

General Information Letter: A partner in a partnership doing business in Illinois generally has sufficient nexus to be subject to Illinois income taxation with respect to his or her share of the partnership's Illinois business income.

September 27, 2012

Dear:

Your correspondence with the Department of Revenue regarding your 2010 Illinois income tax liability has been forwarded to me for consideration. The nature of your correspondence and the information you have provided require that we respond with a General Information Letter, which 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 found on the Department's web site at [www. tax.illinois.gov](http://www.tax.illinois.gov).

In your most recent letter, dated May 18, 2012, you have stated the following:

Attached please find the letter dated April 13, 2012, (but mailed out over a month later on May 18, 2012 per the attached envelope) which I received from the Office of the Comptroller of the State of Illinois in response to my April 6, 2012 letter, which is also attached hereto.

As you can see, the Comptroller indicates that my letter was sent to you for action.

As we can all agree, a state may not levy an income tax on any individual who does not have a minimal constitutional nexus with that state.

Since I have not even stepped foot in Illinois at all relevant times, much less worked in Illinois, earned money in Illinois, owned property in Illinois nor have I ever had any ownership interest in the pass-through entity, that nexus does not exist.

In your correspondence with the Department, you included a federal Schedule K-1, Partner's Share of Income, Deductions, Credits, etc., from COMPANY, LLP, for 2010, which shows a CITY address for that partnership and reports that you received \$X in guaranteed payments, and that the partnership paid \$X in health insurance premiums on your behalf and \$X to a 401(k) plan on your behalf. You also included a Schedule K-1-P, Partner's or Shareholder's Share of Income, Deductions, Credits and Recapture from COMPANY, LLP, for 2010, which reports that 64.9236% of its business income is apportionable to Illinois. The Schedule K-1-P also reports your share of partnership business income was \$X, of which \$X was apportioned to Illinois, and your share of "other" business expense was \$X, of which \$X was apportioned to Illinois. Finally, the Schedule K-1-P reports \$X in Illinois tax was withheld from you.

Response

Based on the documents you provided and your statements, the \$X from COMPANY, LLP, is a guaranteed payment under Section 707(c) of the Internal Revenue Code, which states that:

To the extent determined without regard to the income of the partnership, payments to a partner for services or the use of capital shall be considered as made to one who is not a member of the partnership, but only for the purposes of section 61(a)(relating to gross income)

and, subject to section 263, for purposes of section 162(a)(relating to trade or business expenses).

Treas. Reg. Section 1.707-1(c) explains further that:

Guaranteed payments are considered as made to one who is not a member of the partnership only for the purposes of section 61(a) (relating to gross income) and section 162(a)(relating to trade or business expenses) . . . For the purposes of other provisions of the internal revenue laws, guaranteed payments are regarded as a partner's distributive share of ordinary income. Thus, a partner who receives guaranteed payments for a period during which he is absent from work because of personal injuries or sickness is not entitled to exclude such payments from his gross income under section 105(d). Similarly, a partner who receives guaranteed payments is not regarded as an employee of the partnership for the purposes of withholding of tax at source, deferred compensation plans, etc. (emphasis added).

The "ordinary income" of a partnership referred to in this regulation is the partnership's income excluding amounts required to be separately taken into account by the partners, such as capital gains and losses, dividends, charitable deductions, etc. See Sections 702(a) and Section 703(a) of the Internal Revenue Code.

Section 305(a) of the Illinois Income Tax Act ("IITA"; 35 ILCS 5/101 et seq.) provides:

The respective shares of partners other than residents in so much of the business income of the partnership as is allocated or apportioned to this State in the possession of the partnership shall be taken into account by such partners pro rata in accordance with their respective distributive shares of such partnership income for the partnership's taxable year and allocated to this State.

Section 709.5(a) of the IITA provides:

For each taxable year ending on or after December 31, 2008, every partnership (other than a publicly traded partnership under Section 7704 of the Internal Revenue Code or investment partnership), Subchapter S corporation, and trust must withhold from each nonresident partner, shareholder, or beneficiary (other than a partner, shareholder, or beneficiary who is exempt from tax under Section 501(a) of the Internal Revenue Code or under Section 205 of this Act, who is included on a composite return filed by the partnership or Subchapter S corporation for the taxable year under subsection (f) of Section 502 of this Act), or who is a retired partner, to the extent that partner's distributions are exempt from tax under Section 203(a)(2)(F) of this Act) an amount equal to the distributable share of the business income of the partnership, Subchapter S corporation, or trust apportionable to Illinois of that partner, shareholder, or beneficiary under Sections 702 and 704 and Subchapter S of the Internal Revenue Code, whether or not distributed, multiplied by the applicable rates of tax for that partner or shareholder under subsections (a) through (d) of Section 201 of this Act.

Pursuant to these provisions, the \$X guaranteed payment you received from COMPANY, LLP, is ordinary income of the partnership, which was characterized by the partnership as business income. Accordingly, the amount of your guaranteed payment that was apportioned to Illinois by the

partnership is taxable to you by Illinois and is subject to withholding under Section 709.5(a).

A partner in a partnership doing business in Illinois has sufficient nexus with Illinois to be subject to Illinois income taxation. See *Borden Chemicals & Plastics, L.P. v. Zehnder*, 312 Ill. App. 3d 35 (2000). Although the matter has never been raised before an Illinois court, courts in other states have held that guaranteed payments received by a nonresident partner from a partnership doing business in the state are subject to the state's income tax, even when the partner has no other connection with the state. See, e.g., *Matter of Heffron v. Chu*, 144 A.D.2d 729, 535 N.Y.S.2d 14 (1988) and *Matter of Heller v New York State Tax Commn.*, 116 A.D.2d 901, 498 N.Y.S.2d 211 (1986).

It therefore appears that your Illinois income tax liability for 2010 was correctly determined. If you wish to contest this matter, you must file a claim for refund using Form IL-1-040-X, Amended Individual Income Tax Return. If the claim is denied, the notice of denial will inform you of your protest rights.

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, you may contact me at (217) 782-7055.

Sincerely,

Paul S. Caselton
Deputy General Counsel – Income Tax