

IT 14-0011 GIL 9/19/14 Withholding – Other Rulings

Withholding is not required from compensation paid to a nonresident who performs some services in Illinois, but whose base of operations is located in another state.

September 19, 2014

Re: Illinois Individual Income Tax Withholding

Dear Xxxx:

This is in response to your letter dated May 16, 2014 in which you request a legal tax ruling whether income earned as an employee of an Illinois corporation working in STATE is subject to Illinois income tax. The Department's regulations require that the Department issue only two types of letter rulings, Private Letter Rulings ("PLRs") and General Information Letters ("GILs"). PLRs are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding against the Department, but only as to the taxpayer issued the ruling and only to the extent the facts recited in the PLR are correct and complete. GILs do not constitute statements of Department policy that apply, interpret or prescribe the tax laws and are not binding against the Department. See 2 Ill. Adm. Code 100.1200(b) and (c). The nature of your letter and the information provided require that we respond with a General Information Letter.

Your letter states as follows:

1) Statement of Facts

This Private Letter Ruling Request is being made by TAXPAYER; an Illinois taxpaying employee of COMPANY. COMPANY is a small private civil engineering consulting company located in CITY Illinois. To assist you in looking up relevant tax information regarding this request, the following tax identifier information is provided for both parties:

TAXPAYER	Employee's SSN	xxx-xx-xxxx
COMPANY	Employer's Identification Number	XX-XXXXXXX

My employer (COMPANY) withholds IL income tax from all income I (TAXPAYER) earn. It is my belief that, based on IL Department of Revenue's PUB-130, my employer should only withhold Illinois income tax from that fractional portion of income I earn while performing services in Illinois; as further explained below.

In March, 2013 my employer allowed me to move to and reside permanently in STATE, while continuing to work full time as a "satellite" employee. Currently, all our services are performed for Illinois clients. As a civil engineer, I can perform the vast majority of my work from my office in STATE. I estimate that greater than 95% of my time working for my employer is spent in my STATE office. I commute to Illinois occasionally to meet with clients and inspect infrastructure improvements, but am a permanent resident of STATE.

I now refer the reviewer to a pertinent section in PUB-130, page 4 re-typed with my response to that section of PUB-130 following in red print.

"When is compensation paid in Illinois?"

If any of the following localization tests are met, compensation is paid in Illinois.

1. The employee's service is localized in Illinois because all of the service is performed in Illinois."

I estimate that >95% of my service is performed in STATE. Therefore I do not satisfy localization test #1.

2. Some of the employee's services are performed outside Illinois, but the services outside Illinois are **incidental** to the services performed inside Illinois. Incidental services are those that support the employee's primary service, are temporary or transitory, or are isolated transactions.

Some of my services are performed in Illinois, but the services I perform in Illinois are incidental to the services I perform in STATE. The services I perform in Illinois are transitory, isolated transactions that support my primary services in STATE. Based on the Criteria presented in localization test #2 above, **my services are considered localized in STATE** and I do not satisfy localization test #2.

3. The employee's service is **not** localized in any state under either of the rules above, but
- some of the service is performed in Illinois **and**
 - either the base of operations (*i.e.*, the place from which the employee works) is in Illinois, or, if there is no base of operations, the place from which the service is directed or controlled is in Illinois.

Based on the criteria presented in localization test #2 above, my service is localized in STATE. Since my services are localized in STATE, I do not satisfy localization test #3. The only way localization test #3 can apply to an employee is if the employee's services are not localized in any state. But since my services are localized in STATE, I do not satisfy localization test #3.

It is true that my employer's base of operations is in Illinois. But the condition that my employer's base of operations is in IL only enters into the determination as to whether I satisfy localization test #3 **IF** my services are not localized in any state. Since my services are localized in STATE, the fact that my employers base of operations is in Illinois doesn't enter into the determination.

4. The employee's service is **not** localized in any state under any of the rules above, but
- some of the service is performed in Illinois,
 - the base of operations or the place from which the service is directed or controlled is **not** in any state in which some part of the service is performed, **and**
 - the employee is an Illinois resident.

Again, my services are localized in STATE. Therefore I do not satisfy localization test #4.

5. For compensation for services performed by a nonresident as a member of a professional athletic team, the amount that is paid in Illinois is the total compensation for services performed for the team during the year, multiplied by a fraction equal to the number of duty days spent within Illinois by the total number of duty days spent performing services for the team. See Section 304(a)(2)(B)(iv) of the Illinois Income Tax Act for more guidance.

I am not a professional athlete. Therefore, I do not satisfy a "strict" interpretation of this localization test #5.

