

Compensation paid in Illinois under IITA Section 304(a)(2)(B) does not qualify for the credit for taxes paid to other states.

February 13, 2014

Re: TAXPAYER
Credit for Taxes Paid to STATE

Dear Xxxx:

This is in response to your letter dated December 2, 2014, in which you request a letter ruling. The nature of your request 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.

In your letter you have stated the following:

We are writing to your office for assistance in resolving a denied credit for taxes paid by the above taxpayer to the State of STATE. The taxpayer is a resident of Illinois and owns greater than 20% of an STATE S corporation (CORPORATION). The taxpayer receives a W-2 from CORPORATION along with a K-1 from the company. The taxpayer's wages reported on his W-2 do not reflect STATE wages as he lives and works in Illinois. CORPORATION files all appropriate Illinois returns.

The taxpayer was audited by the State of STATE for 2009, 2010, and 2011. As a result of the audit, STATE recharacterized his wages as distributable share of income from the S corporation. Per STATE Revised Code §5733.40(A)(7), a pass-through entity member/shareholder that directly or indirectly owns at least 20% of the pass-through entity must apportion any income from the pass-through entity including wages. Wages are considered distributive share of income by STATE and must be apportioned.

As a result of the STATE audit, the taxpayer filed amended 2009, 2010, and 2011 Illinois income tax returns to claim a credit for additional taxes paid to STATE on his Illinois personal return. Those amended returns have been denied by the State of Illinois and the taxpayer has filed protest for each year. We are including with this letter, copies of the protest letter for each year.

The taxpayer also filed a timely 2012 Illinois resident return and STATE nonresident return reflecting the results of the STATE audit. The 2012 Illinois return reflected a credit for tax paid to another state of \$13,371, but the taxpayer received correspondence from Illinois reducing his credit to \$4,822. The difference in credit relates directly to a denial of credit for wages that have been taxed by STATE under ORC §5733.40(A)(7).

The taxpayer has responded twice by written correspondence to the Illinois Department of Revenue regarding the 2012 return (copies included) and the taxpayer also spoke with Mr. Sam Shetley regarding this matter. Mr. Shetley indicated his supervisor (Ms. Bonnie Graham) would be reviewing the correspondence and would follow-up. As of

the writing of this letter, the taxpayer has not received any follow-up on 2012 and is becoming quite frustrated with all years at issue.

We contacted the Illinois Department of Revenue, Problem Resolution Division, for assistance on resolving 2009, 2010, 2011 and 2012. The Problem Resolution Division suggested we write your office as the issue crosses multiple tax years and relates to allowing a credit for STATE taxes paid by Illinois resident on wages recharacterized as distributable income from a pass-through entity. The taxpayer would like to have someone assigned to all years at issue to resolve this matter as efficiently as possible.

Response

Because your letter provides factual background only with respect to 2012, and because you state that the years 2009, 2010 and 2011 are the subject of administrative hearings, this letter addresses only the 2012 tax year.

Section 601(b)(3) of the Illinois Income Tax Act (35 ILCS 5/601) allows Illinois residents to claim a credit for income taxes paid to other states on income that is taxed by Illinois. That section provides, in part:

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 Schedule CR, Credit for Tax Paid to Other States, implements this provision by providing for an itemization of the taxpayer's base income in Column A of the schedule and an item-by-item determination in Column B of the amount of base income that would be allocated or apportioned to other states, if the other states all used the allocation and apportionment provisions of Article 3 of the Illinois Income Tax Act. The fraction equal to the sum of the amounts of non-Illinois base income in Column B divided by total base income, multiplied by the taxpayer's Illinois income tax liability for the year, is the maximum amount of credit that can be allowed for taxes paid to other states.

In Article 3 of the Illinois Income Tax Act, Section 302(a) (35 ILCS 5/302) provides:

All items of compensation paid in this State (as determined under Section 304(a)(2)(B)) to an individual who is a nonresident at the time of such payment and all items of deduction directly allocable thereto, shall be allocated to this State.

Section 304(a)(2)(B) of the Illinois Income Tax Act (35 ILCS 5/304) provides that, for employees other than professional athletes:

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.

From your description, it appears that TAXPAYER's "base of operations" for his employment is in Illinois, which would mean that all of his employee compensation is sourced to Illinois even if some of his services are performed outside the State. In addition, Section 701(a)(1) of the Illinois Income Tax Act (35 ILCS/701) provides that income tax must be withheld by an employer from "compensation paid in this State (as determined under Section 304 (a)(2)(B) to an individual," and CORPORATION reported on his Form W-2 that all of his employee compensation as Illinois sourced under this provision.

Because TAXPAYER's employee compensation from CORPORATION is allocable to Illinois under Article 3 of the Illinois Income Tax Act, none of that compensation may be included in Column B of the Schedule CR. The maximum amount of credit allowed to TAXPAYER does not include the amount of Illinois income tax attributable to any of his compensation.

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