

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

July 23, 2010

Dear:

This is in response to your letter dated June 11, 2010 in which you state the following:

By this letter, we request that the Office of Legal Services within the Illinois Department of Revenue ("Department") issue a Letter Ruling or General Information Letter to our client, COMPANY, Inc. ("COMPANY"), pursuant to Title 2, Part 1200, §1200.110 or §1200.120, Ill. Admin. Code. Specifically, we request the Department's determination that COMPANY does not have sufficient nexus with Illinois such that COMPANY is not subject to the state's corporate income tax and replacement tax jurisdiction under 35 ILCS, Art. 5, §201. Attached to this letter as Exhibit A is a Power of Attorney.

I. BACKGROUND INFORMATION

A. Identification of Taxpayer

COMPANY, Inc.
STREET
CITY, STATE ZIP CODE

FEI No. XX-XXXXXXX

B. Statement Under Title 2, Part 1200, §1200.110

To the best our knowledge and the knowledge of COMPANY, the Department has not previously ruled on the same or similar issue for COMPANY or a predecessor, and neither COMPANY nor the undersigned have previously submitted the same or a similar issue to the Department but withdrew it before a letter ruling was issued. Finally, COMPANY is unable to locate any authorities contrary to COMPANY's position as discussed in Section V below.

II. FACTS

COMPANY is a foreign corporation whose principal business is manufacturing and/or selling beverage alcohol products, particularly rum. COMPANY's headquarters and manufacturing facilities are located in COUNTRY. COMPANY is not qualified or registered with the Illinois Secretary of State for purposes of conducting business within the state.

Products manufactured by COMPANY are sold throughout the world, including the United States, generally by third party distributors. In COUNTRY, COMPANY distributes its own as well as some products manufactured by others. With respect to the United States market, for the current year and all years prior to this request, COMPANY sold its products to an unrelated, third-party distributor located in the State of STATE. This distributor then re-sold the products to wholesalers throughout the United States, including Illinois. COMPANY sold the product to the distributor F.O.B. COUNTRY. All sales by the distributor to wholesalers were made by the distributor F.O.B. COUNTRY or F.O.B. non-Illinois storage facilities owned or

leased by the distributor. Although COMPANY had to approve of the distributor's customers, the sales were made by the distributor and not by COMPANY.

COMPANY has never owned or maintained tangible personal property or real property in the state. Further, COMPANY did not make any sales in Illinois. Rather, all Illinois sales of product manufactured by COMPANY were made by the distributor or by unrelated wholesalers or retailers. Prior to MONTH of 2009, COMPANY did not have any employees or representatives located in Illinois. On MONTH 1, 2009, however, COMPANY hired an Illinois-resident employee whose responsibility was to increase purchases of its product.

COMPANY's Illinois-resident employee worked from his "in-home" offices since COMPANY did not maintain an office or work location in the state. The employee engaged in the marketing activities on behalf of COMPANY by contacting wholesalers in Illinois for purposes of encouraging purchases of COMPANY-manufactured products from COMPANY's distributor. All orders for these products were placed by the buyers with COMPANY's distributor. The employee did not have the authority to accept any purchase orders and all of the sales were finalized outside of Illinois. In addition, the employee did not handle the product in the state as all orders were filled by shipment or delivery from points outside of Illinois.

III. LAW

Illinois imposes the corporate income tax and replacement tax upon all corporations on the privilege of earning or receiving income in or as a resident of the state. 35 ILCS, Art. 5, §201 The Department's rule explains that activity conducted in interstate commerce may establish sufficient nexus with Illinois to permit imposition of the corporate income and replacement taxes on a non-resident taxpayer, as well, when the non-resident earns or receives income in Illinois within the meaning of the Illinois Income Tax Act. Title 86, Part 100, §100.9720(a), Ill. Admin. Code.