However, my services mimic the professional athlete's services in that a small percentage of my services are provided in Illinois. The principle embodied in this test applies to me. Accordingly, I believe I should pay Illinois tax for the days of service provided in IL. In essence, COMPANY is a team. I am a nonresident member of that team. The amount of my compensation that is paid in Illinois is the total compensation for services performed for my team during the year multiplied by a fraction equal to the number of duty days spent within Illinois by the total number of duty days spent performing services for my team.

I believe the principle embodied in localization test #5 applies to me and request the IL Department of Revenue issue me a Private Letter Ruling stating something to the effect that, "the amount of my compensation that should be considered as "paid in Illinois" is the total compensation for services performed for COMPANY during the year, multiplied by a fraction equal to the number of duty days spent within Illinois divided by the total number of duty days spent performing services for COMPANY and that Illinois income tax should only be withheld from that compensation considered "paid in Illinois." In other words, I'm requesting that Illinois income tax only be withheld from that fractional portion of compensation I earn while performing services in Illinois.

For additional support for my position, I refer the reviewer to a pertinent section of PUB-130, page 5 retyped below with my response to that section of PUB-130 following in red print.

"Additional examples for when withholding is not required

Your company, headquartered in Missouri, hires an Illinois resident to install computer networks for your Missouri-based clients. Occasionally, your employee travels to your clients' branch offices in Illinois to complete network installation. Compensation is not paid in Illinois because your employee's services are localized in Missouri and the services

performed in Illinois are incidental to the services performed in Missouri. Therefore, you do not withhold Illinois Income Tax.”

This example from PUB-130 supports my position that the majority of my compensation should not be considered as “paid in Illinois” because my services are localized in STATE and the services I perform in Illinois are incidental to the services I perform in STATE.

I also refer the reviewer to another pertinent section in PUB-130, page 5 re-typed below with my response to that section of PUB-105 following in red print.

“Am I required to withhold income tax for another state if my employee is not an Illinois resident?”

If your employee is “paid in Illinois” and is a resident of Iowa, Kentucky, Michigan, or Wisconsin, you may, but are not required by Illinois law, to withhold income tax for the other state.

It is my understanding that Illinois does not have a reciprocal agreement with STATE. I have no problem having Illinois income tax withheld from “all income that is paid in Illinois”. I believe the localization test material presented above, particularly localization test #5, explains that “all income paid in Illinois” means “all income that is paid for services performed in Illinois”. Accordingly, the amount of my compensation that should be considered as “paid in Illinois” is the total compensation for services performed for COMPANY during the year, multiplied by a fraction equal to the number of duty days spent within Illinois divided by the total number of duty days spent performing services for COMPANY and that Illinois income tax should only be withheld from that compensation considered “paid in Illinois.”

My Final Argument:

STATE is one of a handful of states that does not have an income tax on wages. However, like most states with no income tax, STATE utilizes these other forms of taxation to support their government to offset their lack of an income tax. As a resident of STATE, I pay these higher taxes to support STATE. If Illinois withholds income tax from all my income, in essence I’m being required to support both Illinois and STATE. I don’t think it has ever been the intent of my government, federal or state, to ask an individual to support with tax dollars the federal and **TWO** state governments. Yet I believe that is what Illinois is asking me to do if they continue withholding state income tax from all my income.

2) Contracts, Licenses, Agreements, Instruments or other Documents Relevant to the Request

I am not aware of any contracts, licenses, agreements, instruments or other documents relevant to this request.

3) Identification of the Tax Period at Issue/Disclosure of Whether an Audit or Litigation is Pending with the Department

I request my Private Letter Ruling apply to the 2014 and all subsequent tax periods (2015, 2016, etc). My employer is currently withholding Illinois income tax on all my income. But with a favorable Ruling from the Department, my employer could prepare a 2014 W-2 that divides out and identifies that fraction of my wages that were performed in Illinois and that fraction that were performed in STATE. Then I could apply for a refund from Illinois for any overpayment of Illinois income tax in 2014. Then, in subsequent years (2015, 2016, etc.), my employer could correctly withhold Illinois income tax, according to the Department’s Ruling, each compensation period.

4) Statement of any Knowledge of Prior Ruling by Department on Same or Similar Issue

To the best of my knowledge, the Department has not previously ruled on the same or a similar issue for me or a predecessor. Neither I, nor any representative of mine, has submitted the same or a similar issue to the Department and then withdrew it before a letter ruling was issued.

5) Statement of Authorities Supporting Taxpayer’s View

Authority #1: PUB-130. The explanation of how PUB-130 supports my views was previously presented in **Item 1) Statement of Facts** above.

Authority #2: CPA 1
COMPANY A
ADDRESS
CITY STATE AND ZIP CODE
XXX.XXX.XXXX

CPA 1 is my tax preparer and is familiar with my situation. CPA 1 told me the withholding of Illinois income tax from all my income is not correct and encouraged me to challenge this activity.

