

IT 01-6

Tax Type: Income Tax

Issue: Income Earned in IL (Non-Resident Athlete-Duty Days)

**STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS**

**THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS**

v.

"JOHN & ANGELA DOE",

Taxpayers

No. 95-IT-0000
SSN: 000-00-0000
TYE: 1991, 1992

RECOMMENDATION FOR DISPOSITION

Appearances: Messrs. Stephen W. Kidder and Joseph L. Bierwirth, Jr. of the firm of Hemenway & Barnes; Messrs. Fred O. Marcus and C. Eric Fader of the firm of Horwood Marcus & Berk Chtd., representing "John & Angela Doe"; Mark Dyckman, Special Assistant Attorney General for the Illinois Department Of Revenue.

Synopsis:

This matter arose upon the timely protest of "John & Angela Doe" ("taxpayer", "Doe" or "Does" collectively) to a Notice of Deficiency ("NOD") issued by the Department of Revenue ("Department") for the tax years ending 12/31/91 and 12/31/92, respectively. The NOD proposed an assessment of tax on a signing bonus and an option year buy-out payment received pursuant to a contract between Mr. "Doe" in his capacity as a professional baseball player and the Chicago National League Ball Club, Inc.

("Cubs" or "Club"). The Department also allocated 100% of taxpayer's compensation from his employment by the Cubs to Illinois.

Issues:

At issue are the following questions, embodied in an executed pre-trial order and agreed to between the parties: ¹

1. Whether Illinois may tax, in its entirety, the signing bonus paid to Mr. "Doe" by the Chicago Cubs?
2. Whether Illinois may tax, in its entirety, the base salary paid to Mr. "Doe" by the Chicago Cubs?
3. Whether Illinois may tax, in its entirety, the contract-buyout payment paid to Mr. "Doe" by the Chicago Cubs?
4. Whether taxing in their entirety the signing bonus, contract buyout and base salary violate:
 - a) the Uniformity Clause of the Illinois Constitution
 - b) The Due Process Clauses of the Illinois and United States Constitutions
 - c) The Equal Protection Clauses of the Illinois and United States Constitutions
 - d) The Commerce Clause of the United States Constitution
 - e) The Privileges and Immunities Clause of the United States Constitution?
5. Whether alternative allocation – as provided under Section 304(f) of the IITA – is permissible if Illinois can tax, in its entirety, the signing bonus, contract buyout and base salary paid to Mr. "Doe" by the Chicago Cubs?
6. Whether reasonable cause exists to abate the IITA Section 1005 penalty?

The parties submitted a stipulated record and filed memoranda supporting their respective positions. After a thorough review of the facts and law presented, it is my recommendation that the matter be resolved for the taxpayer in part and for the

¹ This proceeding represents a "test case" on the matters in controversy. In the interests of administrative and judicial economies, the parties have agreed the ultimate disposition of the issues herein will bind approximately 60 other protested cases involving various professional athletes that are currently on hold before this office.

Department in part. In support thereof, I make the following findings and conclusions in accordance with the requirements of Section 100/10-50 of the Administrative Procedure Act (5 ILCS 100/10-50):

Findings of Fact:

1. On February 28, 1995, the Department timely issued a Notice of Deficiency (“Notice”) to "John & Angela Doe" ² for tax years ending December 31, 1991 and December 31, 1992. Stip. ¶ 85; Stip. Ex. W. Taxpayers timely protested that NOD. Stip. ¶ 86; Stip. Ex. X. The "Doe's" filed an amended protest on March 24, 2000. Stip. ¶ 87; Stip. Ex. Y.
2. During 1991 and 1992, taxpayers were residents of Texas, and were not Illinois residents. Stip. ¶¶ 5-9, 12.
3. "JohnDoe" was employed in Illinois as a professional athlete. Stip. ¶¶ 2, 19. Anna "Doe" was a homemaker. Stip. ¶ 3.
4. The Chicago National League Ball Club, Inc., better known as the Chicago Cubs, is a professional baseball team and is a member of the National League. Stip. ¶ 28. The Cubs is a business with its domicile and base of operations in Illinois. Stip. ¶ 29.
5. During 1991 and 1992, the Cubs employed "Doe" as a pitcher. Stip. ¶ 19.
6. On January 15, 1991, "Doe" and the Cubs executed a National League of Professional Baseball Clubs’ Uniform Player’s Contract and Supplement (collectively, the “Contract”). Stip. ¶ 18; Stip. Ex. G.

² "Angela Doe" is identified under different names on the various returns included in the stipulated record. Stip. Ex. Q, pp. 1-2. For convenience, I will use the name used in the parties’ stipulation ¶ 85.

7. "Doe" signed the Contract outside of Illinois. Stip. ¶ 20. "Doe" signed the Supplement to the Contract in Illinois. Stip. ¶ 21. The Supplement detailed, among other things, the amount and manner of payment of "Doe's" base salary and his other compensation to be paid pursuant to the Contract. Stip. Ex. G.
8. On January 22, 1991, William D. White, President, National League of Professional Baseball Clubs ("National League"), approved "Doe's" Contract with the Cubs. Stip. ¶ 23.
9. On or about January 22, 1991, the Cubs received notice of the National League President's approval of "Doe's" Contract. Stip. ¶ 24.
10. On or about January 27, 1991, and pursuant to ¶ C of the Contract Supplement, the Cubs paid "Doe" a \$1,000,000 signing bonus. Stip. ¶ 25; Stip. Ex. G, p. 5 (¶ C).
11. "Doe" was in Texas when he received the signing bonus. Stip. ¶ 26.
12. But for signing the Supplement, "Doe" had not performed any services in Illinois when he received the signing bonus. Stip. ¶ 21-22, 27.
13. The Cubs Championship Season includes its playing season, the League Championship Series, and the World Series. Stip. ¶ 30.
14. "Doe" was a member of the Cubs during the 1991 and 1992 Championship Seasons. Stip. ¶¶ 39, 49-69.

Relevant Terms of the Contract

15. The Contract provides that the Cubs employed "Doe":

to render, and the Player agrees to render, skilled services as a baseball player during the [applicable] year(s) ... including the Club's training season, the Club's exhibition season, the Club's playing season, the League Championship Series and the World Series (or any other official series in which the Club may participate and in any receipts of which the Player may be entitled to share).

Stip. Ex. G, p. 1.³ (emphasis added)

16. In exchange for performing obligations under the Contract, the Cubs agreed to pay "Doe" a \$1,000,000 signing bonus, a base salary of \$1,400,000 for 1991, \$2,000,000 for 1992, and, in the event the Cubs exercised its option, \$2,400,000 for 1993. Stip. Ex. G, p. 5 (¶¶ A-B). "Doe's" base salary was to be paid, and was in fact paid, in semi-monthly installments between January 1 and December 31 of each year. Stip. Ex. G, p. 5 (¶ B); Stip. ¶¶ 40-41, 58, 63.
17. So long as "Doe" did not violate any of the provisions set forth in Section F of the Contract Supplement, the Cubs guaranteed that it would continue making semi-monthly payments of "Doe's" base salary during the two years of the contract, and during the third year if the Cubs exercised its option. Stip. Ex. G, pp. 7-9.
18. In exchange for his compensation, "Doe" agreed to the following provisions, and to all of the other provisions, in the Contract:
 - 3.(a) The Player agrees to perform his services hereunder diligently and faithfully, to keep himself in first-class physical condition and to obey the Club's training rules,

 - 3.(b) In addition to his services in connection with the actual playing of baseball, the Player agrees to cooperate with the Club and participate in any and all reasonable promotional activities of the Club and its League, which, in the opinion of the Club, will promote the welfare of the Club or professional baseball, and to observe and comply with all reasonable requirements of the Club respecting conduct and services of its team and its players, at all times whether on or off the field.
 - 3.(c) The Player agrees that his picture may be taken for still photographs, motion pictures or television at such

³ During the years at issue, and, in fact, since 1945, participating at World Series is not a continuation of work that Cubs employees have had to worry about.

times as the Club may designate and agrees that all rights in such pictures shall belong to the Club and may be used by the Club for publicity purposes in any manner it desires. The Player further agrees that during the playing season he will not make public appearances, participate in radio or television programs or permit his picture to be taken or write or sponsor newspaper or magazine articles or sponsor commercial products without the written consent of the Club, which shall not be withheld except in the reasonable interests of the Club or professional baseball.

Stip. Ex. G, pp. 1-2 (¶¶ 3.(a)-(c)).

19. The Contract also prohibited "Doe", without the prior written consent of the Cubs, from participating or engaging in:

riding or driving in any kind of race, piloting or learning to operate or serving as a member of a crew of an aircraft, hot air ballooning, parachuting, skydiving, hang gliding, horse racing horseback riding, fencing, boxing, wrestling, karate, judo, jujitsu, water skiing, snow skiing, snowmobiling, bobsledding, ice hockey, field hockey, squash, racquetball, softball, tennis, badminton, basketball, football, white water canoeing, jai alai, lacrosse, soccer, rodeo, bicycle racing, motor boat racing, polo, rugby, handball, volleyball, surfboarding, body surfing, paddle ball, wood chopping, participation in "Superteams" or "Superstars" activities or other television or motion picture athletic competitions.

Stip. Ex. G, p. 8 (¶ 4 of Supplement); *see also* Id., p. 2 (¶¶ 5.(a)-(b)).

20. There are no time limits on "Doe's" obligations as described in ¶¶ 3.(a)-(c) and 5.(a)-(b) of the Contract, or on those described in ¶ 4 of the Contract Supplement.

Stip. Ex. G, pp. 1-2, 8.

21. The Cubs' agreement to make semi-monthly payments of "Doe's" salary was not specifically attributable to or conditioned upon "Doe's" performance during divisible portions, or for each successive day, of the Cubs Championship Season.

Stip. Ex. G, p. 5. That is to say, in the absence of his breach, the Cubs' salary

payments to "Doe" were not severable, or dependent upon "Doe's" performance during the different parts of the Cubs baseball season. Id.

22. "Doe" was paid an annual salary during his two-year employment with the Cubs, and was not a per diem employee. Stip. Ex. G, p. 5.

The 1991 Baseball Season

23. "Doe" participated in the Cubs' spring training camp from February 25, 1991 until April 8, 1991. Stip. ¶¶ 32, 35. The 1991 spring training camp was held outside Illinois. Stip. ¶¶ 31.
24. "Doe" traveled to spring training camp directly from Texas. Stip. ¶ 33.
25. The Cubs spring training camp for pitchers lasted 42 days. Stip. ¶ 36.
26. During the 1991 Championship Season, the Cubs were scheduled to play 162 regular season games, 81 of which were scheduled to be home games (i.e., they were scheduled to be played in Illinois, at Wrigley Field) and 81 of which were scheduled to be played outside Illinois. Stip. ¶ 37.
27. The Cubs' 1991 Championship Season consisted of a playing season of 182 days and no post-season games. Stip. ¶ 38.
28. As provided in the Contract, the Cubs paid "Doe" a base salary of \$1,400,000 in 1991. Stip. ¶ 40.
29. The Cubs issued "Doe" a Form W-2 that reflected federal taxable wages of \$2,455,326.55 for 1991. Stip. ¶ 41; Stip. Ex. J.
30. On January 10, 1991, the "Does" leased a condominium in Chicago, Illinois for a lease term that began on April 1, 1991 and ended on October 31, 1991. Stip. ¶ 42; Stip. Ex. K.

31. Between January 1, 1991 and April 1, 1991, "Doe" did not stay in Illinois, except on January 10, 1991 through January 13, 1991, when "Doe" and his family stayed at the Hyatt Regency Hotel in Chicago, Illinois. Stip. ¶ 43.
32. When the Cubs were not travelling out of town during the 1991 Championship Season, "Doe" lived at his [Chicago] condo. Stip. ¶ 44.
33. "Doe" returned to Texas after the 1991 Championship Season. Stip. ¶ 45.
34. In 1991, "Angela Doe" and the taxpayers' two children lived at their leased condo periodically from mid-June, when the school year ended, until the end of August, when the school year began again. Stip. ¶ 46.
35. Between mid-June and the end of August, 1991, "Angela Doe" and the taxpayers' two children left Illinois at least five times, for approximately five to ten days per trip, when "Doe" and the Cubs would leave Illinois for a road trip. Stip. ¶ 47.
36. "Doe" and the taxpayers' two children returned to Texas after their 1991 summer vacation. Stip. ¶ 48.