However, Public Law 86-272 (codified at 15 U.S.C. §381 et. seq.), restricts states' tax jurisdiction with respect to sales solicitation activities if the taxpayer's activity is limited to solicitation of orders for sales of tangible personal property. Title 86, Part 100, §100.9720, Ill. Admin. Code. The Department's rule provides the following examples of activities that ordinarily fall within the scope of "solicitation" under P.L. 86-272:

- A) Soliciting orders for sales by any type of advertising.
- B) Soliciting orders for sales by an in-state resident employee or representative of the non-resident, so long as that person does not maintain or use any office or place of business in the State, besides an "in-home" office....
- C) Carrying samples and promotional materials only for display or for distribution without charge or other consideration.
- D) Furnishing and setting up display racks and advising customers on the display of the nonresident's products without charge or other consideration.
- E) Providing automobiles to sales personnel for their use in conducting protected activities.
- F) Passing orders, inquiries and complaints on to the home office.

G) Missionary sales activities; i.e., the solicitation of indirect customers for the nonresident's goods. For example, a manufacturer's solicitation of retailers to buy the manufacturer's goods from the manufacturer's wholesale customers would be protected if those solicitation activities are otherwise immune.

H) 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.

I) Checking of customers' inventories without charge (for re-order, but not for other purposes such as quality control).

J) Maintaining a sample or display room for two weeks (14 days) or less at any one location within the State during the tax year.

K) Recruiting, training or evaluating sales personnel, including occasionally using homes, hotels or similar places for meetings with sales personnel.

L) Mediating direct customer complaints when the purpose is solely for ingratiating the sales personnel with the customer and facilitating requests for orders.

M) 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. Therefore, the use of personal property such as a cellular telephone, facsimile machine, duplicating equipment, personal computer and computer software, shall not, by itself, remove the protection under this Section, so long as the use of the office is limited to:

- i) soliciting and receiving orders from customers;
- ii) transmitting orders outside the State for acceptance or rejection by the nonresident; or
- iii) other activities that are protected under P.L. 86-272 or this Section.

N) 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.

Title 86, Part 100, §100.9720(c)(5), Ill. Admin. Code. The Department's rule also lists the following examples of activities that ordinarily fall outside of the scope of "solicitation" and are not protected by P.L. 86-272 unless they are *de minimis* within the meaning of *Wisconsin Dept. of Revenue v. William Wrigley, Jr. Co.*, 505 U.S. 214 (1992):

A) Making repairs or providing maintenance or service to the property sold or to be sold.

B) Collecting current or delinquent accounts, whether directly or by third

parties, through assignment or otherwise.

C) Investigating creditworthiness;

D) Installation or supervision of installation at or after shipment or delivery.

E) Conducting training courses, seminars or lectures for personnel other than personnel involved only in solicitation of sales of tangible personal property.

F) 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 for facilitation of the solicitation of orders.

G) 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.

H) Approving or accepting orders.

I) Repossessing property.

J) Securing deposits on sales.

K) Picking up or replacing damaged or returned property.

L) Hiring, training, or supervising personnel, other than personnel involved only in solicitation.

M) Maintaining a sample or display room in excess of two weeks (14 days) at any one location within the State during the tax year.

N) Carrying samples for sale, exchange or distribution in any manner for consideration.

O) Owning, leasing, or maintaining any of the following facilities or property in-state:

i) Repair shop.

ii) Parts department.

iii) Any kind of office other than an in-home office.

iv) Warehouse.

v) Meeting place for directors, officers, or employees.

vi) Stock of goods other than samples for sales personnel or that are used entirely ancillary to solicitation.

vii) Telephone answering service that is publicly attributed to the nonresident in his or her representative status.

viii) Mobile stores, i.e., vehicles with drivers who are sales personnel making sales from the vehicles.

ix) Real property or fixtures to real property of any kind.

P) Consigning stock of goods or other tangible personal property to any

person, including an independent contractor, for sale.

