

IT 13-0013-GIL 11/4/2013 Apportionment – Sales Factor  
General explanation of the application of IITA Section 304(a)(3)(B) and (C-5).

November 4, 2013

Re: Illinois income tax

Dear Xxxx:

This is in response to your letter dated September 27, 2013 in which you request a letter ruling. The information provided below relates only to the income tax issues raised by your request. We have forwarded a copy of your request to the Sales Tax Division for a separate response addressing the sales tax issues. 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 as follows:

I am writing this letter to obtain a formal ruling on whether my client's business activity, as described below, would present sufficient nexus for which our client would then have sales tax and/or income tax reporting requirements in the state of Illinois.

My client is a STATE 1 resident who will be conducting internet-based business activities from his business location in CITY, STATE 1. The kinds of services and products that will be offered on my client's website would be the on-line sale of individual and group counseling services, teleseminars and virtual retreats, as well as of individual membership privileges, eBooks, audio and DVD courses. (Please note that the sale of memberships, and audio and DVD courses will not be offered at the outset of the internet business activities. These are items that will most likely not be offered to the public until some time next year, after evaluating the success of the internet-based business activity.) Again, all of this business activity would be conducted from his business that is physically located in the STATE 1.

My client would be contracting with a web site hosting company (by the name of ABC COMPANY) that has internet servers that are physically located in the state of STATE 2.

My client will also be contracting with a company (by the name of XYZ COMPANY) that will be handling the on-line shopping cart process (i.e. the processing of on-line purchase transactions made by customers of the website), and this company's internet servers are physically located in the state of Illinois.

My concern is that my client may be subject to sales tax registration and reporting in the state of Illinois due to the fact that the company handling the online shopping cart transactions has internet servers that are physically located in your state.

Please advise as to whether this set of facts and circumstances constitutes sufficient nexus for which my client would be required to collect and remit your state's sales tax for taxable sales that are made to customers who reside within the state of Illinois.

## **RULING**

The determination as to whether a taxpayer has nexus with Illinois is extremely fact-specific. Therefore, the Department does not issue rulings regarding whether a taxpayer has nexus with the State. For information regarding nexus, see Department of Revenue Regulations Section 100.9720 (accessible from the Department's web site). In addition, the following general information may be provided.

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 addition, Illinois may not assert jurisdiction to tax where a 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.

Section 502(a) of the Illinois Income Tax Act ("IITA"; 35 ILCS 5/502(a)) sets forth the requirements for filing Illinois income tax returns. That section states in pertinent part as follows:

- (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.

Under Article 3 of the IITA, business income is apportioned to Illinois based on an apportionment ratio in which the numerator is the amount of the taxpayer's sales in Illinois and the denominator is the amount of the taxpayer's sales everywhere. IITA Section 304(a)(3)(B) allocates sales of tangible personal property to the numerator of the apportionment formula:

- Sales of tangible personal property are in this State if:
- (i) The property is delivered or shipped to a purchaser, other than the United States government, within this State regardless of the f.o.b. point or other conditions of the sale; or
  - (ii) The property is shipped from an office, store, warehouse, factory or other place of storage in this State and either the purchaser is the United States government or the

person is not taxable in the state of the purchaser; provided, however, that premises owned or leased by a person who has independently contracted with the seller for the printing of newspapers, periodicals or books shall not be deemed to be an office, store, warehouse, factory or other place of storage for purposes of this Section. Sales of tangible personal property are not in this State if the seller and purchaser would be members of the same unitary business group but for the fact that either the seller or purchaser is a person with 80% or more of total business activity outside of the United States and the property is purchased for resale.

IITA Section 304(a)(3)(C-5)(iii) allocates income from intangible property (other than patents, copyrights, trademarks, and similar items) to the numerator of the apportionment formula:

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, the income or gain is received from a customer in this State. For purposes of this subparagraph, a customer is in this State if the customer is an individual, trust or estate who is a resident of this State and, for all other customers, if the customer's commercial domicile is in this State. Unless the dealer has actual knowledge of the residence or commercial domicile of a customer during the taxable year, the customer shall be deemed to be a customer in this State if the billing address of the customer, as shown in the records of the dealer, is in this State; 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.

IITA Section 304(a)(3)(C-5)(iv) allocates sales of services to numerator of the apportionment formula:

Sales of services are in this State if the services are received in this State. For the purposes of this section, gross receipts from the performance of services provided to a corporation, partnership, or trust may only be attributed to a state where that corporation, partnership, or trust has a fixed place of business. If the state where the services are received is not readily determinable or is a state where the corporation, partnership, or trust receiving the service does not have a fixed place of business, the services shall be deemed to be received at the office of the customer from which the services were ordered in the regular course of the customer's trade or business. If the ordering office cannot be determined, the services shall be deemed to be received at the office of the customer to which the services are billed. If the taxpayer is not taxable in the state in which the services are received, the sale must be excluded from both the numerator and denominator of the sales factor. The Department shall adopt rules prescribing where specific types of service are received, including, but not limited to publishing, and utility service.

In this case, based on the information contained in your letter, gross receipts from the sale of on-line counseling services would be sourced under IITA Section 304(a)(3)(C-5)(iv), gross receipts from the sale of eBooks would be sourced under IITA Section 304(a)(3)(C-5)(iii), and gross receipts from the sale of audio and DVD courses would be sourced under IITA Section 304(a)(3)(B).

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)