

Determination of Nexus is Fact-Specific. (This is a GIL)

October 2, 2017

Re: Illinois income tax

Dear Xxxxx:

This is in response to your letter dated July 19, 2017, in which you requested a private letter ruling. The nature of your letter and the information provided require 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 86 Ill. Adm. Code 1200.120(b) and (c), which may be accessed from the Department's web site at www.tax.illinois.gov.

Your letter states as follows:

The purpose of this letter is to request a private letter ruling from the Illinois Department of Revenue ("Department"), pursuant to Section 1200.110 of Title 2 of the Illinois Administrative Code, confirming whether COMPANY. ("Taxpayer" or "Company") has nexus with the State of Illinois for purposes of Illinois Corporate Income Tax. For the reasons stated below, we seek the conclusion that the Taxpayer does not have nexus with Illinois due to the fact that its only connection with the state is the presence of a third-party vendor who remanufactures Company-owned goods in Illinois before returning them to the Company.

I. Statement of Facts

Taxpayer, headquartered in Pennsylvania, is a supplier of original equipment dealer automotive and heavy duty replacement parts. The Company has no property or employees located in Illinois that would otherwise create nexus with the state for Corporate Income Tax purposes. The Company contracts with a third party remanufacturing vendor based in Illinois. Pursuant to the arrangement, the Company will purchase used anti-lock brake modules, window switch modules and other automotive parts from various sources and ship them to the Illinois vendor for remanufacturing. Any inventory located within the State is awaiting rebuild by the vendor and the company retains title to this inventory throughout the entirety of the remanufacturing process.

After remanufacturing is completed, the vendor will return the finished parts to the Company in Pennsylvania. The vendor will ship the remanufactured parts back to the Company as soon as reasonably practicable. All customer orders are fulfilled from a Company location outside of Illinois. Under no circumstances are any of the Company's

automotive parts sold directly to customers by the vendor. This is a continuously repeated process. Additionally, Company employees will infrequently visit the vendor to discuss the quality of the product and the progression of the remanufacturing efforts.

II. Issue Statement

Whether nexus is created for Illinois Corporate Income Tax purposes if a third party vendor remanufactures Company-owned automotive parts and returns them to the Company after remanufacturing is completed?

III. Analysis

Statement of Law

Illinois imposes a tax measured by net income ("Corporate Income Tax") on both domestic and nonresident corporations for the privilege of earning or receiving income in the state. Corporations doing business in Illinois are also subject to the Replacement Income Tax, which replaced the state's personal property tax. Nonresident corporations are subject to both the Corporate Income Tax and the Replacement Income Tax if their business activity has sufficient nexus with Illinois.

The Due Process and Commerce Clauses of the United States Constitution limit the power of states to subject out-of-state companies to their taxing jurisdiction. The Due Process Clause requires that there exist some minimum connection between a state and the person, property, or transaction it seeks to tax. Similarly, the Commerce Clause requires that the tax be applied to an activity having substantial nexus with the taxing state. Whether a company is liable for Illinois Corporate Income Tax depends on whether there is sufficient nexus between Illinois and the company's business.

Public Law 86-272 ("P.L. 86-272"), the federal Interstate Income Law, bars state income taxation of interstate businesses whose only contact or nexus with the taxing state is the maintenance in the state of salespersons or independent contractors who solicit orders for out-of-state approval and fulfillment. If a nonresident corporation's activities in Illinois exceed "mere solicitation," it is subject to Illinois income tax. Whether a nonresident corporation's business activity exceeds "mere solicitation" depends on the facts and circumstances of each particular case.

In accordance with federal statutes regulating interstate commerce, United States constitutional jurisprudence and Illinois law, Illinois has adopted regulations listing certain activities qualifying as protected activities under P.L. 86-272, thereby constituting insufficient nexus with Illinois. Similarly, the regulations provide a listing of activities unprotected under P.L. 86-272, thereby subjecting a taxpayer to corporate income tax. Unprotected activities include the following:

- Making repairs or providing maintenance or service to property sold or to be sold;
- Owning, leasing or maintaining a stock of goods in-state.