The 1992 Baseball Season

37. Prior to the 1992 Championship Season, the Cubs held spring training camp outside Illinois. Stip. ¶ 49.
38. "Doe" traveled to spring training camp directly from Texas. Stip. ¶ 51.
39. "Doe" participated in the Cubs spring training camp from February 24, 1992 until April 6, 1992. Stip. ¶ 53.
40. In 1992, the Cubs spring training camp for pitchers, including "Doe", lasted 42 days. Stip. ¶ 54.

41. On February 12, 1992, taxpayers entered into a lease for the same condo they leased during the Cubs' 1991 season, for the same monthly lease term (i.e., beginning April 1, 1992 and ending September 30, 1992), and on a week-to-week basis during the month of October 1992. Stip. ¶ 70; Stip. Ex. O.
42. Between January 1, 1992 and April 1, 1992, "Doe" did not stay in Illinois. Stip. ¶ 71.
43. When the Cubs were not traveling out of town during the Cubs' 1992 Championship Season, "Doe" lived at his leased condo. Stip. ¶ 72.
44. In 1992, "Angela Doe" and the taxpayers' two children periodically stayed at their leased condo from mid-June, when the school year ended, until the end of August, when the school year began again. Stip. ¶ 74.
45. Between mid-June and the end of August of 1992, "Angela Doe" and the taxpayers' two children left Illinois at least five times, for approximately five to ten days per trip, when "Doe" and the Cubs would leave Illinois for a road trip. Stip. ¶ 75.
46. During the 1992 Championship Season, the Cubs were scheduled to play 162 regular season games, 81 of which were home games and 81 of which were away games. Stip. ¶ 55; Stip. Ex. M. During the regular season, the Cubs also played an exhibition game against the Chicago White Sox at Wrigley Field, that is, at home. Stip. Ex. M.⁴

⁴ The game played on May 25, 1992 between the Cubs and the Chicago White Sox was an exhibition game, and the results of that game – while intensely important for local bragging rights – were not taken into account by major league baseball for any regular season performance records, either team or individual. See Stip. Ex. M.

47. The Cubs' 1992 Championship Season consisted of a playing season of 182 days and no post-season games. Stip. ¶ 56; Stip. Ex. M.
48. "Doe" began the 1992 Championship Season as an active member of the Cubs. Stip. ¶ 57.
49. The Cubs paid "Doe" a base salary of \$2,000,000 in 1992. Stip. ¶ 58.
50. On or about October 30, 1992, and pursuant to the buyout provision of the Contract, the Cubs paid "Doe" an additional \$500,000 because the Cubs did not exercise its option to extend the Contract for the Cubs' 1993 season. Stip. ¶ 59; Stip. Ex. G.
51. The contract buyout payment was an incentive for the Club to renew "Doe's" Contract for the 1993 season. Stip. ¶ 60.
52. "Doe" was in Texas when he received the contract buyout payment. Stip. ¶ 61.
53. "Doe" performed no services for the Cubs after receiving the contract buyout payment. Stip. ¶ 62.
54. The Cubs issued "Doe" a Form W-2 that reflected federal taxable wages of \$2,506,385.94 for 1992. Stip. ¶ 63; Stip. Ex. N.
55. On June 9, 1992, the Cubs placed "Doe" on the disabled list, and he remained on the disabled list for the remainder of the Championship Season. Stip. ¶ 64.
56. Prior to being placed on the disabled list, "Doe" participated in 26 home games and in 30 away games. Stip. ¶ 65.
57. "Doe" did not pitch in any major league games for the Cubs on or after June 9, 1992. Stip. ¶ 66. "Doe" did, however, did participate in all of the Cubs' remaining regular season games, by traveling with the Cubs when they played away games

after June 9, 1992 (Stip. ¶ 67) and by being with the team when they played home games in Illinois. See Stip. ¶¶ 59, 62, 65-67.

58. "Doe" underwent arm surgery in September 1992. Stip. ¶ 68.
59. Pursuant to the agreement between the Major League Baseball teams and the Major League Baseball Players Association, any player who becomes disabled from an "... injury sustained in the course and within the scope of his employment under [the C]ontract ..." shall ... [continue] ... to receive his full salary for the period of such disability or for the season in which the injury was sustained (whichever period is shorter)," Stip. Ex. G, p. 3 (¶ 2); Stip. ¶ 69.
60. After being placed on the disabled list, "Doe" was paid the remainder of the amount due under the Contract in semi-monthly installments. Stip. ¶ 69; Stip. Ex. G, p. 3 (¶ 2).
61. "Doe" returned to Texas after the 1992 Championship Season. Stip. ¶ 73.

Facts Regarding Taxpayers' Illinois Returns and the Apportionment Method Used on Those Returns

62. Taxpayers' 1991 Illinois return reported that none of the \$1.0 million signing bonus the Cubs paid to taxpayer was allocable to Illinois, and that only a portion of the "Doe's" base salary paid by the Cubs was allocable to Illinois. Stip. Ex. R.
63. Taxpayers apportioned the amount of "Doe's" base salary from his job with the Cubs by multiplying \$1,455,327 (\$2,455,327 - \$1,000,000) by a fraction, the numerator of which was 81 (representing the total number of the Cubs scheduled regular season home games), and the denominator of which was 220 (representing the sum of the number of days spent in spring training and in the regular baseball season). Stip. ¶¶ 36, 38; Stip. Ex. R. For the 1991 tax year, therefore, taxpayers

reported that only \$535,560 of the \$1,455,327 base salary "Doe" received from his job with the Cubs was attributable to Illinois. Stip. Ex. R.

64. Taxpayers' 1992 Illinois return reported that none of the \$500,000 the Cubs paid to "Doe" for not exercising its option was allocable to Illinois, and that only a portion of his base salary was allocable to Illinois. Stip. Ex. S.
65. Taxpayers apportioned the amount of "Doe's" base salary from his job with the Cubs by multiplying \$2,006,386 (\$2,506,386 - \$500,000) by a fraction, the numerator of which was 26 (representing the number of home games the Cubs played before "Doe" went on the disabled list), and the denominator of which was 220 (representing the sum of the number of days spent in spring training and in the regular baseball season). Stip. ¶¶ 54, 56, 65⁵; Stip. Ex. S.
66. For the 1992 tax year, therefore, taxpayers reported that only \$237,118 of the \$2,000,000 "Doe" received as base salary from his job with the Cubs was attributable to Illinois. Stip. Ex. S.
67. The "Doe's" apportionment fraction for 1992 reveals taxpayers' contention that "Doe" performed income producing activities outside Illinois when he traveled with the Cubs during the away games the team played following his disability, but that he performed no income producing activities inside Illinois when he was with the Cubs during the home games the team played following his disability. Stip. ¶¶ 54, 56, 65; Stip. Ex. S.

⁵ When the parties use the word "participated" in stipulation of fact number 65 ("Prior to being placed on the disabled list, Mr. "Doe" participated in 26 games played in Illinois and 30 games without Illinois."), they mean that "Doe" was physically present with the Cubs when the team played in each of those scheduled 56 regular games, and not that he actually pitched in each of the Cubs first 56 regular season games in that year. *See* Stip. ¶ 65; Stip. Ex. M.

68. Taxpayers' apportionment formula's use of 220 as its denominator shows that they consider all of "Doe's" compensation to have been attributable solely to the 220 days of services that began on the first day of the team's spring training and ended on the last day of the team's regular season. *See* Stip. Exs. H-I, L-M, R-S; *but see* Stip. Ex. G, pp. 1-2 (¶¶ 3.(a)-(c) (*quoted supra*, p. 4) (obliging "Doe" to keep in first class physical condition and to perform other services when asked by the team, "[i]n addition to his services in connection with the actual playing of the baseball").
69. Taxpayers' apportionment formula's use of 81 and 26 as the numerator for each successive year fails to take into account the exhibition games the Cubs played in Illinois, and in which "Doe" participated. Stip. Exs. H-I, L-M; Stip. ¶¶ 53, 57, 59, 62, 65-67
70. For both 1991 and 1992, the Cubs last two exhibition games were played against the Milwaukee Brewers. Stip. Exs. H-I, L-M. In both years, the first of those last two games was played in Milwaukee and the second was played in Wrigley Field, in Illinois. Stip. Exs. H-I, L-M. While including these game days in the denominator of the "Doe's" apportionment fraction, they do not take into account, in the numerator, that one of the games played during the exhibition season was played in Illinois. Stip. Exs. H-I, L-M, R-S.
71. In 1992, the Cubs played an additional exhibition game, against their cross-town rivals, the Chicago White Sox. Stip. Ex. M. That game was a home game for the Cubs, and it was played in Illinois. Stip. Exs. M, R. That game was played on

May 25, 1992 — which is prior to the date the Cubs placed "Doe" on the disabled list. Stip. ¶¶ 64-66, Stip. Ex. M.

72. While the "Does" include the day on which the Cubs/Sox game was played in the denominator of their apportionment fraction for 1992, they do not take into account, in the numerator, the fact that that game was played in Illinois. Stip. Exs. L-M, S.
73. "Doe's" participation in a game such as the Cubs/Sox exhibition game is precisely within the scope of the obligations he agreed to perform in exchange for the Cubs' payment of his salary. Stip. Ex. G, pp. 1 (¶ 1), 2 (¶ 3.(b)).

Conclusions of Law:

On January 15, 1991, taxpayer signed his first and only contract to play professional baseball for the Chicago National League Ball Club, Inc. Stip. ¶¶ 18, 22, 28, 62. The contract covered the years 1991 and 1992 and contained a provision that allowed the Cubs to exercise its option to extend the contract through 1993. Stip. Ex. G. During the years at issue, taxpayer maintained his primary residence in Texas. Stip. ¶¶ 5, 9.

The contract required the Cubs to pay the taxpayer a base salary of \$1.4 million for the 1991 season, a base salary of \$2.0 million for the 1992 season, and, if the Cubs exercised its option, a base salary of \$2.4 million for the 1993 baseball season. Stip. Ex. G. The contract also provided that the Cubs pay the taxpayer a signing bonus upon the execution and approval of the contract and a option year buy-out payment if the Cubs chose not to exercise its option to extend the contract to the 1993 baseball season. Stip. Ex. G.

Taxpayer filed Illinois individual income tax returns for 1991 and 1992 as an Illinois nonresident. Stip. Ex. R and S. The Cubs issued a 1991 Form W-2 that reflected wages of \$2,455,327. Stip. ¶ 41; Stip. Ex. J. Taxpayer did not allocate any of his signing bonus to Illinois and allocated only a portion of the remaining income to Illinois. Stip. Ex. R. To determine his Illinois source income, taxpayer multiplied taxpayer's allocable income of \$1,455,327 by a fraction, the numerator of which was 81 (total number of home games), and the denominator of which was 220 (regular baseball season days). As a result, taxpayer reported Illinois source income of \$535,560 on his 1991 Illinois return. Stip. Ex. R.

In 1992, the Cubs issued the "Doe" a Form W-2 that reflected federal taxable wages of \$2,506,386. Stip. ¶ 63; Stip. Ex. N. He did not allocate any of his \$500,000 option year buy-out payment to Illinois and allocated only a portion of the remainder of his income from the Cubs to Illinois. Stip. Ex. S. Taxpayer determined his Illinois source income by multiplying his allocable income of \$2,006,386 by a fraction, the numerator of which was 26 (the number of games the Cubs played in Illinois before taxpayer went on the disabled list), and the denominator of which was 220 (number of regular baseball season days). Stip. ¶ 65, Stip. Ex. S. Taxpayer did not allocate any income to Illinois based on the days the Cubs played in Illinois following his being placed on the disabled roster. Stip. ¶ 65, Stip. Ex. S.

During the audit of this individual, the Department determined that all of taxpayer's income from the Cubs was allocable to Illinois and issued a Notice of Deficiency, which was timely protested. Stip. ¶¶ 86, 87; Stip. Exs. T and W. The Department maintains taxpayer's base salary, the signing bonus, and the option year buy-

out payment all constitute “compensation” as defined under the Illinois Income Tax Act. (“IITA”).

Nonresidents look to Section 301(c)(1) of the IITA which provides the general allocation rules for compensation, business income and non-business income. With regards to the allocation of compensation, Section 302 of the IITA provides as follows:

§ 302 Compensation paid to nonresidents. (a) In general. 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.

35 ILCS 5/302.

Section 304(a)(2)(B)(3)(iii) provides that compensation is paid in this State if:

Some of the service is performed in this State and either the base of operations, or if there is no base of operations, the place where 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 of the services is performed, but he individual’s residence is in this State.