Q) The maintenance of any office or other place of business in this State that does not strictly qualify as an "in-home" office ... shall, by itself, cause the loss of protection under PL 86-272. A telephone listing or other public listing within the State for the nonresident or for an employee or other representative of the nonresident in such capacity or other indication through advertising or business literature that the nonresident or its employee or representative can be contacted at a specific address within the State shall normally be determined as the nonresident maintaining within this State an office or place of business attributable to the nonresident or to its employee or representative in a representative capacity. However, the normal distribution and use of business cards and stationary identifying the employee's or representative's name, address, telephone and fax numbers and affiliation with the nonresident shall not, by itself, be considered as advertising or otherwise publicly attributing an office to the nonresident or to its employee or other representative.

R) 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 within the State.

S) Conducting any activity that is not on the list of "protected activities" in subsection (c)(5), and that is not entirely ancillary to requests for orders, even if the activity helps to increase purchases.

Title 86, Part 100, §100.9720(c)(4), Ill. Admin. Code.

IV. ISSUE FOR DETERMINATION

The issue presented for determination is whether the COMPANY has corporate nexus with Illinois under Title 86, Part 100, §100.9720 and, therefore, is subject to the tax jurisdiction of the state under 35 ILCS, Art. 5, §201.

V. ANALYSIS

Under Illinois law, the activities of COMPANY and its employees do not cause the company to have nexus with the state under Title 86, Part 100, §100.9720 and, therefore, COMPANY is not subject to the tax jurisdiction of Illinois under 35 ILCS, Art. 5, §201.

The activities of COMPANY and its employees within Illinois fall within those that are protected under P.L. 86-272 and Title 86, Part 100, §100.9720(c)(5). COMPANY has never owned or maintained tangible personal property or real property in the state. Further, COMPANY did not make any sales in Illinois. Rather, all Illinois sales of product manufactured by COMPANY were made by the distributor or by unrelated wholesalers or retailers.

In addition, the one COMPANY-employee's activities within Illinois have been limited solely to "solicitation," which has been defined as: (1) speech or conduct that explicitly or implicitly invites an order, and (2) activities that neither explicitly nor implicitly invite an order, but are entirely ancillary to requests for an order. See, *Wisconsin Dept. of Revenue v. Wrigley*, 505

U.S. 214, 223 (1992). The Illinois-resident employee worked from his "in-home" office since COMPANY did not maintain an office or work location in the state. The employee engaged in the marketing activities on behalf of COMPANY by contacting wholesalers in Illinois for purposes of encouraging purchases of COMPANY-manufactured products from the distributor. All orders for these products were placed by the buyers with COMPANY's distributor. The employee did not have the authority to accept any purchase orders and all of the sales were finalized outside of Illinois. In addition, the employee did not handle the product in the state as all orders were filled by shipment or delivery from points outside of Illinois. Finally, neither COMPANY nor the Illinois employee has engaged in any activity that would have caused the sales transactions to lose protection under P.L. 86-272 and Title 86, Part 100, §100.9720.

As a result, it is COMPANY's position that the company does not have nexus with the state under Title 86, Part 100, §100.9720 and, therefore, is not subject to Illinois' tax jurisdiction under 35 ILCS, Art. 5, §201. Therefore, COMPANY is requesting the Department of Revenue issue a Letter Ruling or General Information Letter stating that COMPANY's activities do not create nexus with the state and, consequently, COMPANY is not subject to tax under 35 ILCS, Art. 5, §201.

VI. REQUEST FOR ORAL PRESENTATION

COMPANY, by and through undersigned counsel, hereby requests the opportunity for a telephone conference to discuss this request prior to the Department's determination of the issue presented herein.

VII. DECLARATION OF REPRESENTATIVES

The undersigned hereby certify to the Department that we are attorneys in good standing with the Florida Bar and that we are authorized to represent COMPANY in this request.

* * *

The determination as to 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.

The United States Constitution restricts a state's power to subject to income tax foreign corporations and other nonresidents. The Due Process Clause requires that there exist some minimum connection between a state and the person, property, or transaction the state seeks to tax. (*Quill Corp. v. N. Dakota*, 504 U.S. 298 (1992)) Similarly, the Commerce Clause requires that a state's tax be applied only to activities with a substantial nexus to the taxing state. (*Id.*) In the case of foreign corporations, Illinois may assert nexus to tax unless the corporation falls under the protection provided under Public Law 86-272. (15 U.S.C. § 381) Public Law 86-272 precludes any state from subjecting a nondomiciliary corporation to a net income tax where such corporation's only activities within the state for the taxable year consist of solicitation activities for sales of tangible personal property.