Illinois regulations further provide that independent contractors may engage in certain limited activities in Illinois on behalf of nonresident taxpayers without the loss of immunity from taxation. Such activities include soliciting sales, making sales or

maintaining an office. Maintenance of a stock of goods in Illinois by an independent contractor under consignment or any other type of arrangement with the nonresident corporation, will remove the nonresident corporation's protection from taxation under P.L. 86-272.

The Illinois Department of Revenue ("Department") has issued various general information letters interpreting nexus standards in Illinois. One information letter considered the activities of a Connecticut operation ("AAA") selling hockey jerseys at retail through an internet site. AAA did not have any other property or employees located in Illinois. An Illinois-based business ("BBB") performed embellishment services, including stitching of letters and numbers, on the jerseys on behalf of AAA prior to the jerseys being shipped to the end customer. The taxpayer provided a number of scenarios to the Department and requested a ruling on whether each activity would create nexus for the taxpayer. The Department concluded that nexus would be created if BBB stored the jerseys until AAA received an order for the jersey, at which time BBB performed its alterations and dropped shipped the jerseys to the end customer on behalf of AAA. The Department reasoned that AAA was no longer protected under P.L. 86-272 when BBB, an independent contractor, stored goods in Illinois for AAA. However, the Department concluded that insufficient nexus would exist if AAA, upon receiving an order for a jersey, shipped its jerseys to BBB for alterations and subsequent drop shipment to the end customer. Similarly, insufficient nexus existed where BBB returned the jerseys to AAA for shipment upon completion of the alterations. The Department determined that using an independent contractor for shipment or delivery purposes allowed AAA to continue its protection under P.L. 86-272.

In *Honeywell International, Inc. v. Illinois Department of Revenue*, the Fifth Division of the Illinois Appellate Court's First District issued an instructive decision regarding the delivery and receipt of physical possession of property in Illinois. In this Service Occupation Tax case, an aerospace service company was not subject to tax on aircraft parts sold to out-of-state customers in conjunction with servicing the customer aircraft in Illinois because the taxpayer delivered and the customers received physical possession of the aircraft and installed parts outside Illinois. The vendor retrofitted the customers' aircraft, which involved the removal of the original engines on the aircraft and the sale and installation of new engines and other aircraft parts. After servicing was completed, the customers visited the vendor location to inspect and accept the installation of the aircraft parts on the customer-owned airplanes. After the inspections, the aircraft were flown by the taxpayer's personnel to out-of-state delivery locations where the customer signed a final acceptance and delivery statement. The court found that neither the taxpayer's installation of the aircraft parts nor the customer approval of the installation constituted the delivery and receipt of physical possession of the parts in Illinois because neither act gave the customer the ability to exercise dominion and control over the parts.

Analysis of Law

The Company has negotiated an arrangement with an Illinois-based third party vendor whereby it ships used automotive parts to the vendor, who remanufactures the

automotive parts for retail sale. After remanufacture is completed, the vendor immediately returns the remanufactured automotive parts to the Company, who subsequently stores the parts in Pennsylvania until an order is placed and fulfilled for shipment to customers. As noted above, Illinois regulations provide that making repairs or providing maintenance or service to property is considered an unprotected activity under P.L. 86-272. However, the third party vendor is providing a different service, the remanufacturing of automotive parts, an activity not specifically listed as unprotected under Illinois regulations. Further, the remanufacturing activities of the third party vendor performing services for the Company should not be attributed to the Company. For these reasons, the vendor's activities in Illinois do not create Illinois nexus for the Company.

In the general information letter described above, the Department determined that an out-of-state business did not have nexus with Illinois where it shipped hockey jerseys to a subcontractor, which proceeded to perform stitching of letters and numbers on the jerseys before either shipping the jerseys to the customer or back to the taxpayer. As long as the subcontractor did not store the jerseys in Illinois before or after an order was placed, the taxpayer did not have nexus with Illinois. If considered an independent contractor, the Company's arrangement with the third-party vendor does not create nexus with Illinois because the vendor does not store or maintain goods in Illinois on behalf of the Company, nor is the vendor engaged in any otherwise unprotected activities under P.L. 86-272 and Illinois regulations.

