

Compensation of an employee performing services in multiple states is sourced entirely to the state in which the employee's base of operations is located.

July 14, 2015

Re: Allocation of Wage Income

Dear Ms. XXXX:

This is in response to your letter dated April 17, 2015, 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](http://www.tax.illinois.gov).

In your letter you have stated the following:

We are trying to what amount should be reported in box 16 on Form W-2 when an employee lives and works in Illinois 75% of the time and works in Ohio 25% of the time. Our payroll software provider has stated the following since the employee posed the question for his 2014 form W-2 as to 100% of his state taxable wages are Illinois and 25% of his state taxable wages are for Ohio:

*"We have always reported the total taxable amount when the is work and resident, even though we calculate the correct amount of tax based on the way the employee is setup in employee us tax authority [e.g. 75% work in the work resident state and 25% in another work state]. The work and resident state will show 100% of the taxable in the state accumulator.*

*Based on the documentation we have and past history for other employers, we are handling the situation correctly in the employee us accumulators and for reporting purposes."*

I spoke with someone at the Illinois Taxpayer Assistance office today and was told that if the taxable wages for Illinois match the federal taxable wages, the assumption is made that 100% of the employee's wages were earned in Illinois; and if the employee tries to claim a credit for the time worked and taxes paid in Ohio, the credit would not be recognized by Illinois.

Can you please provide something in writing to clarify what amount should be reported as taxable wages for the State of Illinois. It seems like 75% should be reported for Illinois; and 25% should be reported for Ohio. As the taxpayer services agent at Illinois stated, when the two copies of the w-2 showing the state taxable wages are added together they should total the federal taxable wages.

## Response

In the allocation and apportionment provisions of 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.

Multistate Tax Commission Model Regulation Section IV.14 defines “base of operations” as “the place of more or less permanent nature from which the employee starts his work and to which he customarily returns in order to receive instructions from the taxpayer or communications from his customers or other persons or to replenish stock or other materials, repair equipment, or perform any other functions necessary to the exercise of his trade or profession at some other point or points.”

Under these provisions, if an employee’s base of operations is in Illinois, 100% of his or her wages will be sourced to Illinois even if he or she works 25% of the time in Ohio and, under Ohio law, the employee is taxed on 25% of his or her wages.

For more guidance on the application of these allocation provisions, see Publication 130, Who is Required to Withhold Illinois Income Tax, which can be found at <http://www.iltax.com/Publications/Pubs/Pub-130.pdf>

These allocation provisions also affect residents in the computation of the credit allowed for taxes paid to other states. That credit is allowed by Section 601(b)(3) of the Illinois Income Tax Act (35 ILCS 5/601), which also provides:

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.

In other words, a resident is entitled to a credit for any taxes paid to other states on income taxed by Illinois, but the total credit cannot exceed a limit. The limit equals the amount of Illinois income tax attributable to the income that is sourced outside Illinois using Illinois' allocation and apportionment provisions, determined by taking the taxpayer's Illinois tax before credits, and multiplying it by a fraction equal to the base income that would be allocated or apportioned to other states if they all used Illinois allocation and apportionment rules, divided by the taxpayer's total base income.

If the resident's only income is from wages allocated to Illinois under Section 304(a)(2)(B) of the Illinois Income Tax Act, the limit on his or her credit for taxes paid to other states is zero because, if they followed Illinois' allocation provisions, no other state would tax those wages. As a result, we ask the employer to report on the W-2 the amount of wages allocated to Illinois under our law in order to allow the employee to compute the amount of credit to which he or she is entitled.

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