Regarding Public Law 86-272, Department Regulations Section 100.9720(c)(2)(A) states:

If a nonresident taxpayer's activities exceed "mere solicitation" as set forth in subsection (a) of PL 86-272 (subsection (c)(1)(A) of this Section), it obtains no immunity under that federal statute. The taxpayer is subject to Illinois income tax and personal property tax replacement income tax for the entire taxable year and its business income is apportioned under IITA Section 304. Whether a nonresident taxpayer's conduct exceeds "mere solicitation" depends upon the facts in each particular case.

You cite Section 100.9720(c)(4) of the Department Regulations in your letter which contains a list of activities that are considered to be beyond "mere solicitation" for purposes of P.L. 86-272. Included in that list of unprotected activities are the following:

- H) Approving or accepting orders.
- S) Conducting any activity that is not on the list of "protected activities" in subsection (c)(5), and that is not entirely ancillary to requests for orders, even if the activity helps to increase purchases.

According to the facts presented in your letter, your client "approves" the distributor's customers. If the distributor is unable to sell products to customers without authorization from your client, then your client's activities are likely unprotected and will be considered beyond "mere solicitation" for purposes of P.L. 86-272. The question then becomes whether the approval is done by the Illinois employee. If not, no nexus would result. If yes, the next question is whether the unprotected activity of "approving" sales is de minimus.

A taxpayer that engages in unprotected activity within Illinois, unless such activity is de minimus, is not entitled to immunity under the federal statute. Regulations Section 100.9720(c)(2)(D) sets forth the test for determining whether unprotected activities are de minimus.

De minimus activities are those that, when taken together, establish only a trivial additional connection with this State. An activity regularly conducted within this State on a regular or systematic basis or pursuant to a company policy (whether such policy is in writing or not) shall normally not be considered trivial. Whether an activity consists of a trivial or non-trivial additional connection with this State is to be measured on both a qualitative and quantitative basis. If the activity either qualitatively or quantitatively creates a non-trivial connection with this State, then the activity exceeds the protection of PL 86-272. The amount of unprotected

activities conducted within this State relative to the amount of protected activities conducted within this State is not determinative of the issue of whether the unprotected activities are de minimus. The determination of whether an unprotected activity creates a non-trivial connection with this State is made on the basis of the taxpayer's entire business activity, not merely its activities conducted within this State. An unprotected activity that would not be de minimus if it were the only business activity of the taxpayer conducted in this State will not be de minimus merely because the taxpayer also conducts a substantial amount of protected activities within this State, nor will an unprotected activity that would be de minimus if conducted in conjunction with a substantial amount of protected activities fail to be de minimus merely because no protected activities are conducted in this State.

As the above provisions indicate, the conduct of approving customers may result in the loss of protection under Public Law 86-272 unless it can be shown that such approval is de minimus when considering the taxpayer's entire business activity. For example, if your client does a one-time "approval" for each customer perhaps for credit-worthiness reasons and those "approved" customers become regular customers of the distributor so that all sales after the initial approval are handled by the distributor only, the one-time involvement by your client may be considered de minimus. A factual determination must be made taking into account the taxpayer's entire business activities.

Section 502(a) of the IITA (35 ILCS 5/502(a)) sets forth the requirements for filing Illinois income tax returns. That section states:

(a) 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.

Under this section, a nonresident must file an Illinois income tax return if it incurs a liability for tax imposed under Section 201 of the IITA (or in the case of a corporation qualified to do business in Illinois, if it is required to file a federal return). A nonresident is liable for Illinois income tax under Section 201 if it computes "Illinois net income" as defined under IITA Section 202. IITA Section 202 defines Illinois 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.

As stated above, this is a GIL 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
Associate Counsel - Income Tax