

General Information Letter: A general explanation is provided of the principles for determining when compensation paid to an employee providing services within and without Illinois is subject to withholding.

June 28, 2010

Dear:

This is in response to your letter dated May 6, 2010 in which you state the following:

COMPANY, Inc. (COMPANY) develops payroll-related software products that allow employers to calculate, report and remit federal, state and local payroll taxes.

Recently, we reviewed the Illinois Publication 130, regarding withholding for compensation paid in Illinois.

On page 6, question ‘*Am I required to withhold income tax for another state if my employee is not an Illinois resident?*’ The answer provides *if there is no reciprocal agreement, then you are required to withhold Illinois Income Tax on **all** income that is paid in Illinois.*

Does this mean 100% of the income paid to the employee? Or, the percentage of wages earned in Illinois?

An example, the employee is a resident of Connecticut, but works 80% in Illinois and 20% in another state. What should be withheld? Should 100% of wages or 80% of wages be taxed in Illinois?

We hope that you will provide an interpretation of the withholding regulation for nonresidents working in Illinois State.

According to the Department of Revenue (“Department”) regulations, the Department may issue only two types of letter rulings: Private Letter Rulings (“PLR”) and General Information Letters (“GIL”). The regulations explaining these two types of rulings issued by the Department can be found in 2 Ill. Adm. Code §1200, or on the website <http://www.tax.illinois.gov/LegalInformation/regs/part1200>.

Due to the nature of your inquiry and the information presented in your letter, we are required to respond with a GIL. GILs are designed to provide background information on specific topics. GILs, however, are not binding on the Department.

Section 701(a)(1) of the Illinois Income Tax Act (“IITA”; 35 ILCS 5/101 et seq.) governs withholding requirements for nonresidents and states:

- (a) In General. 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:
 - (1) compensation paid in this State (as determined under Section 304(a)(2)(B) to an individual); or
 - (2) payments described in subsection (b) shall deduct and withhold from such compensation for each payroll period (as defined in Section 3401 of the Internal Revenue Code) an amount equal to the proportionate part of this withholding exemption (computed as provided in Section 702) attributable to the payroll period for which such

compensation is payable multiplied by a percentage equal to the percentage tax rate for individuals provided in subsection (b) of Section 201.

- (b) Payment to Residents. Any payment (including compensation to a resident by a payor maintaining an office or transacting business within this State (including any agency, officer, or employee of this State or of any political subdivision of this State) and on which withholding of tax is required under the provisions of the Internal Revenue Code shall be deemed to be compensation paid in this State by an employer to an employee for the purposes of Article 7 and Section 601(b)(1) to the extent such payment is included in the recipient's base income and not subjected to withholding by another state. Notwithstanding any other provision to the contrary, no amount shall be withheld from unemployment insurance benefit payments made to an individual pursuant to the Unemployment Insurance Act unless the individual has voluntarily elected the withholding pursuant to rules promulgated by the Director of Employment Security.

Regarding "compensation paid in this state," IITA Section 304(a)(2)(B) provides:

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 example you provide, a Connecticut resident employee works 80% in Illinois and 20% in another state. You indicate that either 100% of the wages or 80% of the wages would be taxed in Illinois. The application of our laws is not so simple and requires more analysis into the facts and circumstances of each individual. Using your example, if 20% of the work performed in another state was "incidental" to the individual's service performed within Illinois, the individual's entire compensation would be subject to Illinois withholding.

There are more factors to consider than simply the localization test as described in 86 Ill.Admin.Code Section 100.7010(c). Section 100.7010(d) discusses the importance of "base of operations" and Section 100.7010(e) describes "place of direction or control." In other words, a nonresident whose "base of operations" is in Illinois will be subject to Illinois withholding on all compensation despite working in various states. This is true also when Illinois is the permanent "place of direction or control" of a nonresident employee working in multiple states. As you may observe, the provisions of IITA 304(a)(2)(B) are designed to apply in such a manner that under them, compensation can generally be paid to a particular individual in only one state. An explanation of the above information is summarized on page 5 of the Illinois Publication 130 which you refer to in your letter.

Please keep in mind this is a general information letter which does not constitute a statement of policy that either applies, interprets or prescribes tax law. It is not binding on the Department. Should you have additional questions, please do not hesitate to contact our office.

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Sincerely,

Heidi Scott
Staff Attorney -- Income Tax