86 Ill. Adm. Code 100.7010(c)(2). Although the amount of time spent or amount of services performed in a particular state may not be decisive, it should be taken into account in determining whether a service is incidental. 86 Ill. Adm. Code 100.7010(c)(3).

Here, the facts demonstrate that the services performed by Employee in Illinois are merely “incidental” to the services performed by Employee in StateA. While in StateA, Employee performs all of his duties. While in Illinois, the Employee’s duties consist solely of attendance at a few of Parent’s board and audit committee meetings. As noted, this travel pattern changed on January 1, 2009. Before that, Employee spent more time in Illinois as a member of the now disbanded Executive Management Committee.

Employee’s attendance at Parent’s board and audit committee meetings is only “incidental” to Employee’s other duties for Employer. Employee’s attendance at these meetings is primarily due to his role as Parent’s Secretary, roles for which he receives no compensation from Employer. Further, these meetings are predominantly concerned with financial reporting topics and operating reports and Employee’s role at these meetings is limited to providing a brief update on Employer’s and Parent’s matters, which lasts approximately fifteen minutes, and performing certain procedural tasks in his role as Parent’s Secretary, such as adopting the minutes from prior meetings. Therefore, Employee’s presence at Parent’s board and audit committee meetings is merely “supportive of” Employee’s role, the primary duties of which are performed by Employee in StateA. See, e.g., 86 Ill. Adm. Code 100.7010(c)(4)(E) (regular buying trips to stores located in Illinois were merely “incidental” to the services performed by the taxpayer as a buyer for a department store located in State X because the duties performed in Illinois are “necessary to” and “supportive of” the individual’s primary duties, which are localized in State X). It is also noteworthy that board meetings are sometimes held in StateA – where Employer’s ultimate corporate parent, is headquartered – rather than Illinois. Two of the last three board meetings were held in StateA, not Illinois.

Further, although the amount of time spent or amount of services performed in a particular state is not the only factor in determining whether that service is incidental, the minimal number of visits made to Illinois each year by Employee (i.e. five or six days per year) further evidences the “incidental” nature of these services with respect to the other duties performed by Employee. The minimal number of visits made by Employee to Illinois each year indicates that the services performed in Illinois are only infrequent and isolated in nature.

B. Employees “base of operations” is his StateA office, and therefore, compensation for such services is not subject to Illinois income tax withholding.

If, under the localization tests, the services performed by Employee are not deemed to be localized in one particular state, income tax withholding will not be required for compensation paid for such services if the individual has a “base of operations” outside of Illinois. 86 Ill. Adm. Code 100.7010(d)(1).

The term “base of operations” refers to the “place or fixed center from which the individual works” and may be the individual’s business office or home office or the place specified in the individual’s contract of employment at which the individual is to receive his directions and instructions. 86 Ill. Adm. Code 100.7010(d)(2). Here, the Employee performs virtually *all* of his duties at his StateA home office, except for five or six days each year spent in Illinois at board meetings. His interactions with the CEO, to whom he reports and from whom he receives direction and instructions, do not take place in Illinois, but rather by e-mail, telephonically, or occasionally in person in StateA.

Further, “[i]n the absence of more controlling factors, an individual’s base of operations may be the place to which he has his business mail, supplies, and equipment sent or the place where he maintains his business records.” 86 Ill. Adm. Code 100.7010(d)(2). Although Employee’s business mail and telephone calls are initially routed to the Illinois office, all physical mail requiring his personal attention, and all telephone calls, are directly forwarded to Employee in StateA. Thus, he receives all of his mail and phone calls at his office in StateA. As previously mentioned, Employee also reports to and receives directions from the CEO while working in StateA. Therefore, the Employee’s office in StateA is clearly the Employee’s “base of operations.”

This conclusion is further evidenced by the following example provided in the regulations with respect to the “base of operations” test:

A is a salesman for the B corporation located in Chicago. A lives in State X and his territory includes State X and part of Cook County, Illinois. A starts his sales calls from and returns to his home daily. He keeps a catalogue and copies of correspondence from customers at his home, and writes his sales reports there. About once a week he reports to B’s sales office in Chicago for consultation with and direction from the sales manager. Communications from customers are to A at home and sometimes dictated by him to a stenographer when he is in the Chicago sales office. Correspondence to A and his paychecks are sometimes picked up by A in Chicago and otherwise are forwarded by the sales office to his home. The duties that A performs at home are sufficient to make his home his base of operations.

86 Ill. Adm. Code 100.7010(d)(3)(B) (emphasis added). The facts in this case are even clearer than the facts in the example set forth above. Unlike the example above, where the individual performed duties in multiple states, Employee performs virtually all of his duties at his office in StateA. As previously mentioned, Employee’s business mail and telephone calls are both routed to his office in StateA. Further, unlike the example above where the employee receives his directions and control in a location outside the state at issue, Employee receives directions from the CEO at his office in StateA.

Therefore, Employer should not be required to withhold Illinois income tax from the

compensation paid to Employee because Employee's "base of operations" is located in StateA.

The taxpayer is unable to locate any authority contrary to the views set forth above. This issue is not currently being examined in an open audit and is not pending in litigation in a case involving the taxpayer or a related taxpayer. To the best of the knowledge of both the taxpayer and the taxpayer's representative, the Department has not previously ruled on the same or a similar issue for the taxpayer or a predecessor, and neither the taxpayer nor the taxpayer's representative have previously submitted the same or similar issue to the Department but withdrew the request before a letter ruling was issued.

