



Illinois Department of Revenue

Informational Bulletin

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Pass-through Entity Payments

To: All tax professionals, S corporations, partnerships, and trusts.

For information or forms...

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This bulletin is written to
inform you of recent changes;
it does not replace statutes,
rules and regulations, or court
decisions.

This bulletin provides detailed information regarding the new law that requires partnerships, S corporations, and trusts (pass-through entities) to make tax payments on behalf of their nonresident partners, shareholders, and beneficiaries (nonresident owners).

What is the new law on withholding by pass- through entities?

For tax years ending on or after December 31, 2008, PA 95-0233 (SB 1544) and PA 95-0707 (SB 783) require pass-through entities to make Illinois tax payments on behalf of nonresident owners. Although this is referred to as "pass-through entity withholding," it is not true withholding. Instead, the pass-through entity is required to make a payment based on its nonresident owners' share of apportioned Illinois business income. If the pass-through entity's payment covers the nonresident owner's Illinois Individual Income Tax obligation, that owner does not need to file Form IL-1040, Individual Income Tax Return.

The pass-through entity is required to notify the nonresident owner of the amount of pass-through entity payment made on his behalf. The nonresident owner who

does file an Illinois tax return must report the income and is allowed to take credit for the pass-through entity payment reported to him.

What does the new law require pass-through entities to do?

Pass-through entities that have nonresident owners must file Form IL-1000, Pass-through Entity Payment Income Tax Return, and make a pass-through entity payment on behalf of those nonresident owners.

Pass-through entity payments are required for all nonresident owners, except

- ◆ individuals for whom the pass-through entity files Form IL-1023-C, Illinois Composite Income and Replacement tax return; or
- ◆ non-individual owners, who document to the pass-through entity on Form IL-1000-E, Certificate of Exemption for Pass-through Entity Payments, that they will file a return and pay the Illinois Income Tax.

The pass-through entity must provide nonresident owners with a Schedule K-1-P, Partner's or Shareholder's Share of Income Deductions, Credits, and Recapture, or Schedule K-1-T, Beneficiary's Share of Income and Deductions, that shows the amount of pass-through entity payments made on their behalf.

NOTE: Nonresident owners are required to attach Schedule K-1-P or K-1-T to their Illinois tax return and cannot receive credit for the payments made on their behalf without the documentation.

The pass-through entity must also accept completed and signed copies of Form IL-1000-E, from non-individual owners who elect not to have pass-through payments made on their behalf.

You should keep copies of Form IL-1000-E in your files. At any time, we may request to review those certificates.

What does the new law require nonresident owners to do?

If the pass-through entity payment covers the nonresident owner's Illinois Individual Income Tax obligation, no IL-1040 must be filed.

If the nonresident owner files an Illinois Income Tax return for any reason, the income passed through from the entity must be reported, and a credit can be taken for the pass-through entity payment made on his behalf.

How is the pass-through entity payment calculated?

The pass-through payment equals the sum of each nonresident owner's share of the business income from the pass-through entity apportioned to Illinois, times the Illinois tax rate applicable to that owner.

When are pass-through payments due?

Pass-through payments and Form IL-1000 are due no later than the pass-through entity's original due date (without regard to any extension) for filing its Illinois income tax return. For example, an S corporation using a calendar taxable year would submit its 2008 payment by March 15, 2009.

What forms will be used?

- **Form IL-1000, Pass-through Entity Payment Income Tax Return**, must be completed and signed. Any amount shown due on Form IL-1000 should be sent with the tax return.

NOTE: Do not make pass-through entity payments on Form IL-941, Illinois Quarterly Withholding Income Tax Return.

- **Form IL-1000-X, Amended Pass-through Entity Payment Income Tax Return**, must be completed by a pass-through entity to report an underpayment of tax due on Form IL-1000.

- **Form IL-1000-E, Certificate of Exemption for Pass-through Entity Payments**, must be used for those owners who are not individuals, to make the election to forgo the pass-through payment process and elect to pay the required tax on their annual tax return.

- **Schedule K-1-P, Partner's or Shareholder's Share of Income, Deductions, Credits, and Recapture**, must be used by the pass-through entity to inform the partners and shareholders of the amount of pass-through entity payment made on their behalf.

Schedule K-1-P must be used by partners and shareholders to claim a credit for the amount of pass-through payment made on their behalf on their annual tax returns.

- **Schedule K-1-T, Beneficiary's Share of Income and Deductions**, must be used by the pass-through entity to notify beneficiaries of a trust of the amount of pass-through payments made on their behalf.

Schedule K-1-T must be used by the beneficiaries of a trust that made pass-through payments on their behalf to claim a credit for the amount on their annual tax returns.

What are the requirements when the owner of an entity is also a pass-through entity (tiered partnerships and distributions)?

