

Nexus issues are not generally suitable for resolution by letter ruling. (This is a GIL.)

October 12, 2023

NAME
ADDRESS
E-MAIL

Re: Illinois Income Tax – Nexus/Corporate Filing Requirements

Dear NAME:

This is in response to your letter received on September 19, 2023, in which you request information regarding income tax nexus under Illinois law for filing an Illinois corporate income tax return for sales of Software as a Service (SaaS). The nature of your request and the information you have provided require that we respond with a General Information Letter (“GIL”), which 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 Section 1200.120(b) and (c), which may be found on the Department’s website at www.tax.illinois.gov.

Your letter states as follows:

Our client is a STATE Corporation, and their primary business location is in STATE. They offer a Software as a Service (SaaS) solution that is hosted on CORPORATION WEBSITE. The users of this product access the SaaS service through the internet and subscribe to it, paying for the service. It’s important to note that the software isn’t installed on the customers’ local computers or environments. In the future some of our clients’ customers will be headquartered/located in Illinois.

We understand SaaS does not create Illinois sales tax nexus for our client. However, it was unclear whether SaaS sales will result in nexus for filing an Illinois corporate income tax return, assuming sales thresholds are met.

Please let us know if the SaaS (hosting fees) is included in the corporate income tax nexus rules and if so what thresholds need to be exceeded to require our client to file an Illinois Corporate Income Tax Return.

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. Such a determination can only be made in

the context of an audit where a Department auditor has access to all relevant facts and information. For information regarding nexus, see 86 Ill. Adm. Code Section 100.9720 (accessible from the Department's website). In addition, the following general information regarding income tax nexus with the State may be provided.

Section 201(a) of the Illinois Income Tax Act ("IITA", 35 ILCS 5/101 et seq.) imposes a tax measured by net income on corporations on the privilege of earning or receiving income in or as a resident of Illinois. In addition, Section 201(c) of the IITA imposes a second tax (the personal property tax replacement income tax) measured by net income on corporations on the privilege of earning or receiving income in or as a resident of Illinois.

86 Ill. Adm. Code Section 100.9720(a) provides in pertinent part:

In general, a resident of this State will always be subject to these taxes. Activity conducted in interstate commerce may establish sufficient nexus with Illinois to permit imposition of these taxes on a non-resident taxpayer, as well, when the non-resident earns or receives income in this State within the meaning of the IITA. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 97 S. Ct. 1076 (1977); *Quill v. North Dakota*, 504 U.S. 298, 112 S. Ct. 1904 (1992). However, the fact that Article 3 of the IITA requires a non-resident taxpayer to allocate or apportion income to this State does not create a presumption that the taxpayer has nexus.

Further, 86 Ill. Adm. Code Section 100.9720(e) provides:

U.S. Constitutional Jurisprudence. If not protected by U.S. or Illinois statute, an income-producing activity may, nonetheless, be protected from State taxation by principles of U.S. Constitutional jurisprudence. Controlling decisions that assert protections afforded by the Interstate Commerce Clause, the Foreign Commerce Clause and the Due Process Clause are accepted by this State as limitations on the reach of its income tax and personal property tax replacement income tax statutes. However, nothing stated in this subsection (e) shall prevent Illinois from challenging taxpayer assertions of U.S. Constitutional protection.

In *South Dakota v. Wayfair, Inc.* (138 S. Ct. 2080 (2018)), the United States Supreme Court ruled that states may tax remote sales based on economic as well as physical presence. For sales tax purposes, Illinois requires remote sellers to collect sales tax from Illinois customers if their amount of sales into Illinois exceed \$100,000 or 200 transactions. Illinois has not adopted a similar threshold for income tax nexus but asserts jurisdiction to tax business income to the full extent allowed under the U.S. Constitution.

The Due Process Clause and the Commerce Clause of the United States Constitution limit the power of states to subject foreign corporations and other nonresidents to income tax. The Due Process Clause requires that there exists 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 the case of foreign corporations, Illinois may not assert jurisdiction to tax where a corporation falls under the protection provided 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.

Section 502(a) of the IITA sets forth the requirements for filing Illinois income tax returns. This 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.

Pursuant to 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 income tax return, regardless of whether such person is liable for Illinois income tax.

A nonresident is liable for Illinois income tax under Section 201 of the IITA if it computes "net income" as defined under Section 202. Section 202 of the IITA 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 Section 203 of the IITA, base income is generally determined by starting with the taxpayer's federal taxable income (adjusted gross income in the case of an individual) and adjusting that amount by certain statutorily prescribed addition and subtraction modifications. Base income must then be classified as between nonbusiness income and business income, and allocated or apportioned to Illinois, respectively, according to the rules set forth in Article 3 of the IITA. Under Article 3, 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.

Section 304 of the IITA 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 Sections 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.

Section 304(a)(3) of the IITA provides various rules for determining whether sales are sourced to Illinois for sales factor purposes. Section 304(a)(3)(C-5)(ii) provides that sales from the lease or rental of tangible personal property are sourced to Illinois if the property is located in Illinois during the rental period. Section 304(a)(3)(C-5)(iii) provides that income from intangible personal property is sourced to Illinois where, (i) if the taxpayer is a dealer with respect to the item of intangible personal property, the income is received from a customer in Illinois, or (ii) if the taxpayer is not a dealer, the income producing activity of the taxpayer is performed in Illinois. Section 304(a)(3)(C-5)(iv) provides that sales of services are sourced to Illinois if the services are received in Illinois.

86 Ill. Adm. Code Section 100.3370 provides rules for determining "sales" in various situations, except for when an alternative method of determining the sales factor is prescribed in Section 100.3380. 86 Ill. Adm. Code Section 100.3370(c)(8)(D) provides guidance on whether the SaaS sales for your client would be characterized as a sale of service or a lease of property. In addition, proposed Treasury Regulation 1.861-19 provides guidance, for certain provisions of the Internal Revenue Code, on the treatment of income from cloud transactions as either service income or lease of property (Classification of Cloud Transactions and Transactions Involving Digital Content, 84 FR 40317, August 14, 2019 (to be codified at 26 CFR 1.861-19)). If you determine the SaaS solution to be treated as a sale of service after considering all the relevant factors, then receipts from sales would be sourced for sales factor purposes under IITA Section 304(a)(3)(C-5)(iv).

As stated above, this is a GIL. A GIL does not constitute a statement of Department policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you require additional information, please visit the Department's website at www.tax.illinois.gov or contact the Department's Taxpayer Assistance Division at (800) 732-8866.

Sincerely,

Jennifer Uhles
Associate Counsel (Income Tax)