35 ILCS 5/304(a)

The statute defines the term compensation in Section 1501. Section 1501(a)(3) of the IITA states that “[t]he term compensation means wages, salaries, commissions and any other form of remuneration paid to employees for personal services.” **35 ILCS 5/1501(a)(3)**. In further definition of that term, the Department’s regulation states that “compensation” is comparable to the term “wages” as defined for federal income tax withholding purposes. *See*, 86 Ill. Admin. Code § 100.3100(a) referencing 26 U.S.C. § 3401(a).

Signing Bonus

The initial issue to be determined, is whether the signing bonus paid to "Doe" constitutes "compensation" under the IITA. The signing bonus of \$1,000,000 was paid to taxpayer for signing his first contract with the Cubs in 1991. Stip. ¶ 22, Stip. Ex. G. The contract provided for the signing bonus as follows:

C. Signing Bonus

Player shall be paid a signing bonus of \$1,000,000 (less usual withholding) in a lump sum within 5 days following Club's receipt of notice of the National League President's approval of this Agreement.

(Stip. Ex. G).

The Department argues that this signing bonus is in fact remuneration paid to "Doe" for his personal services and in truth is merely a means of "front-loading" the compensation for "Doe's" services. Department Brief p. 11. It also points out that the contract contained the language "less usual withholding" and consistent with the terms of the contract, the Cubs withheld taxes from the signing bonus and issued "Doe" a W-2 Statement for wages that included the signing bonus and his base salary for 1991. Stip. Ex. N. Lastly, it emphasizes that "Doe" reported the signing bonus on line 7 as "wages salaries, tips, etc." on his federal income tax return. Stip. Ex. P. Taxpayers contend that the signing bonus does not constitute "compensation" under the statute because the income does not represent remuneration for services performed. Instead, the signing bonus was paid to the taxpayer solely in return for his execution of the contract. Taxpayers' Opening Brief p. 7.

Department Regulation 100.3100(a), dealing with the term "compensation", specifically cross-references Section 3401(a) of the Internal Revenue Code. As such, the

IRS' Revenue Ruling that addresses whether a baseball player's signing bonus represents wages subject to federal income tax withholding is directly relevant in the instant matter.

In Rev. Rul. 58-145, the IRS determined that a bonus paid to a new player solely for signing his first contract, when there was no requirement of subsequent service did not represent remuneration for services performed and therefore, did not constitute wages subject to the withholding of income tax under Section 3402 of the IRC. Rev. Rul. 58-145, 1958-1 C.B. 360; *see*, Taxpayers' Supp. App. 1 & 2. The IRS further stated that a bonus paid in installments over a period of years, i.e., some of the installments would be paid at a time when the player would have the status of an employee of the club does not in itself, establish such bonus as wages subject to the withholding of income tax. Id.

The Department attempts to distinguish IRS Rev. Rul. 58-145, 1958-1 C.B. 360 from this case by focusing on the fact that the letter ruling involved a first time professional contract as opposed to a contract with an already established professional baseball player. The Department also notes that the ruling does not take into account the realities of modern professional sports as it existed in the 1990s and at the present time. Dept. Brief p. 12.

The Revenue Ruling clearly supports the taxpayers' position. Further, the Department's arguments are unconvincing because the ruling did address whether a signing bonus paid in installments to a continuing employee constituted wages subject to withholding and concluded that such a bonus was not necessarily subject to the withholding of income tax. Further, modern professional sports may well be different

than those of an earlier era, however, the Department has not adequately provided how these differences render the IRS's analysis in this letter ruling inapplicable to this case.⁶

To further emphasize the point, Professor Arthur L. Corbin, an acknowledged and renowned authority in the field of contract law, has stated that it is not unusual in professional sports contracts for a team to offer a promise of a large bonus to induce a player to sign a specific contract. He writes:

“The signature of the promisee to that instrument constitutes the acceptance of the offer, the entire consideration for the offered promise, and the entire performance that is the agreed exchange for the ‘bonus’ money. The transaction is in truth, a promise for a promise. (The employer) has offered his promise to pay the ‘bonus’ in exchange for the making of player’s promise his ‘entering into’ the bilateral service contract). When the player attaches his signature to the service contract, he has performed an act that constitutes the full agreed equivalent of the ‘bonus’ (the money payment).” (emphasis added)

1 Corbin on Contracts § 70 at 297.

The Cubs paid the signing bonus in a lump sum to the taxpayer within two weeks after the taxpayer executed the contract. Stip. ¶ 25; Stip. Ex. G. Taxpayer received the signing bonus while he was residing in Texas. Stip. ¶ 26. Taxpayer did not perform any

⁶ While not controlling in this case, it should be noted that other states including California, Connecticut, Indiana, Iowa, Maine, Maryland, Massachusetts, Minnesota, New Jersey, New York, North Carolina, Oregon, Rhode Island, Utah, Virginia, and Wisconsin have held that a nonresident professional athlete's signing bonus is not compensation because it does not represent remuneration for services. *See, e.g., Appeal of Testaverde*, No. 9A-0197 (Cal. Bd. Of Appeals Feb. 1, 2000)(Supp. App. 6); Conn. Agencies Regs. Sec. 12.711(c)-7(a)(2)(E)(Supp. App. 11); Ind. Code sec. 6-3-22.7 (a)(1)(B)(Supp. App. 14); Iowa Admin. Code r. 701-40.46(1)(c)(2)(Supp. App. 17); Code Me. R. No. 806 (.04)(D)(1) (Supp. App. 21); Md. Admin. Release ADR No. 24 (III)(B)(3)(g)(4)(b)(ii) (Oct. 1, 1999) (Supp. App. 26); Mass. Regs. Code tit. 830, sec 62.5A.1(6)(e)(Supp. App. 29); Minn. Stat. Sec. 290.17 (subd. 2)(a)(2)(I)(Supp. App. 47); N.J. Admin. Code sec. 18:35-5.1(b)(4)(iv)(2)(Supp. App. 52); *In re Clark v. New York State Tax Comm'n*, 86 A.D.2d 691, 446 N.Y. Sup. Ct. 518 (N.Y. App. Div. Jan. 7, 1982)(Suppl. App. 55); N.Y. Comp. Codes R. & Regs. Sec. 132.22(b)(4)(ii)(6)(Supp. App. 57); N.C. Admin. Code tit. 17, sec. 06B.3905(a)(3)(E)(ii) (Supp. App. 60); Or. Admin. R. 150.316.127-(F)(2)(d)(B)(ii)(Supp. App. 63); R.I. Code Reg. PIT 97-21 (II)(3) (Supp. App. 66); Utah Admin. Code R 865-9I-44(C)(5)(b)(2)(Supp. App. 70); Va. Ruling of Comm'r, P.D. 93-22 (Feb. 5, 1993) (Supp. App. 73); and Wisc. Admin. Code sec. 2.31(3)(c)(2)(Supp. App. 75).

services in Illinois or elsewhere prior to receiving the signing bonus. Stip. ¶ 27. Further, the signing bonus was not conditioned upon taxpayer's continued employment with the Cubs. Stip. Ex. G, supp. sec. C. The contract also provided that the signing bonus was income separate and apart from the payment of salary or other compensation. Stip. Ex. G, supp. sec. C. For these reasons, the signing bonus cannot represent remuneration paid for personal services under applicable legal or regulatory definitions and should not be allocated to Illinois under §§302.

Option Year Buy-Out Payment

Taxpayer's 1992 Illinois base income included his option year buy-out payment since it was included within his federal adjusted gross income. *See*, Stip. Exs. Q and S. Taxpayer did not include this option year buy-out payment in his Illinois net income because he contends that it is not income allocable to Illinois. Taxpayers' Opening Brief p. 11. Similar to his argument concerning the signing bonus, the taxpayer maintains that the option year buy-out payment is not compensation because it does not represent remuneration for services performed. Taxpayers' Opening Brief p. 12.

The contract stated as follows:

E. Club Option for 1993.

Club shall have the option, in its sole discretion, to extend this Agreement by electing to have it cover the 1993 Major League baseball season. To exercise this option, Club must deliver written notice of such exercise to Player on or before October 15, 1992, unless Club participates in the 1992 League Championship Series or World Series, in which event such notice shall be delivered no later than the day following the last game in such Series or Series' in which Club participates, time to be of the essence. In the event Club exercises this option it shall pay Player the Salary for 1993 as specified in Section B of this Supplement and Award Bonuses, if earned, as provided in

Section D, subject to all of the provisions of this Agreement. In the event Club does not exercise its option as set forth above, it shall then be obligated to pay Player \$500,000 in a lump sum (less usual withholding), such payment to be made within fifteen days after the last day Club could have exercised its option pursuant to this Section E, and Player shall have the right to elect free agency in accordance with the procedures set forth in the Basic Agreement.

Stip. Ex. G.

The Cubs did not exercise the option in 1992. Therefore, pursuant to the contract, they paid "Doe" an option year buy-out payment. Stip. ¶ 59. This payment was received by him on or about October 30, 1992. Stip. ¶ 59, 61, 73. "Doe" received the payment at his Texas residence, and the Cubs did not condition the payment upon the performance of other services. Stip. ¶¶ 61, 62.

As previously mentioned, the Department chose to define compensation by referencing the definition of wages for federal income tax withholding purposes. 86 Ill. Admin. Code §100.3100(a) cross-referencing 26 U.S.C. §3401(a). Similar to the signing bonus, taxpayer's option year buy-out payment should not be considered "compensation" because it does not represent remuneration for services performed. As stipulated by the parties, the option year buy-out payment was an incentive for the Cubs to renew taxpayer's contract for the 1993 baseball season. Stip. ¶ 60; Stip. Ex. G (contract).⁷

⁷ While not controlling in this case, it should be noted that other states including, Indiana, Iowa, Maryland, New Jersey, New York, North Carolina, Oregon, Rhode Island, Utah, and Wisconsin have similarly found that a contract or option year buy-out payment received by a nonresident professional athlete is not compensation because it is not payment for services rendered. *See e.g.* Ind. Code sec. 6-3-2-2.7(a)(6); Iowa Admin Code r. 701-40.46(1)(c); Md. Admin. Release ADR No. 24 (III)(B)(4)(a)(Oct. 1, 1999); N.J. Admin. Code sec. 18:35-5.1(b)(4)(iii); N.Y. Comp. Codes R. & Reg. Sec. 132.22(b)(4)(I); N.C. Admin. Code title 17, sec. 06B.3905(a)(3)(D); Or. Admin. R. 150.316.127-(F)(2)(d)(A); R.I. Code Reg. PIT 97-21(ii); Utah Admin. Code R865-9I-44(C)(5)(a); and Wisc. Admin. Code sec. 2.31(3)(d).

Once again, there is a Revenue Ruling that provides additional guidance here. In Rev. Rul. 58-301, the IRS held that a payment made for the cancellation of an employment contract does not represent wages subject to federal income tax withholding because it is not a payment for personal services. Rev. Rul. 58-301, 1958-1 C.B. 23 (Supp. App. 3); Rev. Rul. 55-520, 1955-2 C.B. 393 (Supp. App. 5).

As a supplemental position against taxation of the transactions just discussed, taxpayer additionally proffers the argument that the signing bonus and the option year payment do not constitute business income. In response, the Department posits in its post-hearing memorandum of law, that the payments are clearly compensation and it questions whether the business/non-business test even applies to individuals engaged in professional sports contracts. Moreover, it suggests that the transactional and functional tests as used by Illinois courts make very little sense in the context of an individual personal service contract. *See*, Dept. Brief fn 6. Nonetheless, the Department reserves the position that, in the event such concepts do apply to this matter, both the signing bonus and the option year payment should be business income wholly allocable to Illinois.

I cannot disagree with the Department's hesitation to characterize the signing bonus and option pay-out as either business or non-business income. Initially, it must be observed that the "Does" did not report those amounts as either business or non-business income. This significant omission was most likely made because they have never once asserted, in any return, federal or state, that they had income that was attributable to a business in which they are engaged. Stip. Exs. P-Q (p. 1, line 12 of each return), R-S (p. 2, Part II, line 5 & Part III of each return). The business/non-business income distinction

comes into play only where a person is, in fact, engaged in a business. 35 **ILCS** 5/304(a); Stip Exs. R-S (p. 2, Parts II–III). In that very fundamental and relevant respect then, the arguments on this topic are absolutely contradicted by taxpayer's own returns. While I base my conclusions on the taxable nature of the signing bonus and contract buy-out *in toto* on the Department's own interpretation of the amounts that constitute compensation that are to be considered remuneration in exchange for services from employment (*see* 86 Ill. Admin. Code § 100.3100(a)), the aspect of the taxpayer's argument *vis-à-vis* non-business income nevertheless needs to be addressed.