Pass-through entities that are owners of a pass-through entity with Illinois business income must file Form IL-1000, and make a pass-through entity payment for their nonresident owners on the Illinois business income passed through to them, as well as on any Illinois business income they earn directly. The tiered entity must issue Schedule(s) K-1-P or K-1-T to its owners.

Example:

Partnership A has business income of \$1,000 and an Illinois apportionment factor of 40 percent, for a total Illinois-sourced income of \$400. It has two equal partners:

- Individual A, an Indiana resident, and
- Partnership B, a partnership doing business only in Indiana. Partnership B has not submitted an IL-1000-E. It has two equal partners, both individual residents of Ohio.

Partnership A must file an IL-1000 and make a total pass-through entity payment of \$9.00:

$\$200 \times 3 \text{ percent} = \6.00 distributable to Individual A, and

$\$200 \times 1.5 \text{ percent} = \3.00 distributable to Partnership B.

Partnership B must file an IL-1000 and make \$6 in pass-through entity payments on the \$200 of Illinois business income that passed through to it from Partnership A:

$\$100 \times 3 \text{ percent} = \3.00 distributable to Individual Ohio resident A, and

$\$100 \times 3 \text{ percent} = \3.00 distributable to Individual Ohio resident B.

Partnership B must also file an IL-1065 and pay replacement tax on the \$200. It may claim a credit for the \$3 of pass-through entity payments made on its behalf on either its Form IL-1000 or Form IL-1065.

NOTE: If Partnership B submits an IL-1000-E to Partnership A, Partnership A will not be required to make a pass-through entity payment on the \$200 distributable to Partnership B. However, Partnership B will still be required to pay replacement tax and make pass-through entity payments on the \$200.

How will my partners, shareholders, and beneficiaries claim the pass-through payments?

We are adding lines to all tax returns that allow pass-through entity payments to be credited towards an Illinois taxpayer's tax liability. This includes Forms

- *IL-1040, Individual Income Tax Return,*
- *IL-1120, Corporation Income and Replacement Tax Return,*
- *IL-1120-ST, Small Business Corporation Replacement Tax Return,*
- *IL-1065, Partnership Replacement Tax Return, and*
- *IL-1041, Fiduciary Income and Replacement Tax Return,*
- *IL-1023-C, Composite Income and Replacement Tax Return.*

New columns are also added on Forms IL-1065 and IL-1120-ST, Schedule B, and Form IL-1041, Schedule D. Partnerships, S corporations, and trusts will provide separate owner information on these schedules that will allow us to match pass-through payment amounts.

What about software vendors?

The IL-1000 and IL-1000-X will be part of the tax forms the vendors may wish to create. In addition, Form IL-1000-V will be available for submission of payments. (This is similar to the existing IL-1040-V, IL-1120-V, etc.)

What about electronic filing?

We are unable to accept the Form IL-1000 and payments electronically for the 2008 tax year. In addition, nonresident individuals claiming a credit may not file their Form IL-1040 electronically. A paper Form IL-1040 must be filed.

What if I am overpaid? Can I file an amended return?

If you overpaid your tax on Form IL-1000, you cannot file an amended return. The owner will be responsible for filing an annual tax return and claiming any overpayment. Form IL-1000-X is for increased deficiencies only.

Where can I ask questions or find updated information?

At this time, this bulletin contains the most up-to-date detailed information regarding pass-through entity withholding. As new information becomes available, we will add it to our web page under "Businesses, Featured Topics."

Questions may also be submitted on our web site's new blog, "Tax Talk."

Quick Check

If you are a **pass-through entity**, you must:

- ✓ Use Form IL-1000 to make pass-through entity payments on behalf of your Illinois nonresident owners, unless the owner has filed Form IL-1000-E.
- ✓ Notify all nonresident owners of their pass-through payment amount on Schedules K-1-P or K-1-T.
- ✓ File your annual Illinois income or replacement tax return and pay any Illinois tax liability.
- ✓ Maintain exemption information from business owners who file Form IL-1000-E.

If you are an **owner who is not a pass-through entity**:

- ✓ Do nothing, if the pass-through entity payments reported on your Schedule K-1-P or K-1-T covers your Illinois Income Tax liability.
- ✓ File your Illinois income and replacement tax return and pay any remaining liability.

If you are a **pass-through entity that is also an owner of a pass-through entity receiving distributable Illinois-sourced income**, you must

- ✓ Make the election to have the pass-through entity make payments on your behalf or file Form IL-1000-E with the entity and pay the tax liability yourself;
- ✓ Make pass-through entity payments for your nonresident owners on the income passed through to you by the pass-through entity, as well as on any Illinois business income earned directly by you;
- ✓ Make the election to treat any pass-through payment made for you as a credit on your Illinois income or replacement tax return or use the credit as the pass-through payment for your owners if you do not file Form IL-1000-E.
- ✓ File your Illinois income and replacement tax return and pay any remaining liability.