6) Statement of Authorities Contrary to Taxpayer's View

Authority #3: CPA 2
COMPANY B
ADDRESS
CITY STATE AND ZIP CODE
XXX.XXX.XXXX ext XXXX

CPA 2 is my employer's accountant and guides my employer regarding tax matters. I explained my position to CPA 2. CPA 2 said CPA 2 would look into it. In a follow-up email to my employer (See Email Attached) she recommended to my employer that he continue withholding IL income tax from all my income. I then reviewed PUB-130 and came to the conclusion that she is interpreting it incorrectly. I presented PUB-130 to my tax prepared, CPA 1, and CPA 1 agreed with my interpretation of PUB-130. CPA 1 encouraged me to continue challenging this activity.

7) Identification of any Trade Secret Information to be Deleted from Departments Publicly Disseminated Version of the Private Letter Ruling

There is no trade secret information that I request be deleted from the publicly disseminated version of the private letter ruling.

8) Signature of Taxpayer

My signature is provided below as the signature part of this letter.

I have discussed this matter with my employer. As far as I know my employer has no position on this matter and just wants to do what is correct. We seek the Department's Ruling on the matter.

In summary, I request a Private Letter Ruling from the Department stating something to the effect that, "the amount of my compensation that should be considered as "paid in Illinois" is the total compensation for services performed for COMPANY during the year, multiplied by a fraction equal to the number of duty days spent within Illinois divided by the total number of duty days spent performing services for COMPANY and that Illinois income tax should only be withheld from that compensation considered "paid in Illinois." In other words, I'm requesting that Illinois income tax only be withheld from that fractional portion of compensation I earn while performing services in Illinois.

I have endeavored to provide the Department with all the information requested in Section 1200.110 Private Letter Rulings, paragraph b). If you need additional information, feel free to contact me and I will do my best to provide you with any additional information you might need.

RESPONSE

Your letter requests guidance as to certain payments made to nonresident alien students, visitors/scholars and other foreign individuals and entities. Your letter indicates that the payments in question are "non-wage payments," but that federal income tax withholding is required per IRS regulation.

Illinois Income Tax Act (IITA) Section 701(a), 35 ILCS 5/701(a) provides that:

Every employer maintaining an office or transacting business within this State and required under the provisions of the Internal Revenue Code to withhold a tax on ... compensation paid in this State (as determined under Section 304(a)(2)(B)... shall deduct and withhold [Illinois Income Tax] from such compensation.

IITA 304(a)(2)(B) states in relevant part that:

(B) Compensation is paid in this State if

- (i) The individual's service is performed entirely within this State;
- (ii) The individual's service is performed both within and without this State, but the service performed without this State is incidental to the individual's service performed within this State; or
- (iii) Some of the service is performed within this State and either the base of operations, or if there is no base of operations, the place from which the service is directed or controlled is within this State, or the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in this State.

In the situation described by your letter, you do not perform all of your services within Illinois, nor are your services performed outside Illinois incidental to the services provided within Illinois. Accordingly, neither Section 304(a)(2)(B)(i) nor (ii) would apply.

86 Ill. Adm. Code Section 100.7010(a)(3) provides:

The foregoing rules are to be applied in such manner that, if they were in effect in other states, an item of compensation would constitute "compensation paid in" only one state.

Pursuant to this provision, in your situation you state that the services performed in Illinois are incidental to the services performed in STATE, the wages would be "paid in the other state" under Section 304(a)(2)(B)(ii) and could not be treated as "paid in this State." Therefore, withholding would not be required under Section 701(a)(1).

Assuming the wages are not "paid in another state" under the principles of Section 304(a)(2)(B)(ii), Section 304(a)(2)(B)(iii) would apply. Under that statute, because your "base of operations" is outside Illinois, your wages would not be "paid in this State."

86 Ill. Adm. Code Section 100.7010(d)(2) provides:

The term "base of operations" refers to the place or fixed center from which the individual works. An individual's base of operations may be his business office (which may be maintained in his home), or his contract of employment may specify a place at which the employee is to receive his directions and instructions. In the absence of more controlling factors, an individual's base of operations may be the place to which he has his business mail, supplies, and equipment sent or the place where he maintains his business records.

In your situation, you state that you have a "permanent job location" in STATE, which you described as a "home office." Based on that description, the "permanent job location" is the "base of operations," and none of the wages paid to you would be "paid in this State." Accordingly, none of the wages paid to you would be subject to Illinois income tax withholding under Section 701(a)(1).

As stated above, this is a general information letter which 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 any further questions, you may contact me at (217) 524-7580.

Sincerely,

Matthew Crain
Associate Counsel (Income Tax)