

IT 14-0003 GIL 04/02/2014 APPORTIONMENT – Sales Factor
General explanation of the sales factor sourcing rules for software and related services.

April 2, 2014

Re: GIL Request

Dear Xxxxx:

This is in response to your letter dated February 14, 2014 in which you request 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 86 Ill. Adm. Code 1200.120(b) and (c), which may be accessed from the Department's web site at www.Iltax.com.

Your letter states as follows:

We are seeking a general information letter with respect to the above noted entities. Primarily, we are interested in the State's perspective on each companies "origin of sales." It is the taxpayers' wish to determine, as foreign businesses doing business in Illinois, what the appropriate amount of sales that should be apportioned to Illinois.

Background:

ABC Company, Inc. (ABC) was incorporated in the State. Likewise, Company was also organized under State law.

Business:

ABC developed proprietary software designed to "pull," among other things, the credit reports for individuals from all three credit reporting bureaus. It employs computer programmers who maintain the software and related computer servers, hereinafter known as the "infrastructure." ABC licenses and manages the infrastructure to and for Company. The file servers and programmers are located in Illinois for convenience.

Company works with banks and other mortgage lenders throughout the United States. It provides access to the infrastructure, licensed from ABC, for bankers and mortgage lenders who are collecting credit history for prospective borrowers. In addition, it will solicit data collection and or, where warranted, aid the lenders in "cleaning-up" the credit history of their prospective borrowers.

Revenues:

ABC receives licensing and management fees from Company for use and management of its infrastructure. It also receives general management fees for normal recurring general business and personnel matters.

Company receives its fee revenue from various individual banks and mortgage lenders throughout the United States that use Company's services to gather credit data for their prospective borrowers.

Questions:

1. What is the origination of sale for Company revenues? Is it Illinois because the servers and software are located there? Should it be each state where the particular inquiring bank or lender is located?
2. What is the origination of sale for ABC's revenue? Should it be State since that is where the software was originated and license agreement signed and is governed under State law?

RULING

Section 304 of the Illinois Income Tax Act ("IITA"; 35 ILCS 5/304) contains apportionment rules that determine the amount of business income of a nonresident that is taxable in Illinois where the income is derived from Illinois and one or more other states. Under Section 304(a) and (h), the general apportionment rule requires a taxpayer to multiply its business income for the taxable year by its sales factor. Section 304(a)(3)(A) defines the "sales factor" as the fraction consisting of the taxpayer's total sales in Illinois during the taxable year over its total sales everywhere during the taxable year. The apportionment required under Section 304(a) is to be performed following the close of the taxpayer's taxable year. The taxpayer determines its total business income for the taxable year, and then apportions to Illinois that part of such income that bears the same ratio as the taxpayer's Illinois sales for the taxable year bears to total taxable year sales.

IITA Section 304(a)(3) provides various rules for determining whether sales are sourced to Illinois for sales factor purposes. Under Section 304(a)(3)(B-1), gross receipts from the license, sale, or other disposition of a copyright are sourced to Illinois,

to the extent the item is utilized in this State during the year the gross receipts are included in gross income.

...

A copyright is utilized in a state to the extent that printing or other publication originates in the state. If a copyright is utilized in more than one state, the extent to which it is utilized in any one state shall be a fraction equal to the gross receipts from sales or licenses of materials printed or published in that state divided by the total of such gross receipts for all states in which the copyright is utilized.

However, under IITA Section 304(a)(3)(B-2), gross receipts from the disposition of patents, copyrights, trademarks, and similar items of intangible personal property may be included in the numerator and denominator of the sales factor only if such items comprise more than 50% of the taxpayer's total gross receipts included in gross income during the tax year and during each of the 2 immediately preceding tax years; provided that, when a taxpayer is a member of a unitary business group, such determination shall be made on the basis of the gross receipts of the entire unitary business group.

Section 304(a)(3)(C-5)(iii) provides that income from intangible personal property is treated as an Illinois sale 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 a 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.

Section 304(a)(3)(C-5)(iv) provides the sourcing rule for sales of services:

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 location of 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 the denominator of the sales factor.

Under this provision, gross receipts from sales of services are generally assigned to the numerator of the Illinois sales factor if the services are received in Illinois. However, in the case of services provided to a corporation, partnership, or trust, gross receipts from services received in Illinois are not included in the numerator of the Illinois sales factor unless the corporation, partnership, or trust maintains a fixed place of business in Illinois. 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, gross receipts are treated as Illinois sales if either (i) the customer ordered the services in the regular course of business from its Illinois office, or (ii) if the ordering office cannot be determined, the services are billed to the customer's Illinois office. In addition, gross receipts from services received outside of Illinois may be deemed received in Illinois, and thus included in the numerator of the Illinois sales factor, if the recipient corporation, partnership, or trust does not maintain a fixed place of business in the state in which the services are actually received and either (i) the customer ordered the services in the regular course of business from its Illinois office, or (ii) if the ordering office cannot be determined, the services are billed to the customer's Illinois office. Finally, where a taxpayer is not taxable in the state in which the services are actually or deemed received, the associated gross receipts must be excluded from both the numerator and denominator of the Illinois sales factor.

In this case, your letter does not provide sufficient information to determine whether either taxpayer is transferring software to customers or using the software to provide services to customers. If either taxpayer is transferring a copyright in software to its customers, gross receipts from such transactions are sourced according to the rule at IITA Section 304(a)(3)(B-1). On the other hand, if either taxpayer is licensing software to its customers (other than a copyright right), gross receipts from such transactions are sourced according to the rules at IITA Section 304(a)(3)(C-5)(iii). Finally, if either taxpayer is providing a service to its customers, gross receipts from such transactions are sourced under IITA Section 304(a)(3)(C-5)(iv). In addition, note that if ABC and COMPANY constitute a unitary business group, intercompany sales would be eliminated in determining either member's or the group's sales factor. 86 Ill. Adm. Code 100.5215, 100.5270.

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 have questions regarding this GIL you may contact Legal Services at (217) 782-7055. If you have further questions related to Illinois income tax laws, visit our website at www.revenue.state.il.us or contact the Department's Taxpayer Information Division at (217) 782-3336.

Sincerely,

Brian L. Stocker
Staff Attorney (Income Tax)