IT 10-0023-GIL 10/14/2010 PARTNERSHIPS

General Information Letter: Explanation of the subtraction allowed to partnerships for "personal service income" as defined in IRC Section 1348(b)(1), as in effect on December 31, 1991.

October 14, 2010

Dear:

This is in response to your letter dated September 20, 2010 in which you request a letter ruling. The nature of your request and the information provided requires that we respond with a General Information Letter (GIL). A GIL is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code § 1200.120(b) and (c).

Your letter states:

> We are a Medicare certified Home Health Agency providing services to home bound patients. Our services include visiting nurses, certified nurses aides, physical, occupational and speech therapists, and medical social workers.
>
> Line 26 of 2009 Form IL-1065 provides for a deduction from income for "personal service income." We seek a ruling to determine if our business meets the definition of "personal service income."
>
> Since our business provides a "personal service" to our patients are we entitled to claim our taxable income as a deduction on this line thus negating any tax liability?
>
> We have no audit or litigation pending with the department.

**RULING**

Section 203(d)(2)(H) of the Illinois Income Tax Act ("IITA" ; 35 ILCS 5/203(d)(2)(H)) allows a partnership to deduct:

> Any income of the partnership which constitutes personal service income as defined in Section 1348(b)(1) of the Internal Revenue Code (as in effect December 31, 1981) or a reasonable allowance for compensation paid or accrued for services rendered by partners to the partnership, whichever is greater.

Section 1348 of the Internal Revenue Code, as in effect on December 31, 1981, provided that the tax rate on personal service income may not exceed 50%. That section stated that "personal service income" means:

> Any income which is earned income within the meaning of section 401(c)(2)(C) or section 911(b) or which is an amount received as a pension or annuity which arises from an employer-employee relationship or from tax-deductible contributions to a retirement plan.

Section 911(b) of the Internal Revenue Code (as in effect on December 31, 1981) provided:

> For purposes of this section, the term "earned income" means wages, salaries, or professional

> fees, and other amounts received as compensation for personal services actually rendered, but does not include that part of the compensation derived by the taxpayer for personal services rendered by him to a corporation which represents a distribution of earnings and profits rather than a reasonable allowance as compensation for services actually rendered. In the case of a taxpayer engaged in a trade or business in which both personal services and capital are material income-producing factors, under regulations prescribed by the Secretary, a reasonable allowance as compensation for the personal services rendered by the taxpayer, not in excess of 30 percent of his share of the net profits of such trade or business, shall be considered earned income.

Section 1348(b)(1)(A) provided that:

> For purposes of this subparagraph, section 911(b) shall be applied without regard to the phrase, "not in excess of 30 percent of his share of net profits of such trade or business".

Therefore, if capital is a material income-producing factor, "personal service income" is defined in Section 1348 as a "reasonable allowance for compensation for services rendered," without regard to the 30% limitation.

Treasury Regulation § 1.911-2(b)(3) expanded on the statutory definition by stating that:

> Earned income includes all fees received by a taxpayer engaged in a professional occupation (such as a doctor or lawyer) in the performance of professional activities. Professional fees constitute earned income even though the taxpayer employs assistants to perform part or all of the services rendered, provided the taxpayer's patients or clients look to the taxpayer as the person responsible for the services.

Treasury Regulation § 1.1348-3(a)(2) continues:

> The entire amount received as professional fees shall be treated as earned income if the taxpayer is engaged in a professional occupation, such as a doctor, dentist, lawyer, architect, or accountant, even though he employs assistants to perform part or all of the services, provided that the patients or clients are those of the taxpayer and look to the taxpayer as the person responsible for the services performed.

In this case, based on the facts stated in your letter, compensation for services provided by the Agency to home bound patients would constitute "earned income" under former IRC Section 911(b), and thus "personal service income" under repealed Section 1348. Accordingly, Agency would be allowed a subtraction modification under IITA Section 203(d)(2)(H). Other income earned by Agency that is not personal service income, such as interest or dividend income, may not be subtracted under IITA Section 203(d)(2)(H).

As stated above, this is a GIL. A GIL does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you wish to obtain a PLR which will bind the Department, please submit a request conforming to the requirements of 2 Ill. Adm. Code § 1200.110(b).

Sincerely,

Brian L. Stocker
Associate Counsel (Income Tax)