

General Information Letter: Business gain on the sale of stock by a person other than a trader in that stock is sourced to Illinois using the income-producing activity test.

September 28, 2009

Dear:

This is in response to your letter dated May 28, 2009 in which you state the following:

My wife and I are not residents of Illinois. Neither of us has resided in Illinois for over 40 years. We have been required to file Illinois income tax returns because my wife owns farmland in Illinois and until January of this year, she also owned shares in a Subchapter S corporation, CORPORATION located in CITY, Illinois.

On January 15, 2009 following a merger with the BANK, the new bank bought out my wife's stock in the CORPORATION. We want to know if the capital gain on the sale of this S corporation stock is subject to Illinois state income tax. In the instructions for Schedule NR for 2008, Line 11, it says that nonbusiness capital gains or losses that resulted from the sale of intangibles are not taxed by Illinois.

Is stock in a S corporation considered an intangible? If so, we would not have to pay Illinois income tax on the gain from this sale. Please let us know about this.

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.

Your letter refers to the instructions for Line 11 on the 2008 Schedule NR which states in its entirety:

Line 11: Capital gain or loss

Write any capital gains or losses, other than business capital gains or losses, that you received from the sale of real property or tangible personal property located in Illinois at the time of the sale or exchange. Nonbusiness capital gains or losses that resulted from your sale of intangibles are not taxed by Illinois.

Capital gains or losses that you received as part of a business conducted in Illinois are taxed by Illinois. If you received your business income or loss

- Entirely from Illinois sources, write the amount from Column A.
- From both inside and outside Illinois, complete the IAF Worksheet on Page 10 to figure the Illinois portion of your capital gain or loss, and include the amount from Line 3 of the worksheet.

You are correct that nonbusiness capital gains or losses from sales of stock by nonresident individuals are not taxed by Illinois. You then ask whether the stock in an S corporation is considered an intangible. The answer is yes. However, whether the gains from the sale of stock are tangible or not tangible is not what determines whether you will pay Illinois income tax. The question is whether

the capital gains received from the liquidation of CORPORATION is business income (in which case the gains will be taxed by Illinois) or nonbusiness income (gains will not be taxed by Illinois). Section 1501(a)(1) of the Illinois Income Tax Act ("IITA"; 35 ILCS 5/101 et seq.) provides the definition for business income in Illinois:

- (1) Business income. The term "business income" means all income that may be treated as apportionable business income under the Constitution of the United States. Business income is net of the deductions allocable thereto. Such term does not include compensation or the deductions allocable thereto. For each taxable year beginning on or after January 1, 2003, a taxpayer may elect to treat all income other than compensation as business income. This election shall be made in accordance with rules adopted by the Department and, once made, shall be irrevocable.

Business income is explained in greater detail in the Illinois Administrative Code, including how the definition has evolved over the last few years. Prior to July 30, 2004, the business income definition read "business income is *income arising from transactions and activity in the regular course of a trade or business and includes income from tangible and intangible property constituting integral parts of a person's regular trade or business operations.*" By creating the new definition as shown above, the General Assembly was specifically overruling certain court decisions such as Blessing/White, Inc. V. Zehnder, 329 Ill.App.3d 714 (Third Div. 2002) (gain on a liquidating sale was nonbusiness income) and Hercules, Inc. V. Zehnder, 324 Ill.App.3d 329 (First Div. 2001).

The legislative change to the definition of business income broadened the scope of what is considered "business income" and includes the situation described in your letter. Thus, the capital gain on the sale of your wife's stocks in CORPORATION is considered business income.

The next inquiry is whether, as a nonresident, the business income at issue will be apportioned to Illinois. Apportionment of business income of persons other than residents is addressed in IITA Section 304. The relevant portions of the Illinois statute are as follows, beginning with IITA Section 304(a)(3)(A):

- (A) The sales factor is a fraction, the numerator of which is the total sales of the person in this State during the taxable year, and the denominator of which is the total sales of the person everywhere during the taxable year.
- (B) ...
- (C) For taxable years ending before December 31, 2008, sales, other than sales governed by paragraphs (B), (B-1), and (B-2), are in this State if:
 - (i) The income-producing activity is performed in this State; or
 - (ii) The income-producing activity is performed both within and without this State and a greater proportion of the income-producing activity is performed within this State than without this State based on performance costs.
- (C-5) For taxable years ending on or after December 31, 2008, sales, other than sales governed by paragraphs (B), (B-1), (B-2) and (B-5), are in this State if any of the

following criteria are met:

...

- (iii) In the case of interest, net gains (but not less than zero) and other items of income from intangible personal property, the sale is in this State if:
 - (a) In the case of a taxpayer who is a dealer in the item of intangible personal property within the meaning of Section 475 of the Internal Revenue Code, ... (based on the information in your letter, your wife does not appear to be a “dealer” within the meaning of IRC Section 475); or
 - (b) In all other cases, if the income-producing activity of the taxpayer is performed in this State or, if the income-producing activity of the taxpayer is performed both within and without this State, if a greater proportion of the income-producing activity of the taxpayer is performed within this State than in any other state, based on performance costs.

Your letter does not indicate that your wife had any “income-producing *activity*” in the state of Illinois. She lives in Washington and her shares in CORPORATION were sold as a result of a bank merger and not as a result of her “activities” in Illinois. The facts stated in your letter do not provide a reason to believe that the capital gains resulting from the sale of CORPORATION should be allocated to Illinois.

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
Staff Attorney -- Income Tax