Section 1501(a)(1) defines business income as “income arising from transactions and activity in the regular course of the taxpayer’s trade or business, . . . and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer’s regular trade or business operations.” 35 **ILCS** 5/1501(a)(1). Income constitutes business income in Illinois if either the “transactional” or the “functional” test is met. Texaco-Cities Service Pipeline Co. v. McGaw, 182 Ill. 2d 262, 270 (1998). The transaction test classifies income as business income if the income is derived from a type of business transaction in which the taxpayer regularly engages. Id. at 269. The functional test, classifies income as business income if it is derived from property used in the taxpayer’s regular trade or business operations. Id.

Neither the signing bonus nor the option buy-out payment constitute business income under the transactional or the functional test. Neither payment could be considered business income under the transactional test because taxpayer did not receive the payments from a transaction in which he regularly engages. Stip. 25, 62.

The signing bonus and the buy-out payment also do not constitute business income under the functional test. The functional test focuses on the role or function of the property that generated the income. Texaco-Cities Service Pipeline Co. v. McGaw, 182 Ill. 2d 262, 695 N.E. 2d 481 (1998). Here, the income was not derived from any type of “income producing property.” Accordingly, under any relevant or operable definition, taxpayer's argument here is without merit.

Allocation of Taxpayer's Compensation

As the principal component of the present controversy, the question is put as to whether the Department's allocation of 100% of taxpayer's compensation to Illinois was legally permissible. While the taxpayers and the Department have presented this matter as a test case which challenges the propriety of Illinois' statutory scheme of taxing nonresidents who are employed as professional athletes by Illinois based sports teams, the proper perspective must be kept by noting that § 302 does not just apply to nonresident professional athletes. It applies, uniformly, to all nonresident employees of Illinois employers. There are no restrictions under the statute, either direct or implied, as to occupation, position or job classification. That truth notwithstanding, taxpayer nevertheless refuses to accept that § 302 of the IITA *requires* nonresidents to allocate to Illinois “... the amount of compensation that is paid in this state (as determined under Section 304(a)(2)(B)).” 35 ILCS 5/302(a); Taxpayers' Opening Brief, p. 19. Instead, reference is made to the effect of § 302 as being only the Department's *interpretation* of that provision, or of § 304(a)(2)(B). Taxpayers' Opening Brief, pp. 19-24.

During the years at issue, § 302(a) provided:

Compensation paid to nonresidents. (a) In general. 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.

35 ILCS 5/302(a). Section 304(a)(2)(B), in turn, provided that an item of compensation is paid in Illinois 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.

* * * *

35 ILCS 5/304(a)(2)(B).⁸

Both taxpayer and the Department agree that § 304(a)(2)(B)(iii) is the particular provision that best describes taxpayer's employment situation here. Taxpayers' Opening Brief, pp. 17-18; Department's Brief, p. 7. The Department urges that since the facts show that some of the services "Doe" performs for his employer are performed in Illinois, and since his employer's base of operations is in Illinois, "Doe's" compensation is paid in Illinois. Since his compensation is paid in Illinois, the Department's argument continues,

⁸ Effective for tax years ending on or after December 31, 1992, the Illinois General Assembly amended § 304(a)(2)(B) by adding a final paragraph, which provides for a retaliatory tax to be assessed on nonresident professional athletes who reside in a state which assesses a tax measured by net income on athletes residing in Illinois. Since "Doe" does not reside in such a state, that amended provision does not affect any of the facts or conclusions set forth here. "Doe", moreover, does not assert any constitutional challenge to § 304(a)(2)(B) based on the legislature's enactment of the retaliatory tax, effective during the year ending December 31, 1992.

§ 302 unambiguously requires him to allocate the amount of his compensation from his Illinois job to Illinois. Department's Brief, p. 7.

Taxpayer, however, argues that § 304(a)(2)(B)(iii) does not require him to allocate *all* of his compensation to this State. Taxpayers' Opening Brief, pp. 16-18. That is true, in a technical sense, because it is not § 304 but § 302 that requires him to allocate to Illinois the amount of compensation that is "... paid in Illinois." Section 304(a)(2)(B) just defines the kinds of compensation that are "paid in Illinois." 35 **ILCS** 5/304(a)(2)(B).

Taxpayer poses that "[t]he General Assembly could not have reasonably intended to tax all of an employee's compensation when some services are performed within and without Illinois, merely because the employer maintains its base of operations within Illinois." Taxpayers' Opening Brief, p. 18. However, a straightforward reading of the terms of the statute reveals that is exactly what the legislature said should be done in § 302(a) of the IITA. 35 **ILCS** 5/302(a). That section does not state that *some* of the compensation that is paid in Illinois shall be allocated. Nor does it provide that some of such compensation *may* be allocated to Illinois. As the Illinois supreme court has repeatedly held, "[t]here is no rule of construction which authorizes a court to declare that the legislature did not mean what the plain language of the statute imports." Illinois Power Co. v. Mahin, 72 Ill. 2d 189, 194, 381 N.E.2d 222, 224 (1978) (*quoting* Western National Bank v. Village of Kildeer, 19 Ill. 2d 342, 350, 167 N.E.2d 169, 174 (1960)). Thus, it is not the Department but rather the taxpayer who is misinterpreting §§ 302 and 304(a)(2)(B)(iii) of the IITA, by asking that the Department apportion a nonresident's compensation that is paid in Illinois, instead of allocating it, whenever an Illinois-based

employee performs services outside of Illinois during the course of his employment. Taxpayers' Opening Brief, p. 18. In force and effect, "Doe" is asking the Department to act expressly contrary to what the statute directs.

Section 304(a)(2)(B)(iii) provides that one of the ways compensation will be paid in Illinois is in the case of an employee who "... perform[s] ... [some of the service] 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" 35 ILCS 5/304(a)(2)(B)(iii). There are other ways a nonresident individual's compensation will be paid in Illinois as well (35 ILCS 5/304(a)(2)(B)(i)-(ii)), but in all cases, compensation that is paid in Illinois is, pursuant to § 302, to be allocated to Illinois. The Department is not interpreting §§ 302 and 304. Instead, it is merely reading the text of those related provisions, and asking that the plain language used in them be heeded. Giving effect to the plain text of those provisions in this case, moreover, does not lead to an absurd or unconstitutional result as claimed here.

The result is not absurd, first of all, because the particular item of income § 302 requires to be allocated to Illinois is the compensation "Doe" receives from his Illinois employer, in the same fashion and identical manner as any other nonresident employee of an Illinois employer is required to report. There are different types of income, and the IITA treats the different types of income in different ways. *See generally* 35 ILCS 5/301-5/304. Section 302 pertains only to items of compensation that are paid in Illinois. 35 ILCS 5/302(a); *see also* 86 Ill. Admin. Code § 100.3120(c)(1) (setting forth exceptions to general allocation rules for compensation paid to nonresidents).⁹ It does not pertain to

⁹ During the years at issue, prior to such years, and currently, an applicable income tax regulation distinguished between compensation that is paid in Illinois and other types of compensation that are not

compensation that is not paid in Illinois, or to business or non-business income, or to other unspecified items of income. In the event a nonresident who receives compensation paid in Illinois also conducts a multi-state business, the business income attributable to such a multi-state business would be apportioned under § 304, not § 302.

The "Does", however, reported no items of business income on their Illinois or federal returns for the years at issue. Stip. Exs. P-Q (line 12 of each federal return), R-S (Part II line 5 of each Illinois return). They did report other items of income that did not relate to the compensation to "Doe" paid by the Cubs. Stip. Exs. P-Q (p. 1, lines 8a-18 of each of the "Does'" federal returns), R-S (p. 2, Part II, lines 2-9 of the Schedule NR for each of the "Does'" Illinois returns). Those items of income, however, were not taxed by Illinois. Stip. Ex. W, p. 2. The only item of income the Department allocated wholly to Illinois was the amount "Doe" reported, on both his federal and state income tax returns, as being the income that was attributable to his compensation from the Cubs. *Id.* The

"paid in" Illinois. *See* 86 Ill. Admin. Code § 100.3120(c)(1) (1992-1998); 86 Ill. Admin. Code § 302-1(c)(1) (1981). Except for non-substantive changes, that section has always provided:

While "compensation" may include items of income taken into account by a nonresident employee under the provisions of 26 U.S.C. 401 through 424, such as, for example, amounts received by a beneficiary of an employees' trust (taxable to the employee under 26 U.S.C. 402, whether the trust is exempt or non-exempt from federal income tax), or income resulting from a disqualifying disposition of stock acquired pursuant to the exercise of a qualified stock option (taxable to the employee under 26 U.S.C. 421(b) above), such compensation is not allocated under IITA Section 302(a). Such compensation is allocated under the rules of IITA Section 301(b)(2)(A), i.e., is not allocated to Illinois, whereas compensation which is allocated pursuant to IITA Section 302(a) is allocated to Illinois, if "paid in" this State (see subsections (a) and (b) above). Consequently, a nonresident claiming that compensation which would otherwise constitute compensation paid in Illinois should not be allocated to Illinois under IITA Section 301(b)(2)(A) must establish that such compensation was properly taken into account by such individual under the provisions of 26 U.S.C. 401 through 424.

86 Ill. Admin. Code § 100.3120(c)(1).

compensation a nonresident individual taxpayer receives from his employer is not business income, and, under Illinois' tax scheme, was never intended to be apportioned among the various states the employee might have entered and/or traversed during the course of his employment. *Compare 35 ILCS 5/302 with 5/304(a).*

Second, the record shows that "Doe's" compensation from his employment with the Cubs was not, and was never meant to be, a function of the number of individual games he played as an employee, the number of games he played inside versus outside Illinois, or the quality of his performance during the Cubs' home and/or away games.

The Cubs employed "Doe":

to render, and the Player agrees to render, skilled services as a baseball player during the [applicable] year(s) ... including the Club's training season, the Club's exhibition season, the Club's playing season, the League Championship Series and the World Series (or any other official series in which the Club may participate and in any receipts of which the Player may be entitled to share). (emphasis added)

Stip. Ex. G, p. 1. In exchange for signing the contract of employment with the Cubs, the Cubs agreed to pay "Doe" a signing bonus, as well as "... a base salary of \$1,400,000 for 1991, \$2,000,000 for 1992, and, in the event Club exercises its option as provided in Section E of [the contract], \$2,400,000 for 1993, in each case payable in semi-monthly installments between January 1 and December 31 of each year." *Id.*, p. 5. So long as "Doe" did not violate any of the provisions set forth in Section F of the Supplement, moreover, the Cubs guaranteed that it would continue making semi-annual payments of "Doe's" base salary during the two years of the contract, and during the third year, if the Cubs exercised its option. *Id.*, pp. 7-9.

The language of the contract is clear. The Cubs controlled and directed "Doe's" activities as an employee beyond pre-season, regular and post-season scheduled play, as the contract language includes, but does not limit its terms to those times. Nor are penalties for breach by "Doe" determined, necessarily, by a pro-rata measure based upon games played. Thus, "Doe" was not a day laborer or per diem employee, and his compensation under his contract was not dependent upon his performance of services during each successive and identifiable part of the Cubs' playing season, or during each successive game played throughout that season. Indeed, from the provisions and restrictions imposed by the contract, it is eminently clear that this taxpayer was an employee of the Cubs and subject to that organization's requirements and demands 365 days out of the year.

There is no dispute that "Doe" was employed by the Cubs, and received compensation from that employer, for the whole of the 1991 and 1992 seasons. Stip. ¶¶ 18-19, 41, 63. His base salary was paid in 24 semi-monthly installments during those calendar years, even though "Doe" was disabled during most of the Cubs' 1992 playing season. Stip. ¶¶ 64-66; Stip. Ex. G, p. 5. For at least the 1992 calendar, therefore, most of the compensation "Doe" received from the Cubs cannot be attributed to his pitching, hitting or fielding a ball during any regular or post-season game. "Doe", however, wants the Department to decide that Illinois has no claim to any portion of his compensation which he suggests was earned from the services he performed on the away games the Cubs played outside Illinois, even though he pitched not one ball for the Cubs after being disabled in June 1992. Stip. ¶ 64; Stip. Ex. S, p. 10 (attachment to 1992 Illinois return); Taxpayers' Opening Brief, pp. 4-5.

