

General Information Letter: All compensation paid to employees is included in the payroll factor.

March 13, 2003

Dear:

This is in response to your letter dated March 1, 2003 in which you state the following:

As an accounting instructor and member of the Social Science and Business faculty of COLLEGE, I would like your agency to answer the following questions related to the State Corporate Income Tax treatment in the payroll factor of the apportionment ratio prior to the change to a single sales factor.

1. Are severance and other termination payments, subject to FICA taxes, included on an employee's W-2 form as compensation and reported on form 941 included in the numerator and denominator of the payroll factor?

1. Are severance and other termination payments treated as supplemental unemployment benefits, which are not subject to FICA taxes, included on an employee's W-2 form as compensation and reported on form 941 included in the numerator and denominator of the payroll factor?

1. Is income generated from the exercise and sale of long-term performance-based stock options, subject to FICA taxes, included on an employee's W-2 form as compensation and reported on form 941 included in the numerator and denominator of the payroll factor?

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.revenue.state.il.us/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 answer to all three of your questions require the same background information. To answer your questions, it is critical to understand Illinois' definition of "payroll factor" as well as Illinois' definition of "compensation." Since the payroll factor considers both in state and out of state compensation, it may also be beneficial to explain what Illinois considers to be compensation "paid in Illinois." Any and all compensation considered "paid in Illinois" is included in both the numerator and denominator of the payroll factor.

Section 304(a)(2) of the Illinois Income Tax Act ("IITA," 35 ILCS 5/101 et seq) states as follows:

(2) **Payroll Factor**

(A) The payroll factor is a fraction, the numerator of which is the total amount paid in this state during the taxable year by the person for compensation, and the denominator of which is the total compensation paid everywhere during the taxable year.

(B) 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.

IITA Section 1501(a)(3) defines the term "compensation" to mean wages, salaries, commissions and any other form of remuneration paid to employees for personal services. The Illinois Administrative Code further describes the statutory definition of compensation in 86 Ill. Adm. Code 100.3100(c):

The name by which remuneration for services is designated is immaterial. Thus, salaries, fees, bonuses, commissions on sales or on insurance premiums, and pensions and retired pay are compensation within the meaning of the statute if paid for services performed by an employee for his employer.

86 Ill. Adm. Code 100.3100(d) states:

Remuneration for personal services constitutes compensation even though at the time paid the relationship of employer and employee no longer exists between the person in whose employ the services were performed and the individual who performed them, so long as such relationship existed when the services were rendered.

Pursuant to these provisions, severance and other termination payments must generally be considered "compensation" for purposes of the IITA. As such, severance and other termination payments are taxable in Illinois if "paid in this State" under IITA Section 302(a). Since your letter doesn't indicate otherwise, we will assume that these severance and other termination payments were "paid in this State." As a result, the severance and other termination payments in all three of your questions would be included in both the numerator and denominator of the payroll factor.

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. If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items one through eight of 86 Ill. Adm. Code 1200.110(b). Should you have additional questions, please do not hesitate to contact our office.

Sincerely,

Heidi Scott  
Staff Attorney - Income Tax