Finally, similar to the taxpayer in *Honeywell International*, the Company never receives physical possession of the remanufactured automotive parts in Illinois. Rather, the vendor ships the remanufactured parts to the Company outside of Illinois, where they await fulfillment of customer orders. Although the Company may retain title to the property during the remanufacturing process, it lacks dominion and control over the property during this time, as illustrated in the *Honeywell* case. The fact that Company employees occasionally visit the vendor's location to inspect the remanufactured property merely relates to the location at which the vendor's services are provided. The only significance of the Illinois location is that the vendor performs its remanufacturing services on Company-owned products in Illinois. However, the Company does not hold or store property at this location, and the vendor never directly sells the parts to the Company's customers. Thus nexus is not created under such circumstances.

Based on the above analysis, so long as the vendor does not store the automotive parts in Illinois before or after the remanufacturing process, such arrangement does not subject the Company to Illinois Corporate Income Tax.

Conclusion

For the reasons stated above, we request that the Department conclude that the activities of the Illinois-based third party vendor on behalf of the Taxpayer do not create nexus with Illinois for Corporate Net Income Tax purposes. The vendor does not store or maintain Company-owned goods in Illinois, nor does it engage in any unprotected activities under P.L. 86-272. Further, the activities of the vendor are not properly

attributed to the Company, whose employees and property are located outside of Illinois.

In support of this request, we hereby enclose an executed Form IL-2848, Power of Attorney, confirming our appointment as Taxpayer's representative.

We respectfully request a private letter ruling from the Department regarding this matter. Should you disagree with this opinion, please contact me to discuss this opinion prior to issuing a ruling. If you have any further questions or require any additional information, please do not hesitate to contact me.

RULING

The determination 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. See IT-03-0010-GIL (March 14, 2003); IT-03-114-GIL (April 14, 2003); IT-03-0017-GIL (May 12, 2003); IT-05-0025-GIL (May 19, 2005); IT-07-0036-GIL (November 9, 2007); IT-08-0020-GIL (July 3, 2008); and IT-13-0013-GIL (November 4, 2013). 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)) The Commerce Clause requires that a state's tax be applied only to activities with a substantial nexus to the taxing state. (*Id.*) In the case of foreign corporations, Illinois may assert nexus to tax unless the corporation falls under the protection conferred by 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.

Department Regulations Section 100.9700(c)(1) states:

Public Law 86-272. In 1959, Congress enacted PL 86-272 (15 USC 381-384), which prohibits states and their political subdivisions from imposing a net income tax on nonresident taxpayers who operate primarily in interstate commerce and whose activity within a state is limited. PL 86-272 provides in pertinent part:

(A) No state or political subdivision thereof shall have the power to impose . . . a net income tax on the income derived within such state by any person from interstate commerce if the only business activities within such state by or on behalf of such person during such taxable year are either, or both of the following:

(i) the solicitation of orders by such person, or his representative, in such state for sales of tangible personal property, which orders are sent outside the state for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the state;

(ii) and the solicitation of orders by such person, or his representative, in such state in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in subsection (c)(1)(A)(i).

(C) For the purposes of subsection (c)(1)(A) of this Section, a person shall not be considered to have engaged in business activities within a state during any taxable year merely by reason of sales in such state, or the solicitation of orders for sales in such state, of tangible personal property on behalf of such person by one or more independent contractors whose activities on behalf of such person in such state consist solely of making sales, or soliciting orders for sales, of tangible personal property.

Your letter indicates that the taxpayer ships property into Illinois for purposes of remanufacture by a third-party manufacturer, who then returns the property to the taxpayer's out-of-state facility where the property remains awaiting sale to customers. In addition, you indicate that taxpayer's employees infrequently visit the third-party manufacturer in Illinois for purposes of discussing product quality and the progression of remanufacturing efforts. These activities are not those described under P.L. 86-272. Therefore, unless these activities are de minimus, it appears that the taxpayer would not be protected from taxation in Illinois under Public Law 86-272.

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 are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b). If you have any further questions regarding this letter, you may contact me at (217) 782-2844.

Sincerely,

Brian L. Stocker
Associate Counsel (Income Tax)