"Doe" wants the Department to treat his contract, despite the import of its express terms, as one that pays him a salary that is severable and dependant upon his performance from spring training through the Cubs regular season. To use modern parlance, taxpayer wants this issue resolved within the context of a 220 day box. "Doe's" contract with the Cubs, however, included his agreement to undertake obligations that are *outside* the box "Doe" insists must be used. "Doe" was a Cubs employee the whole year round, for two straight years. His employment contract with the Cubs reveals the continuing nature of the Cubs' control over him throughout each full year of the contract, and not just during the exhibition and regular season games the team played during each of the contract's term years. Specifically, the contract required "Doe" "... to keep himself in first-class physical condition and to obey the Club's training rules" Stip. Ex. G, p. 1. The contract also prohibits, without the prior written consent of the Club, his participation or engagement in:

... riding or driving in any kind of race, piloting or learning to operate or serving as a member of a crew of an aircraft, hot air ballooning, parachuting, skydiving, hang gliding, horse racing horseback riding, fencing, boxing, wrestling, karate, judo, jujitsu, water skiing, snow skiing, snowmobiling, bobsledding, ice hockey, field hockey, squash, racquetball, softball, tennis, badminton, basketball, football, white water canoeing, jai alai, lacrosse, soccer, rodeo, bicycle racing, motor boat racing, polo, rugby, handball, volleyball, surfboarding, body surfing, paddle ball, wood chopping, participation in "Superteams" or "Superstars" activities or other television or motion picture athletic competitions.

Stip. Ex. G, p. 8 (¶ 4 of supplement).

There are no time limits on either of those obligations "Doe" undertook pursuant to his employment contract with the Cubs; they applied throughout the term of the

contract. During the time this document was being written, the annual Cubs fan convention was held. While the parties did not address whether "Doe" was asked to take part in the 1991 and 1992 conventions, or whether he, in fact, took part in them, there is no doubt that, under his contract, he agreed to attend such functions in Illinois had the team directed him to do so. Stip. Ex. G, p. 1-2 (¶ 3.(b)).

Without a doubt, "Doe's" job included what many would consider significant perks — most notably a guaranteed salary. In one particular respect, however, his Illinois-based employment is not so different from jobs held by many other nonresidents. Especially in areas close to a state's border, a company whose base of operations is located in one state will frequently employ residents of the neighboring state. Some of those employees, moreover, will be required to travel, some more often than others, outside the state where their employer's business is located. Some of those frequent travelers will, like professional athletes, find themselves working outside Illinois on behalf of their Illinois based employer even more than they find themselves working in Illinois. Such employees will, like "Doe", have jobs the compensation from which will fit within § 304(a)(2)(B)(iii)'s description of compensation that is paid in Illinois. With the advent of telecommuting, and the fact that many employers allow their employees to work significantly greater amounts of time at home, it should not surprise anyone if the frequency with which such employment arrangements occur, only increases.

Section 302 of the IITA classifies nonresidents based on whether they earned or received income in the form of compensation that was paid in Illinois. 35 ILCS 5/302. It applies equally to all such persons, and it treats all nonresident employees alike whose compensation is paid in Illinois, be they well-paid professional athletes or moderately

paid salesmen. Those having a reporting obligation and having compensation paid in Illinois are required to allocate the amount of their compensation paid in Illinois to Illinois. Those having a reporting obligation but having no compensation that is paid in Illinois will allocate no compensation to Illinois. What § 302 requires, therefore, is that each and every nonresident — including this taxpayer — *shall* allocate to Illinois the amount of their compensation that is paid in Illinois. 35 ILCS 5/302(a). Generally, the term “shall” indicates a mandatory obligation, not a permissive one. Newkirk v. Bigard, 109 Ill. 2d 28, 33, 485 N.E.2d 321, 323 (1985). It is beyond cavil here that the Cubs has its base of operations in Illinois, and that it controls "Doe's" performance of his duties as a Cubs employee throughout the contract year and not only during the training season, exhibition, regular and post-season game time. As such, it is both reasonable and logical to conclude that the items "Doe" reported as compensation from his employer were paid in Illinois, and must, pursuant to § 302(a), be allocated to Illinois.

Taxpayer’s Claims of Unconstitutionality

In addressing taxpayer's specific constitutional challenges to the NOD, some preliminary points must be clearly understood. First, pursuant to Article VI of the Illinois Constitution, only a circuit or higher court has the authority to declare a legislative act unconstitutional. *See* Ill. Const., art. VI, § 1. In contrast, the Department, including myself as an agent of the Director, lacks any such authority even if so inclined. *See* 20 ILCS 2505/39b (Powers of the Department). The statutes involved here, however, do not violate any federal or state constitutional prohibitions.

Second, “a person to whom a statute may constitutionally be applied may not challenge that statute on the ground that it may conceivably be applied unconstitutionally

to others in situations not before the Court.” New York v. Ferber, 458 U.S. 747, 767, 102 S.Ct. 3348, 3360, 73 L.Ed.2d 1113 (1982); *see also*, Chicago Teachers Union, Local 1 v. Bd. of Educ. of the City of Chicago, 189 Ill. 2d 200, 206, 724 N.E.2d 914, 918 (2000). As will be discussed, "Doe" has failed to include any evidence in this record to show that he has suffered any discrimination or injury due to any of the statutory provisions of which he complains.

It is first alleged that Illinois discriminates against nonresident athletes employed by Illinois sports teams by imposing a greater tax on them than on residents similarly situated. Taxpayers’ Opening Brief, p. 20. Taxpayer claims that this discrimination violates the Privileges and Immunities Clauses of the United States Constitution. Id. pp. 20-22. One right secured by the Privileges and Immunities Clause is:

... the right of a citizen of any State to “remove to and carry on business in another without being subjected in property or person to taxes more onerous than the citizens of the latter State are subjected to.” Shaffer, *supra*, at 56, 40 S.Ct., at 227; *see also* Toomer v. Witsell, 334 U.S. 385, 396, 68 S.Ct. 1156, 1162, 92 L.Ed. 1460 (1948); Ward v. Maryland, 12 Wall. 418, 430, 20 L.Ed. 449 (1871).

Of course, nonresidents may “be required to make a ratable contribution in taxes for the support of the government.” Shaffer, 252 U.S., at 53, 40 S.Ct., at 225. That duty is one “to pay taxes not more onerous in effect than those imposed under like circumstances upon citizens of the ... State.” Ibid.; *see also* Ward v. Maryland, *supra*, 430, 20 L.Ed. 449 (nonresidents should not be “subjected to any higher tax or excise than that exacted by law of ... permanent residents”). Nonetheless, as a practical matter, the Privileges and Immunities Clause affords no assurance of precise equality in taxation between residents and nonresidents of a particular State. Some differences may be inherent in any taxing scheme, given that, “[l]ike many other constitutional provisions, the privileges and immunities clause is not an absolute,” Toomer, *supra*, at 396, 68 S.Ct., at 1162, and that “[a]bsolute equality is

impracticable in taxation,” Maxwell v. Bugbee, 250 U.S. 525, 543, 40 S.Ct. 2, 7, 63 L.Ed. 1124 (1919).

Lunding v. New York Tax Appeals, 522 U.S. 287, 296-97, 118 S.Ct. 766, 773-74, 139 L.Ed.2d 717 (1998).

The argument is made that Illinois’ allocation of all of a nonresident’s compensation from a job in Illinois imposes a greater tax on nonresidents than on residents because a similarly situated resident would be able to obtain a foreign tax credit on the amount of tax the resident pays regarding his Illinois compensation. Taxpayers’ Opening Brief, pp. 22-24. However, the Department correctly points out that, under § 601 of the IITA, a similarly situated resident who, like "Doe", is also employed by an Illinois based sports team, will not receive a foreign tax credit on the taxes he might pay to another state. Department’s Brief, pp. 18-19. The taxpayer's position then, is without foundation.

Section 601(b) of the IITA provides for certain credits to be applied against the amount of tax the person owes for a given year under the IITA. 35 **ILCS** 5/601(b). Section 601(b)(3) provides a credit for certain amounts of foreign tax that may have been imposed upon a resident taxpayer’s income. Specifically, that paragraph provides:

(3) Foreign tax. The aggregate amount of tax which is imposed upon or measured by income and which is paid by a resident for a taxable year to another state or states on income which is also subject to the tax imposed by subsections 201(a) and (b) of this Act shall be credited against the tax imposed by subsections 201(a) and (b) otherwise due under this Act for such taxable year. The aggregate credit provided under this paragraph 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 subject to tax both by such other state or states and by this State bears to his total base income subject to tax by this

State for the taxable year. For purposes of this subsection, no compensation received by a resident which qualifies as compensation paid in this State as determined under Section 304(a)(2)(B) shall be considered income subject to tax by another state or states. The credit provided by this paragraph shall not be allowed if any creditable tax was deducted in determining base income for the taxable year. Any person claiming such credit shall attach a statement in support thereof and shall notify the Director of any refund or reductions in the amount of tax claimed as a credit hereunder all in such manner and at such time as the Department shall by regulations prescribe.

35 **ILCS** 5/601(b)(3) (emphasis added). Thus, the Illinois General Assembly clearly expressed that the foreign tax credit would not be available for any amount of a foreign state's tax that was assessed on a resident's compensation that was paid in Illinois. 35 **ILCS** 5/601(b).

In its reply, "Doe" severely criticizes the Department's "interpretation" of § 601, and suggests that, up until the date he received the Department's brief, he could not have possibly understood § 601 to deny a foreign tax credit for the amount of foreign tax paid on the compensation the resident earned or received from a job based in Illinois. He also asserts, for the first time, that a nonresident professional athlete's compensation paid in Illinois must be apportioned instead of allocated under § 302 because § 601 discriminates between similarly situated Illinois residents. What is clear, however, is that the Privileges and Immunities Clause is not concerned with any state scheme that might arguably discriminate between its residents; rather, it protects nonresidents who are not accorded "substantial equality of treatment" in comparison to a state's residents. Lunding, 522 U.S. at 297-98, 118 S.Ct. at 774.

It must be reiterated emphatically here that the Department has not "interpreted" § 601, it has merely expressed the very words the legislature enacted into law. A statute

needs to be interpreted only when there is some uncertainty caused by the language used in the applicable provision. Illinois Power Co. v. Mahin, 49 Ill. App. 3d 713, 718, 364 N.E.2d 597, 601 (4th Dist. 1977) (“...in determining legislative intent ... we must first look to the words used, for it is only when the words are inadequate that we turn to legislative history and interpretive aids to more clearly perceive intent, or, indeed, in some instances to discover it.”), *aff’d*, 72 Ill. 2d 189, 194, 381 N.E.2d 222, 224 (1978). Section 601(b)(3) is not unclear. The plain and clear text of that provision grants the credit to a resident whose compensation is not paid in Illinois, and who paid tax to another state with regard to that item of income. It does not grant the credit, however, to a resident whose compensation was paid in Illinois. Contrary to the argument made, the IITA’s foreign tax credit provision treats the compensation of nonresidents and residents who are employed by an Illinois employer *exactly* the same.

"Doe's" argument relative to the Privileges and Immunities Clause must necessarily fail. Allocating all of a nonresident’s compensation that is paid in Illinois does not, as a matter of either fact or law, tax a nonresident’s compensation more harshly than a resident whose compensation is also paid in Illinois. Under the plain and obvious terms of § 601(b)(3), neither a resident nor a nonresident who is employed by an Illinois employer will be allowed to take a credit for the amount of a foreign tax that might be assessed on such an item. 35 **ILCS** 5/601(b)(3). There is, therefore, no discrimination against nonresidents here. The Illinois resident, it must be recalled, will generally be taxed on all items of his income (35 **ILCS** 5/301(a)). On the other hand, the nonresident will only be taxed (assuming no income is derived from, *inter alia*, property that is situated in Illinois) on the amount of compensation paid in Illinois. 35 **ILCS** 5/302(a).

Illinois Uniformity Clause

By way of reply, "Doe", for the first time, asserts that § 601 unlawfully discriminates between Illinois residents in violation of the Illinois Constitution's Uniformity Clause. Article IX, section 2 of the Illinois Constitution provides:

In any law classifying the subjects or objects of non-property taxes or fees, the classes shall be reasonable and the subjects and objects within each class shall be taxed uniformly. Exemptions, deductions, credits, refunds and other allowances shall be reasonable.

Ill. Const. 1970, art. IX, § 2. The Illinois Constitution's uniformity clause was intended to encompass the equal protection clause and add to it even more limitations on government. If a tax passes muster under the uniformity clause, it inherently fulfills the requirement of the equal protection clause. Geja's Cafe v. Metropolitan Pier & Exposition Authority, 153 Ill. 2d 239, 247 (*citing* Searle Pharmaceuticals, Inc. v. Department of Revenue, 117 Ill. 2d 454, 468 (1987)).

