IT 12-0009-GIL 04/16/2012 ALLOCATION

General Information Letter: Nonresident individual is not taxable on gain realized on sale of stock in a corporation doing business in Illinois unless the sale was made in connection with a business the individual was conducting in Illinois.

April 16, 2012

Dear:

This is in response to your letter dated November 30, 2011 in which you state the following:

> We are writing regarding a tax situation for one of our clients.
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> The taxpayer is a 100% owner of a C-Corporation domiciled in Illinois with substantially all sales (85%) in Illinois. The taxpayer is a salaried officer of the corporation making management decisions and currently works full time for the company. He and his wife are currently a resident of Illinois, but plan on moving to Florida in 2012 and becoming permanent residents in that state. He plans on selling his shares in his C-Corporation to his employees at some point in the next few years. When that occurs, he will also do some limited work for the company as an employee working out of Florida, but as stated, he will no longer be an Illinois resident.
>
> There is some confusion as to the taxability in Illinois of any gain on the sale of the C-Corporation stock when that occurs in the next few years. Does the taxpayer have to pay Illinois income tax on the gain from the sale of his stock in the C-Corporation if he is a Florida resident in the year of sale? In the instructions for Schedule NR for 2010, Line 11, it says that nonbusiness capital gains or losses that resulted from the sale of intangibles are not taxed by Illinois.
>
> Thank you for your attention to this matter.

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.

Your letter refers to the instructions for Line 11 on the Schedule NR which, in the current 2011 version states in its entirety:

> Line 11: Capital gain or loss
> Write any capital gains or losses, other than business capital gains or losses, you received from the sale of real property or tangible personal property located in Illinois at the time of the sale or exchange. Nonbusiness capital gains or losses that resulted from your sale of intangibles are not taxed by Illinois.
> Capital gains or losses you received as part of a business conducted in Illinois are taxed by Illinois. If the business was conducted
>
> - entirely in Illinois, write the amount from Column A.

- both inside and outside Illinois, complete the IAF Worksheet on Page 10 to figure the Illinois portion of your capital gain or loss, and include the amount from Line 3 of the worksheet.

You are correct that nonbusiness capital gains or losses from sales of stock by nonresident individuals are not taxed by Illinois. Section 1501(a)(1) of the Illinois Income Tax Act ("IITA"; 35 ILCS 5/101 et seq.) provides the definition for business income in Illinois:

> (1) Business income. The term "business income" means all income that may be treated as apportionable business income under the Constitution of the United States. Business income is net of the deductions allocable thereto. Such term does not include compensation or the deductions allocable thereto. For each taxable year beginning on or after January 1, 2003, a taxpayer may elect to treat all income other than compensation as business income. This election shall be made in accordance with rules adopted by the Department and, once made, shall be irrevocable.

Business income is explained in greater detail in the Illinois Administrative Code, including how the definition has evolved over the last few years. Prior to July 30, 2004, the business income definition read "business income is *income arising from transactions and activity in the regular course of a trade or business and includes income from tangible and intangible property constituting integral parts of a person's regular trade or business operations.*" By creating the new definition as shown above, the General Assembly was specifically overruling certain court decisions such as Blessing/White, Inc. V. Zehnder, 329 Ill.App.3d 714 (Third Div. 2002) (gain on a liquidating sale was nonbusiness income) and Hercules, Inc. V. Zehnder, 324 Ill.App.3d 329 (First Div. 2001).

The legislative change to the definition of business income broadened the scope of what is considered "business income." However, your letter does not contain sufficient facts to allow us to determine whether or not the capital gain on the sale of your client's stock is considered business income.

If the gain is business income, it may be apportioned to Illinois. Apportionment of business income of persons other than residents is addressed in IITA Section 304. The relevant portions of the Illinois statute are as follows, beginning with IITA Section 304(a)(3)(A):

> (A) The sales factor is a fraction, the numerator of which is the total sales of the person in this State during the taxable year, and the denominator of which is the total sales of the person everywhere during the taxable year.
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> …
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> (C-5) For taxable years ending on or after December 31, 2008, sales, other than sales governed by paragraphs (B), (B-1), (B-2), (B-5) and (B-7), are in this State if any of the following criteria are met:
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> (i) Sales from the sale or lease of real property are in this State if the property is located in this State.
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> …

(iii) In the case of interest, net gains (but not less than zero) and other items of income from intangible personal property, the sale is in this State if:

(a) In the case of a taxpayer who is a dealer in the item of intangible personal property within the meaning of Section 475 of the Internal Revenue Code, … (based on the information in your letter, your client does not appear to be a "dealer" within the meaning of IRC Section 475); or

(b) In all other cases, if the income-producing activity of the taxpayer is performed in this State or, if the income-producing activity of the taxpayer is performed both within and without this State, if a greater proportion of the income-producing activity of the taxpayer is performed within this State than in any other state, based on performance costs.

A more detailed explanation of income producing activity is found in 86 Ill.Adm.Code Section 100.3370(c)(3):

3) Sales other than sales of tangible personal property in this State. The sales factor includes gross receipts from transactions other than sales of tangible personal property (including transactions with the United States Government); gross receipts are attributed to this State if the income producing activity which gave rise to the receipts is performed wholly within this State. Also, gross receipts are attributed to this State if, with respect to a particular item of income, the income producing activity is performed in this State, based on costs of performance.

A) Income producing activity defined. *The term "income producing activity" applies to each separate item of income and means the transactions and activity directly engaged in by the person in the regular course of its trade or business for the ultimate purpose of obtaining gains or profit. Such activity does not include transactions and activities performed on behalf of a person*, such as those conducted on its behalf by an independent contractor. The mere holding of intangible personal property is not, of itself, an income producing activity. Accordingly, the income producing activity includes but is not limited to the following:

i) The rendering of personal services by employees or the utilization of tangible and intangible property by the person in performing a service.

ii) The sale, rental, leasing, licensing or other use of real property.

iii) The rental, leasing, licensing or other use of tangible personal property.

iv) The sale, licensing or other use of intangible personal property.

B) Costs of performance defined. The term "costs of performance" means direct costs determined in a manner consistent with generally accepted accounting principles and in accordance with accepted conditions or practices in the trade or business of the person.

C) Application. Receipts (other than from sales of tangible personal property) in respect to a particular income producing activity are in this State if:

i) the income producing activity is performed wholly within this State; or

ii) the income producing activity is performed both in and outside this State and a greater proportion of the income producing activity is performed in this State than without this State, based on costs of performance.

Emphasis added.

As highlighted above, the income producing activity test must be applied to each separate item of income. Also, only the activities of your client are considered. Your letter does not state any facts concerning what, if any, activities your client will perform in Illinois with respect to the sale of stock. Unless he performs some activities within Illinois, however, the capital gains on this sale of stock will not be allocable 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