DEPARTMENT RULING

Section 701(a) of the Illinois Income Tax Act ("IITA"; 35 ILCS 5/701(a)) states:

Every employer maintaining an office or transacting business within this State and required under the provisions of the Internal Revenue Code to withhold tax on ... compensation paid in this State (as determined under Section 304(a)(2)(B)) to an individual ... 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 the 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.

Section 302(a) of the IITA states:

All items of compensation paid in this State (as determined under Section 304(a)(2)(B)) to an individual who is a nonresident at the time of such payment and all items of deduction directly allocable thereto, shall be allocated to this State.

IITA Section 304(a)(2)(B) states:

Compensation is paid in this State if:

- (i) The individual's service is performed entirely within this State;
- (ii) The individual's service is performed both within and without this State, but the service performed without this State is incidental to the individual's service performed within this State; or
- (iii) Some of the service is performed within this State and either the base of operations, or if there is no base of operations, the place from which the service is directed or controlled, is within this State, or the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in this State.

In applying IITA Section 304(a)(2)(B), Department Regulations § 100.7010(a)(3) (86 Ill. Adm. Code 100.7010(a)(3)) states that the rules set forth therein “are to be applied in such manner that, if they were in effect in other states, an item of compensation would constitute ‘compensation paid in’ only one state. Thus, if an item would, under these rules, constitute compensation paid in a state other than Illinois because the individual’s service was localized in such other state under the tests of [section 304(a)(2)(B)], it could not also be compensation paid in Illinois.” In addition, Department Regulations § 100.7010(c)(1) states that if compensation is paid in Illinois because the service is localized in Illinois under either Section 304(a)(2)(B)(i) or (ii), the factors set forth in Section 304(a)(2)(B)(iii) are not considered. Therefore, in order to determine whether compensation of a nonresident employee is taxable in Illinois, it must first be determined whether the employee’s services are localized in Illinois or another state. Where the services are localized in Illinois the compensation is allocated to Illinois, and where the services are localized in another state the compensation is not allocated to Illinois. If, on the other hand, the employee’s services are not localized in any state under the tests set forth in Section 304(a)(2)(B)(i) or (ii), then whether or not the compensation is taxable in Illinois depends upon the location of the employee’s base of operations or the place from which the employee is directed or controlled as set forth under Section 304(a)(2)(B)(iii).

In this case, the facts set forth in your letter are not sufficient to conclude that Employee’s services are localized in StateA. Department Regulations § 100.7010(c)(2) states that for purposes of determining whether services performed in one state are incidental to services performed in another, the term “incidental” refers to any service which is necessary to or supportive of the primary service performed by the employee or which is temporary or transitory in nature or consists of isolated transactions. Although Employee spends most of his time in StateA performing the duties, and very little of his time in Illinois, Regulations § 100.7010(c)(3) states that the amount of time spent or the amount of services performed in a state is not decisive in itself of the question whether services in a state are incidental to services in another state. To this point, the regulations provide the following example:

[A is a resident of State X and a salesman for the B corporation, located in State X.] A’s regular territory covers several counties in Illinois and one or two towns in State X. A goes to the State X towns on a regular basis even though more than 95% of his time and sales are with reference to his Illinois territory. The compensation for service which A performs in Illinois and State X is not localized in Illinois within the meaning of subsection (a)(2) because the service performed in State X is regular and permanent in nature and is not necessary to or supportive of sales made in Illinois.

Your letter indicates that Employee, in addition to serving Employer, also serves as Parent’s Secretary. As Secretary, Employee generally spends five to six days each year in Illinois performing duties during Parent’s quarterly board and audit committee meetings. Your letter does not demonstrate how Employee’s duties as Secretary are necessary to or supportive of the Employee’s duties as XXXXX. It appears that the two positions are independent of each other. In addition, Employee’s duties as Secretary are regular and permanent in nature. Therefore, it cannot be concluded that the services performed in Illinois are merely incidental to the services performed in StateA. It follows from the facts you have provided that Employee’s services may not be considered localized in any state.

Department Regulations § 100.7010(d)(1) states:

The localization tests are not applicable where an individual's employment normally or continually includes service within this State and also services without the State which are not "incidental" to the services performed within this State. In such case, if the individual's base of operations is within this State, his entire compensation will be subject to withholding, but if his base of operations is without this State, none of his compensation will be subject to withholding.

Regarding an employee's base of operations, Regulations § 100.7010(d)(2) states:

The term "base of operations" refers to the place or fixed center from which the individual works. An individual's base of operations may be his business office (which may be maintained in his home), or his contract of employment may specify a place at which the employee is to receive his directions and instructions. In the absence of more controlling factors, an individual's base of operations may be the place to which he has his business mail, supplies, and equipment sent or the place where he maintains his business records.

In this case, it is clear that Employee's base of operations is StateA. Employee performs nearly all of his duties from his StateA office, and these duties require the vast majority of Employee's time spent working for Employer. Therefore, the StateA office is the place or fixed center from which Employee works, and under Department Regulations § 100.7010(d)(1), none of his compensation is subject to withholding. This ruling shall bind the Department for all taxable years, except as limited pursuant to 2 Ill. Adm. Code 1200.110(d) and (e).

The facts upon which this ruling is based are subject to review by the Department during the course of any audit, investigation or hearing and this ruling shall bind the Department only if the material facts as recited in this ruling are correct and complete. This ruling will cease to bind the Department if there is a pertinent change in statutory law, case law, rules or in the material facts recited in this ruling.

If you have questions concerning this Private Letter Ruling, you may contact me at (217) 782-2844. If you have further questions related to the Illinois sales tax laws, please visit our website at www.tax.illinois.gov or contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Terry D. Charlton
Chairman, Private Letter Ruling Committee