Statutes are presumed constitutional, and broad latitude is afforded to legislative classifications. *See, e.g., Geja's Cafe*, 153 Ill. 2d at 248. A tax classification is valid under the uniformity clause if it is based on a real and substantial difference between the persons taxed and those not taxed, and if the classification bears some reasonable relationship to the object of the legislation or to public policy. The party challenging a classification on uniformity grounds has the burden of showing that the classification is arbitrary or unreasonable. Id.

There is an initial and foundational procedural impediment to "Doe's" uniformity challenge. Even if § 601 might, *arguendo*, discriminate vis-à-vis Illinois residents by withholding a foreign tax credit to a resident whose compensation is paid in Illinois while

granting it to the resident whose compensation is not paid in Illinois, this taxpayer is admittedly not an Illinois resident. Therefore he cannot be affected by its import. “It is well established that a court may not address the constitutionality of a statute unless the party challenging the statute has standing to challenge it.” Northern Illinois Home Builders Ass'n v. City of St. Charles, 297 Ill. App. 3d 730, 737, 697 N.E.2d 442, 447 (2d Dist. 1998) (*citing* People v. Capitol News, Inc., 137 Ill.2d 162, 169, 560 N.E.2d 303 (1990)). "Doe" first made the uniformity argument in his reply brief, and in response to the Department's argument that the text of § 601 provides that no foreign tax credit is allowed against a resident's receipt of compensation that is paid in Illinois. Due to the briefing schedule agreed upon by the parties, the Department had no opportunity to respond to the uniformity challenge based on a claimed injury to a class of taxpayers to which he did not belong nor of which he was a bona fide representative.

“The doctrine of standing is intended to assure that issues are raised only by those parties with a real interest in the outcome of the controversy.” Chicago Teachers Union, Local 1 v. Bd. of Educ. of the City of Chicago, 189 Ill. 2d 200, 206, 724 N.E.2d 914, 918 (2000). To have standing to challenge the constitutionality of a statute, one must have sustained or be in danger of sustaining a direct injury as a result of enforcement of the challenged statute. Id. Since "Doe" is not an Illinois resident, he is not a person who can either assert or properly defend the rights of an Illinois resident. Rodgers v. Whitley, 282 Ill. App. 3d 741, 668 N.E.2d 1023 (1996) (in order to have standing to challenge a statute, a party must be within the class of people as to whom the statute is allegedly unconstitutional).

Even if "Doe" *were* a proper person to complain about § 601's alleged discrimination between residents, that section's classification of residents is based on a real and substantial difference between such persons. The classification, moreover, is reasonably related to the legislature's constitutional authority to tailor the scope of the foreign tax credit.

From the day it was first enacted, the IITA's method of allocating items of compensation reflected the General Assembly's determination that only two states would be able to lay claim to 100% of a resident's compensation — the state where the employment is based, and the state of the employee's residence. In 1984, the Illinois legislature amended § 601 to specifically provide that the foreign tax credit would be made available for foreign tax paid on items of a resident's compensation only where such compensation is not paid in Illinois. Ill. Rev. Stat. ch. 120, ¶ 6-601(b) (1987) (amended by P.A. 83-1352, eff. Sept. 8, 1984). The different treatment reflects the legislature's decision that, notwithstanding the fact that Illinois is entitled to tax all items of a resident's income from whatever source, it made a policy decision to extend its foreign tax credit only under circumstances where another state would be more likely to exercise a tax measured by 100% of that compensation. It is quite reasonable for the legislature to have concluded that a foreign state is more likely to impose a tax on 100% of an Illinois resident's compensation when the resident is employed outside Illinois, that is to say, where the compensation is not paid in Illinois. Such a reasonable classification between residents in palpably distinct circumstances has never been found to violate the Illinois Constitution's uniformity clause. *See Illinois Gasoline Dealers Ass'n. v. Chicago*, 119 Ill. 2d 391, 402 (1988) ("... there is no constitutional restraint against more than one

privilege or excise tax where the total does not exceed reasonable taxation for the privilege enjoyed.”) (*citing* People v. Deep Rock Oil Corp., 343 Ill. 388 (1931)).

Further, a state is not constitutionally required to offer any foreign tax credits at all. Oklahoma Tax Commission v. Chickasaw Nation, 515 U.S. at 463 & n.12, 115 S.Ct. at 2222-23. If it does, it is a matter of legislative grace. Where the legislature has granted credits or deductions as a matter of legislative grace, they should be implemented not only in a manner which takes into account the general policy supporting the particular credit or deduction (*see* Zunamon v. Zehnder, 308 Ill. App. 3d 69, 76, 719 N.E.2d 130, 135 (1999)),¹⁰ but also in a way which gives effect to the words the legislature used when specifically describing the scope of the credit. Caterpillar Tractor Co. v. Lenkos, 84 Ill. 2d 102, 126-28, 417 N.E.2d 1343, 1356 (1981).

Due Process and Commerce Clauses

"Doe" next asserts that Illinois' allocation of 100% of his compensation violates the Due Process Clause because it taxes income that is not apportioned or fairly related to services provided by Illinois. *See*, e.g. Taxpayer's Opening Brief, pp. 24-28. At this point, it is important to recognize that an unstated but implied fundamental assumption underlies most of taxpayer's arguments in this matter. That fundamental premise is that he is engaged — and as a class, all professional athletes are each engaged — in his own multi-state business. Proceeding from that basic postulate, taxpayer then maintains that the amount of compensation any nonresident professional athlete receives from an

¹⁰ One of the bases for the Zunamon court's decision was that there was no express indication in § 601 that the legislature intended Illinois' foreign tax credit to be applied differently as between the various classes of Illinois residents. Zunamon, 308 Ill. App. 3d at 75, 719 N.E.2d at 135. This matter clearly reveals that § 601 *is* explicit in its classification between individual residents — at least as far as items of income in the form of compensation is concerned. Compensation will, as a practical matter, be earned or received only by individuals.

Illinois employer may not be allocated pursuant to § 302, but must instead be treated like an item of business or non-business income. That is, it is to be either apportioned or allocated pursuant to §§ 303 and 304 of the IITA. *See, e.g.*, Taxpayers' Opening Brief, p. 24.

There should be little doubt, after the United States Supreme Court's decision in Flood v. Kuhn, that taxpayer's employer, the Cubs, is operating a multi-state business which is in turn engaged in interstate commerce. Flood v. Kuhn, 407 U.S. 258, 282, 92 S.Ct. 2099, 2112, 32 L.Ed.2d 728 (1972). The conclusion that taxpayer argues must derive from that fact, *i.e.* that taxpayer is also engaged in interstate commerce, however, is without any substantive legal or factual support. The United States Supreme Court has long declined to treat an entity's employees as though they shared the same tax characteristics as their employer. Graves v. New York ex rel O'Keefe, 306 U.S. 466, 59 S.Ct. 595, 83 L.Ed. 927 (1939) (employee of an instrumentality of the United States did not share the same tax-exempt status as his employer). Accordingly, it would be quite a conceptual stretch to conclude that every employee of an employer that is engaged in a multi-state business is, *ipso facto*, also engaged in a multi-state business. Unlike the relatively continued presence a multi-state business will have in different jurisdictions, the locus of an individual's employment - which is the source of the particular compensation at issue - does not change just because the employee may be sent, temporarily, to other places to perform a task for his employer. Yet that is precisely what taxpayer argues for here - his compensation must be treated in the same manner and fashion as the income earned by his multi-state business employer.

The record in this case aptly demonstrates that "Doe" is an employee, pure and simple. Granted, employment as a professional athlete has some differences from employment in other occupations. Perhaps chief among them are that an athlete has comparatively greater visibility, above average compensation and the relatively greater number of persons who are interested in the quality of the employee's job performance. Nonetheless, there are many other nonresident employees who are employed by Illinois multi-state businesses who also travel outside Illinois when performing services on behalf of their Illinois employers. To repeat, §§ 302 and 304(a)(2)(B)(iii) were not written solely to allocate items of compensation earned by professional athletes. The simple fact that "Doe" is employed as a professional athlete, therefore, ought not make any constitutional difference in the application of § 302. The only exception to this might come if one is also willing to accept the tenuous assumption that every other nonresident employee of a multi-state business is also engaged in his own multi-state business. Then the compensation paid to every such an employee must also be apportioned depending on how many days the employee is working, *in Illinois*, for his Illinois employer. It must be recognized, however, that such an assumption would completely rewrite Illinois' comparatively simple method for determining whether a nonresident's compensation is subject to Illinois income tax.

The logical extension of "Doe's" argument, then, is that the Due Process and Commerce Clauses effect a blanket prohibition against any state that imposes an income tax measured by the full amount of any nonresident's compensation from employment based in the taxing state, whenever the employee, as part of his duties, performs services outside that state. If "Doe" is correct about his constitutional arguments, then a state has

jurisdiction to tax only that portion of an employee's compensation which is attributable to the number of days he performs services on behalf of his employer within the taxing state. *See* Taxpayers' Opening Brief, pp. 3-6 (describing the means by which "Doe" apportioned his compensation for 1991 and 1992).¹¹ The United States Supreme Court, however, has never uttered such a holding, and taxpayer cites no case that contains such any definitive precedent accepting this position.

The attempt to compare a state's power to tax all of the compensation an employee earns from a job based within the state with its jurisdiction to tax only an apportioned share of the business income earned by a multi-state business triggers the concern Justice Frankfurter voiced when considering arguments about different constitutional provisions that affect a state's right to tax the persons or activities over which they assert jurisdiction:

Constitutional provisions are often so glossed over with commentary that imperceptibly we tend to construe the commentary rather than the text. We cannot, however, be too often reminded that the limits on otherwise autonomous powers of the states are those in the Constitution and not verbal weapons imported into it. 'Taxable event,' 'jurisdiction to tax,' 'business situs,' 'extraterritoriality,' are all compendious ways of implying the impotence of state power because state power has

¹¹ Actually, "Doe" stretches the concept even further for 1992, by attributing compensation to Illinois only for the home games for which he was physically present prior to being placed on the disabled list. During the period of his disability, "Doe" wants Illinois to treat his compensation as being attributable to the services performed outside Illinois when he was with traveling with the Cubs, disabled and not playing, during away games. Taxpayers' Opening Brief, p. 4. During the same period, however, he does not want any compensation to be considered allocable to Illinois for games when he was with the Cubs, disabled and not playing, during home games, although he may also have been physically present at them. *Id.*, pp. 4-5. In other words, during his disability "Doe" wants the Department to accept that he earned a fractional share of his compensation just by being with the Cubs in any state where the team played an away game, but that he didn't earn any of his compensation in Illinois when the Cubs played a home game. "Doe" cannot have it both ways, and his self-interested method of describing his "income producing activities" reveals just some of the myriad problems that would, inevitably, be encountered if Illinois were required to read § 302 as requiring a nonresident to allocate only "some of" his compensation that is paid in Illinois. Stip. Exs. R-S; Taxpayers' Opening Brief, p. 17.

nothing on which to operate. These tags are not instruments of adjudication but statements of result in applying the sole constitutional test for a case like the present one. That test is whether property was taken without due process of law, or, if paraphrase we must, whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state. The simple but controlling question is whether the state has given anything for which it can ask return.

* * * We must be on guard against imprisoning the taxing power of the states within formulas that are not compelled by the Constitution but merely represent judicial generalizations exceeding the concrete circumstance which they profess to summarize.

Wisconsin v. J.C. Penney Co., 311 U.S. 435, 444-445, 61 S.Ct. 246, 250, 85 L.Ed. 267, 270-71 (1940).

When considering whether Illinois has the power to allocate 100% of the compensation of a nonresident who is an Illinois employee, it is important to recall that it is Illinois law that provides protections and benefits to all persons employed in Illinois, without regard to whether they are residents. The Illinois Workers' Compensation Act ("WCA") defines an employee as, *inter alia*:

Every person in the service of another under any contract of hire, express or implied, oral or written, including persons whose employment is outside Illinois where the contract of hire is made within the State of Illinois, persons whose employment results in fatal or nonfatal injuries within the State of Illinois where the contract of hire is made outside of the State of Illinois, and persons whose employment is principally localized within the State of Illinois, regardless of the place of the accident or the place where the contract of hire was made, and including aliens, and minors who, for the purpose of this Act are considered the same and have the same power to contract, receive payments and give quittances therefore, as adult employees.

820 **ILCS** 305/1(b)(2). The WCA also defines the “employer[s]” that are covered by the Act. 820 **ILCS** 305/1(a).

