IT 11-0007-GIL 03/22/2011 CREDITS – FOREIGN TAX

General Information Letter: Taxpayer under audit by Iowa is entitled to an Illinois refund if, as the result of the audit, the taxpayer's Iowa tax and, therefore, the credit allowable for taxes paid to another state are increased and a timely refund claim is filed.

March 22, 2011

Dear:

This is in response to your letter dated January 11, 2011 in which you state the following:

> I have a question regarding which state has taxation authority. I have a farm in Iowa and the only income generated from that farm is the CRP payment (USDA Conservation reserve Program Payment for land idled from production). The State of Iowa does not recognize this payment as farm income and classes this income as non-farm income. Another example of non-farm income in the Iowa Tax code would be the production and sale of Christmas trees.
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> So, if I were to raise and sell Christmas trees wholesale to a distributor in California, which state would have the superior right of taxation of the income generated from the sale of those trees. I live in the State of Illinois, and thus by business would be based in Illinois. Would the State of Illinois have the superior right of taxation or Iowa? The CRP payment would be a similar scenario situation in that the income is generated from the federal government of which the State of Iowa has only 1/50th claim. If I were to own land in say, Georgia, would the scenario be the same. I realize this line of reasoning is a logical progression, and the tax laws do not always follow logic.
>
> Since I felt the State of Illinois had the superior right, I have paid tax on this income to the State of Illinois for many, many years. If the State of Iowa demands the claim of these back taxes, how do I make a claim to the State of Illinois to recover money paid, which the State of Iowa would demand at their maximum tax rate. If there would be no mechanism to do this, it would amount to double taxation.

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.

Under the Illinois Income Tax Act ("IITA"; 35 ILCS 5/101 et seq.) a resident of Illinois is taxable on income received from farm land in Iowa. Specifically, Section 301(a) provides:

> All items of income or deduction which were taken into account in the computation of base income for the taxable year by a resident shall be allocated to this State.

Under IITA Section 203(a), "base income" is the amount reported on Line 9 of the Form IL-1040, and is equal to the individual's "adjusted gross income" as properly reported on his or her federal income tax return and on Line 1 of the Form IL-1040, after taking into account the modifications reported on Lines 2 through 8.

CRP payments are agricultural program payments reported by the Farm Service Agency on Form 1099-G and includable in income either on Line 17 (rental real estate) or 18 (farm income/loss) of Form 1040. As an Illinois resident, you have correctly paid Illinois tax on the CRP payments regardless of whether the land is in Iowa or Georgia. This would also be true under the hypothetical scenario you mention in your letter regarding an Illinois based business selling Christmas trees raised in Iowa to a distributor in California.

Your next question is if Iowa demands back taxes on CRP payments already received and for which you already paid Illinois taxes on, can you request a credit from Illinois on taxes paid to Illinois to avoid double taxation (tax paid once to Illinois and again to Iowa). Illinois law cannot and does not control the question of whether Iowa also has jurisdiction to tax CRP income under some principle of Iowa law. To ameliorate the circumstances where double taxation of income does occur, Illinois provides for its residents a tax credit for taxes paid to other states at IITA Section 601(b)(3):

> (3) Foreign tax. The aggregate amount of tax which is imposed upon or measured by income and which is paid by a resident for a taxable year to another state or states on income which is also subject to the tax imposed by subsections 201(a) and (b) of this Act shall be credited against the tax imposed by subsections 201(a) and (b) otherwise due under this Act for such taxable year. For taxable years ending prior to December 31, 2009, the aggregate credit provided under this paragraph shall not exceed that amount which bears the same ratio to the tax imposed by subsections 201(a) and (b) otherwise due under this Act as the amount of the taxpayer's base income subject to tax both by such other state or states and by this State bears to his total base income subject to tax by this State for the taxable year. For taxable years ending on or after December 31, 2009, the credit provided under this paragraph for tax paid to other states shall not exceed that amount which bears the same ratio to the tax imposed by subsections 201(a) and (b) otherwise due under this Act as the amount of the taxpayer's base income that would be allocated or apportioned to other states if all other states had adopted the provisions in Article 3 of this Act bears to the taxpayer's total base income subject to tax by this State for the taxable year. The credit provided by this paragraph shall not be allowed if any creditable tax was deducted in determining base income for the taxable year. Any person claiming such credit shall attach a statement in support thereof and shall notify the Director of any refund or reductions in the amount of tax claimed as a credit hereunder all in such manner and at such time as the Department shall by regulations prescribe.

Please note that there is a difference in calculating the credit for taxable years ending prior to December 31, 2009 versus taxable years ending on or after December 31, 2009. The Illinois Schedule CR, Credit for Tax Paid to Other States, must be completed to receive a credit for taxes paid to Iowa. Illinois Publication 111 describes Schedule CR in more detail. You may file a claim for refund by completing an amended return, IL-1040-X, within the statute of limitations period. All forms and publications can be found on the Illinois Department of Revenue website www.tax.illinois.gov

As stated above, 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.

Sincerely,

Heidi Scott
Associate Counsel -- Income Tax