The protections afforded by the WCA are accorded, as § 1(b)(2) provides, to Illinois employees regardless where the injury occurs. *Id.* The WCA and its protections, just like the IITA, apply to all Illinois employees, including both resident and nonresident professional athletes who are employed by an Illinois based professional sports team. 35 **ILCS** 5/301(a), 5/302; 805 **ILCS** 305/1.

In *Albrecht v. Industrial Comm’n*, 271 Ill. App. 3d 756, 756, 648 N.E.2d 923, 924 (1st Dist. 1995), *app. den’d*, 163 Ill. 2d 547, 657 N.E.2d 615 (1995), the Illinois appellate court was called upon to decide whether § 8(d)1 of the WCA applied to persons employed as professional athletes. Section 8(d)1 of the WCA provides for a wage differential award to an employee whose incapacitation from a job related injury prevents him from pursuing his usual and customary line of employment, resulting in an impairment of earnings. 820 **ILCS** 305/8(d)1; *Albrecht*, 271 Ill. App. 3d at 758-59, 648 N.E.2d at 925.

Ted Albrecht was employed by the Chicago Bears football team from 1977 to 1983, when he resigned. In 1982, while attending the team’s training camp in Platteville, Wisconsin and performing physical exercises, Albrecht injured his back. He was placed on injured reserve and remained there for the whole of the 1982 season. In a case of first impression in Illinois, the court held that Albrecht proved entitlement to the wage differential award due to his 1982 out-of-state injury. What made this decision remarkable was the seemingly universally understood opinion that, even where healthy, a professional athlete is not guaranteed continued employment. *See* *Survey on Illinois Law:*

Workers' Compensation, 2000 SIU L.J. 995, 1022 (finding the case "... very significant in that the appellate court disregarded the claimant's actual work life expectancy and instead relied on a literal reading of section 8(d)(1). The court noted that while the text of section 8(d)(1) did not speak to situations of shortened work expectancy, there was no indication that the legislature intended to exclude such employees. [footnotes omitted] The court concluded that professional football players are skilled workers as contemplated under the statute and that any shortened work expectancy in this particular claimant's career would not preclude him from a wage loss differential beginning in 1983 when he started his travel business.").

The protections and remedies afforded by the Illinois WCA are not apportioned. An Illinois employee injured outside Illinois while working for an employer enjoys the right of a whole statutory remedy through Illinois law. The statutory remedies and procedures do not require the employee to seek redress against the employer in the state where an injury occurred — or, to use "Doe's" arguments, in the state where the employee allegedly earned the fractional share of his compensation attributable to that game or training day. *See Albrecht*, 271 Ill. App. 3d 756, 648 N.E.2d 923. Here, it is "Doe's" employer that directs and causes him to be playing baseball outside Illinois (or to not be playing baseball, depending on the exercise of the Cubs' control), and it is Illinois' laws that primarily protect and apply to "Doe's", or any other Illinois employee's relations with that Illinois employer.

Taxpayer signed the supplement to his Cubs contract, that is, the part of the contract that detailed the amount of his salary and the manner in which it was to be paid, in Illinois. *Stip.* ¶ 21; *see also*, 820 ILCS 305/1(b)(2) (that part of the contract, therefore,

was "... made in Illinois"). Thus, the Illinois General Assembly's decision to allocate to Illinois 100% of the amount of a nonresident's compensation that is paid in Illinois cannot be seen as an exaction for which Illinois has given nothing in return.

As to the suggestion that § 302 "... fails to 'actually reflect a reasonable sense of how income is generated'" (Taxpayers' Opening Brief, p. 26), I cannot agree. It is this taxpayer who fails to articulate why his compensation must be treated as though it was generated by a day laborer. It is this taxpayer who does not offer a rational argument why he is in the same category as someone who worked under an express or implied contract which provided that the employee would be paid a certain amount of money for whatever work he performed each day. It is that argument, or lack of same, which fails to take into account the terms of "Doe's" employment contract with the Cubs, and how "Doe" earned or received his compensation that was paid in Illinois.

The basis for and method of "Doe's" compensation was not dependent upon how many games he played inside or outside Illinois. Stip. Ex. G, p. 1. "Doe" received compensation based on a yearly rate, not on a per-game rate. *Id.* p. 5. He received his yearly base salary in 24 equal amounts during each year of the contract. *Id.* In exchange for that compensation, "Doe" was required to forego, *throughout the year*, engaging in many activities he otherwise and everyone else would be able to enjoy. *Id.*, p. 9. He was also required to keep himself in first class physical condition. *Id.*, p. 1. Additionally, he was to be paid even if he was disabled — which "Doe" was for much of the 1992 regular season — and could not pitch, catch or field a ball for the Cubs at the home or away games he attended with the team. *Id.*, p. 3 (¶ 2); Stip. ¶¶ 63-66. "Doe's" contract and the other evidence of record show that he earned or received his compensation in Illinois,

even if his Illinois employer sent him outside Illinois during the course of his employment.

I cannot reasonably conclude that the Due Process Clause of the United States Constitution proscribes Illinois' jurisdiction to tax the compensation of persons employed within her borders. This taxpayer earned the compensation at issue as an employee of the Chicago Cubs. He did not earn his income as an independent contractor nor as any other form of business entity. The Cubs withheld, and paid over to the federal and state governments, income taxes in an amount that reflected the whole of his compensation. Stip. ¶¶ 41, 63. That he traveled outside of Illinois on the team's behalf, and during the course of his employment with the Cubs, was done strictly as an incident of his employment and was done when and where the Cubs management directed and controlled. The "Does" acknowledge that they leased a condominium [in] Chicago, Illinois, and lived there during the regular baseball seasons in 1991 and 1992. Stip. ¶¶ 70-72. The contract also provides for "Doe" to appear at whatever time and wherever, including within Illinois, his employer directed without restriction to the pre-season, regular and post-season season games calendar. Stip. Ex. G, p. 3 (¶¶ 3(b)-(c)). This record shows, therefore, that they both enjoyed — in no incidental way — access to the services and benefits provided by the State of Illinois. These services and benefits include, but are not limited to, police and fire protections, transportation and communication services, recreational and legal systems and facilities, as well as arts and entertainment venues.

Commerce Clause

Taxpayer's challenge under the Commerce Clause is predicated entirely on his assertion that Illinois cannot tax, on an unapportioned basis, all the income of a nonresident when only a portion of his income is earned within the state. Taxpayers' Opening Brief, pp. 24-25. It is argued that since Illinois allocates 100% of his income to Illinois, without apportioning it, the tax cannot meet the test announced in Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 97 S.Ct. 1076, 51 L.Ed.2d 326 (1977). Taxpayers' Opening Brief, p. 22. In a nutshell, the question that arises from this position, is whether a state may treat as being "earned or received" within its jurisdiction 100% of the compensation a nonresident receives from a job that is based within the taxing state, but which employment requires travel outside the state.

"Doe's" first argument is that Illinois' allocation of 100% of his compensation facially discriminates against interstate commerce because similarly situated residents will obtain a foreign tax credit for the amount of foreign tax paid on the item of compensation paid in Illinois. *See* Taxpayers' Opening Brief, p. 22. As was already discussed, however, "Doe" has either ignored or refused to accept the plain text of § 601. Neither a resident nor a nonresident whose compensation is paid in Illinois is entitled to a credit for the amount of a foreign state's tax assessed against that particular item of income. 35 ILCS 5/601(b)(3). A resident whose compensation is paid in Illinois and a nonresident whose compensation is paid in Illinois are both taxed at precisely the same rate and in the same manner. Therefore, §§ 302 and 601 of the IITA (and, to the extent applicable, § 304(a)(2)(B)(iii)), do not facially discriminate against interstate commerce.

Even where a tax does not facially discriminate against interstate commerce, the United States Supreme Court has applied a four-part test to determine whether a tax

assessed on an instrumentality of interstate commerce or on interstate commerce itself violates the dormant commerce clause. Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 97 S.Ct. 1076, 51 L.Ed.2d 326 (1977) (where the Court introduced the issue as, “Once again we are presented with the perennial problem of the validity of a state tax for the privilege of carrying on within a state, certain activities related to a corporation’s operation of an interstate business.”) (internal quotation marks omitted). That four-part test includes determinations whether the tax: (1) is applied to an activity with a substantial nexus with the taxing state; (2) is fairly apportioned; (3) does not discriminate against interstate commerce; and (4) is fairly related to the services provided by the State. Id. at 279, 97 S.Ct. at 1079.

When making those determinations, the Court has considered “not the formal language of the tax statute but rather its practical effect” Id. Here, Illinois taxes the compensation of a nonresident depending on whether that compensation is paid in Illinois. 35 **ILCS** 5/302. What that means, as a practical matter, is that a nonresident’s compensation will be considered paid in Illinois if: (1) he performs all of his work in Illinois; (2) he performs some of his work in Illinois and some of it outside Illinois, but his work outside Illinois is incidental to his work in Illinois; or (3) he performs some of his work inside Illinois and some of it outside Illinois, and his employer’s base of operations is in Illinois. 35 **ILCS** 5/304(a)(2)(B).

Taxpayer specifically alleges that the IITA’s allocation of 100% of the compensation from his job with the Cubs violates the second and fourth prongs of the Complete Auto test. Taxpayers’ Opening Brief, p. 24. I cannot concur. With regard to the fourth prong, the Supreme Court has held that “[w]hen a tax is assessed in proportion

to a taxpayer's activities or presence in the state, the taxpayer is shouldering its fair share of supporting the State's provision of police and fire protection, the benefit of a trained work force, and the advantages of a civilized society." Commonwealth Edison Co. v. Montana, 453 U.S. 609, 627, 101 S.Ct. 2946, 2958, 69 L.Ed.2d 884 (1981) (internal quotation marks omitted).

All of the compensation at issue was derived as a direct result of "Doe's" contractual relationship of employment with an Illinois-based employer. Stip. ¶¶ 39-41, 57-60, 63-66; Stip. Ex. G. Illinois' power to tax 100% of an individual's compensation from a job held within the state is similar to a state's right to impose a severance tax like the one at issue in Commonwealth Edison Co. v. Montana, wherein the state of Montana levied an unapportioned tax on each ton of coal mined in the State, including that which was placed into the stream of interstate commerce. In the Commonwealth Edison Co. case, Montana coal mine producers and out-of-state utility customers brought the challenge to the tax, conceding that Montana could impose some severance tax on the coal mined there. When discussing the tax, the Court said:

Appellants argue that they are entitled to an opportunity to prove that the amount collected under the Montana tax is not fairly related to the additional costs the State incurs because of coal mining.¹⁰ Thus, appellants' objection is to the *rate* of the Montana tax, and even then, their only complaint is that the *amount* the State receives in taxes far exceeds the *value* of the services provided to the coal mining industry. In objecting to the tax on this ground, appellants may be assuming that the Montana tax is, in fact, intended to reimburse the State for the cost of specific services furnished to the coal mining industry. Alternatively, appellants could be arguing that a State's power to tax an activity connected to interstate commerce cannot exceed the value of the services specifically provided to the activity. Either way, the premise of appellants' argument is invalid. Furthermore, appellants

have completely misunderstood the nature of the inquiry under the fourth prong of the *Complete Auto Transit* test.

[footnote] 10. Appellants expect to show that the "legitimate local impact costs [of coal mining]--for schools, roads, police, fire and health protection, and environmental protection and the like--might amount to approximately 2 [cents] per ton, compared to present average revenues from the severance tax alone of over \$2.00 per ton." Brief for Appellants 12. Appellants contend that inasmuch as 50% of the revenues generated by the Montana tax is "cached away, in effect, for unrelated and unknown purposes," it is clear that the tax is not fairly related to the services furnished by the State. Reply Brief for Appellants 8.

At oral argument before the Montana Supreme Court, appellants' counsel suggested that a tax of "perhaps twelve and a half to fifteen percent of the value of the coal" would be constitutional. Mont., 615 P.2d at 851.

This Court has indicated that States have considerable latitude in imposing general revenue taxes. The Court has, for example, consistently rejected claims that the Due Process Clause of the Fourteenth Amendment stands as a barrier against taxes that are "unreasonable" or "unduly burdensome." See, e. g., *Pittsburgh v. Alco Parking Corp.*, 417 U.S. 369, 94 S.Ct. 2291, 41 L.Ed.2d 132 (1974); *Magnano Co. v. Hamilton*, 292 U.S. 40, 54 S.Ct. 599, 78 L.Ed. 1109 (1934); *Alaska Fish Salting & By-Products Co. v. "Doe"*, 255 U.S. 44, 41 S.Ct. 219, 65 L.Ed. 489 (1921). Moreover, there is no requirement under the Due Process Clause that the amount of general revenue taxes collected from a particular activity must be reasonably related to the value of the services provided to the activity. Instead, our consistent rule has been:

"Nothing is more familiar in taxation than the imposition of a tax upon a class or upon individuals who enjoy no direct benefit from its expenditure, and who are not responsible for the condition to be remedied.

"A tax is not an assessment of benefits. It is, as we have said, a means of distributing the burden of the cost of government. The only benefit to which the taxpayer

is constitutionally entitled is that derived from his enjoyment of the privileges of living in an organized society, established and safeguarded by the devotion of taxes to public purposes. Any other view would preclude the levying of taxes except as they are used to compensate for the burden on those who pay them, and would involve abandonment of the most fundamental principle of government--that it exists primarily to provide for the common good." Carmichael v. Southern Coal & Coke Co., 301 U.S. 495, 521-523 [57 S.Ct. 868, 878-879, 81 L.Ed. 1245 (1937)] (citations and footnote omitted).

There is no reason to suppose that this latitude afforded the States under the Due Process Clause is somehow divested by the Commerce Clause merely because the taxed activity has some connection to interstate commerce; particularly when the tax is levied on an activity conducted within the State.***

The relevant inquiry under the fourth prong of the *Complete Auto Transit* test is not as appellants suggest, the *amount* of the tax or the *value* of the benefits allegedly bestowed as measured by the costs the State incurs on account of the taxpayer's activities. Rather, the test is closely connected to the first prong of the *Complete Auto Transit* test. Under this threshold test, the interstate business must have a substantial nexus with the State before *any* tax may be levied on it. Beyond that threshold requirement, the fourth prong of the *Complete Auto Transit* test imposes the additional limitation that the *measure* of the tax must be reasonably related to the extent of the contact, since it is the activities or presence of the taxpayer in the State that may properly be made to bear a "just share of state tax burden,". As the Court explained in *Wisconsin v. J. C. Penney Co.*, supra, 311 U.S., at 446, 61 S.Ct. at 250 (emphasis added), "the incidence of the tax *as well as its measure* [must be] tied to the earnings which the State ... has made possible, insofar as government is the prerequisite for the fruits of civilization for which, as Mr. Justice Holmes was fond of saying, we pay taxes."

Commonwealth Edison Co. v. Montana, 453 U.S. at 621-26, 101 S.Ct. at 2956-58.

The contacts Illinois maintains with any nonresident's compensation that is paid in Illinois include the laws that have been developed to protect and to provide benefits for all persons employed in Illinois. 820 ILCS 305/1 *et seq.*; Albrecht, 271 Ill. App. 3d at 758-59, 648 N.E.2d at 925; *see also* Chapter 820 of the Illinois Compiled Statutes, which sets forth forty-four separate acts under the umbrella description of "Employment", and which are further divided into five categories titled: Labor Relations; Wages and Hours; Health and Safety; Injuries; and Unemployment Insurance. In this case, "Doe's" travels outside Illinois for pre-season training and for away games had absolutely no effect on the amount of his compensation; rather it was based solely on the terms of his employment contract which was protected by Illinois' laws. *See* Stip. Ex. G. Further, the extent of taxpayer's contract with his Illinois based employer reaches beyond pre-season and scheduled regular season games, as the employer can cause "Doe" to be present in Illinois for employment related matters, such as, for example, the annual Cubs' convention. *Id.*, p. 3 (¶¶ 3(b)-(c)). Finally, something within Illinois has provided Cubs employees with a remarkably loyal fan base, more often than not, without any logical basis for such loyalty. Thus, Illinois' allocation of 100% of "Doe's" compensation that was paid in Illinois does not violate the fourth prong of the Complete Auto test.

The central purpose of the second prong of the Complete Auto test is to ensure that each state taxes only its fair share of an interstate transaction. Oklahoma Tax Comm. v. Jefferson Lines, Inc., 514 U.S. 175, 184, 115 S.Ct. 1331, 1338, 131 L.Ed.2d 261 (1995). The Court measures any threat of malapportionment by examining first whether the tax is "internally consistent" and, if so, whether it is also "externally consistent." *Id.*

Internal consistency asks whether the tax, if applied by every other state, would subject the taxpayer to multiple taxation. If Illinois' scheme were applied by every other state, "Doe" would not be subjected to improper double taxation since Illinois would be only state to tax his compensation as a nonresident. Of course Texas, his state of residence, would, assuming Texas had the same law as Illinois, tax such income for the privilege of earning or receiving income as a resident of that state. It would, however, also offset any tax liability owed to it by providing "Doe" with a foreign tax credit for the amount of the Illinois tax imposed on his compensation. *See Goldberg v. Sweet*, 488 U.S. 252, 261-62, 109 S.Ct. 582, 589, 102 L.Ed.2d 607 (1989).

The critical question here, however, is whether Illinois' taxation of 100% of the compensation derived by any nonresident employee whose compensation is paid in Illinois passes the external consistency test. Regarding the external consistency test in Goldberg, the Court made the following analysis:

The external consistency test asks whether the State has taxed only that portion of the revenues from the interstate activity that reasonably reflects the in-state component of the activity being taxed. *Container Corp.*, supra, 463 U.S., at 169-170, 103 S.Ct., at 2942-2943. We thus examine the in-state business activity that triggers the taxable event and the practical or economic effect of the tax on that interstate activity. Appellants first contend that any tax assessed on the gross charge of an interstate activity cannot reasonably reflect in-state business activity and therefore must be unapportioned. The Director argues that, because the Tax Act has the same economic effect as a sales tax, it can be based on the gross charge of the telephone call. [citations omitted]

We believe that the Director has the better of this argument. The tax at issue has many of the characteristics of a sales tax. It is assessed on the individual consumer, collected by the retailer, and accompanies the retail purchase of an interstate telephone call. Even though such

a retail purchase is not a purely local event since it triggers simultaneous activity in several States, ... the Tax Act reasonably reflects the way that consumers purchase interstate telephone calls.

The Director further contends that the Illinois telecommunications tax is fairly apportioned because the Tax Act reaches only those interstate calls which are (1) originated or terminated in Illinois and (2) charged to an Illinois service address. Appellants Goldberg and McTigue, by contrast, raise the specter of many States assessing a tax on the gross charge of an interstate telephone call. Appellants have exaggerated the extent to which the Tax Act creates a risk of multiple taxation. We doubt that States through which the telephone call's electronic signals merely pass have a sufficient nexus to tax that call. ... We also doubt that termination of an interstate telephone call, by itself, provides a substantial enough nexus for a State to tax a call.

We believe that only two States have a nexus substantial enough to tax a consumer's purchase of an interstate telephone call. The first is a State like Illinois which taxes the origination or termination of an interstate telephone call charged to a service address within that State. The second is a State which taxes the origination or termination of an interstate telephone call billed or paid within that State. ***

It should not be overlooked, moreover, that the external consistency test is essentially a practical inquiry. In previous cases we have endorsed apportionment formulas based upon the miles a bus, train, or truck traveled within the taxing State. [footnotes omitted] But those cases all dealt with the movement of large physical objects over identifiable routes, where it was practicable to keep track of the distance actually traveled within the taxing State. These cases, by contrast, involve the more intangible movement of electronic impulses through computerized networks. An apportionment formula based on mileage or some other geographic division of individual telephone calls would produce insurmountable administrative and technological barriers. We thus find it significant that Illinois' method of taxation is a realistic legislative solution to the technology of the present-day telecommunications industry.

Goldberg, 488 U.S. at 262-65, 109 S.Ct. at 589-91.

In Jefferson Lines, the Court distinguished between taxes that are ordinarily apportioned and other taxes, and made the following observations:

The very term “apportionment” tends to conjure up allocation by percentages, and where taxation of income from interstate business is in issue, apportionment disputes have often centered around specific formulas for slicing a taxable pie among several States in which the taxpayer's activities contributed to taxable value. In Moorman Mfg. Co. v. Bair, 437 U.S. 267, 98 S.Ct. 2340, 57 L.Ed.2d 197 (1978), for example, we considered whether Iowa could measure an interstate corporation’s taxable income by attributing income to business within the State “in that proportion which the gross sales made within the state bear to the total gross sales.” *Id.*, at 270, 98 S.Ct., at 2342-2343. We held that it could. In Container Corp., we decided whether California could constitutionally compute taxable income assignable to a multi-jurisdictional enterprise’s in-state activity by apportioning its combined business income according to a formula “based, in equal parts, on the proportion of [such] business’ total payroll, property, and sales which are located in the taxing State.” 463 U.S., at 170, 103 S.Ct., at 2943. Again, we held that it could. Finally, in Central Greyhound, we held that New York’s taxation of an interstate bus line’s gross receipts was constitutionally limited to that portion reflecting miles traveled within the taxing jurisdiction. 334 U.S., at 663, 68 S.Ct., at 1266.

In reviewing sales taxes for fair share, however, we have had to set a different course. A sale of goods is most readily viewed as a discrete event facilitated by the laws and amenities of the place of sale, and the transaction itself does not readily reveal the extent to which completed or anticipated interstate activity affects the value on which a buyer is taxed. We have therefore consistently approved taxation of sales without any division of the tax base among different States, and have instead held such taxes properly measurable by the gross charge for the purchase, regardless of any activity outside the taxing jurisdiction that might have preceded the sale or might occur in the future. See, *e.g.*, McGoldrick v. Berwind-White Coal Mining Co., *supra*.

Such has been the rule even when the parties to a sales contract specifically contemplated interstate movement of the goods either immediately before, or after, the transfer of ownership. See, *e.g.*, *Wardair Canada Inc. v. Florida Dept. of Revenue*, 477 U.S. 1, 106 S.Ct. 2369, 91 L.Ed.2d 1 (1986) (upholding sales tax on airplane fuel); *State Tax Comm'n of Utah v. Pacific States Cast Iron Pipe Co.*, 372 U.S. 605, 83 S.Ct. 925, 10 L.Ed.2d 8 (1963) (*per curiam*) (upholding tax on sale that contemplated purchaser's interstate shipment of goods immediately after sale). The sale, we held, was "an activity which ... is subject to the state taxing power" so long as taxation did not "discriminat[e]" against or "obstruc[t]" interstate commerce, *Berwind-White*, 309 U.S., at 58, 60 S.Ct., at 398, and we found a sufficient safeguard against the risk of impermissible multiple taxation of a sale in the fact that it was consummated in only one State. ***

Oklahoma Tax Comm. v. Jefferson Lines, Inc., 514 U.S. 175, 186-87, 115 S.Ct. 1331, 1338-39, 131 L.Ed.2d 261 (1995).

This matter does not involve Illinois' attempt to tax the various types of income that might be realized by a person that is conducting a multi-state business. Rather, it involves Illinois' statutory requirement that a nonresident employee whose compensation is paid in Illinois allocate 100% of that particular item of income to Illinois. In this particular regard, the incidence of the tax at issue has more in common with taxes discussed in Goldberg and in Jefferson Lines, and the severance tax at issue in Commonwealth Edison v. Montana. Here, as in those cases, the tax is imposed on income derived exclusively from an activity — employment — that has its primary locus within the taxing state. Concomitantly, the taxing state has developed protections and facilitated conditions that contribute directly to the value of the contractual relationship from which such compensation is realized. The tax is applied uniformly to all nonresidents having compensation that is paid in Illinois, and at the same rate. Requiring

a nonresident whose compensation is paid in Illinois to pay tax on 100% of such compensation does not in any way inhibit or interfere with interstate commerce.

Nor, as a practical, administrative matter, is there any way to conclude how much of "Doe's" compensation may have been earned, in any real sense of the word, as a result of his activities outside Illinois. The contract with the Cubs certainly anticipated that he would travel out of state with the team, but it did not condition any part of his compensation to his performance of any particular activities outside Illinois. *See* Stip. Ex. G. There is no suggestion in this record that "Doe's" compensation was calculated to reflect a percentage of the Cubs' income from its interstate activities. Nor is there any evidence to suggest that the Cubs is a partnership, and that "Doe" is a partner in the Cubs. In other words, "Doe's" compensation does not represent some type of pro-rata distribution of the Cubs' profits or of its income from *its* activities in interstate commerce. Thus, attributing a proportionate share of his compensation to the states in which the Cubs held spring training or played away games is a purely ad hoc way of accounting for that income, and it bears no realistic relationship to the terms of contract of employment he signed with the Cubs.

Finally, and perhaps most important, taxpayer provides no indication how his interpretation of § 302, i.e., to require the allocation of *some of* the compensation that is paid in Illinois, would be practically administered. Would apportionment based on days spent working in Illinois be the rule? Would the rule vary depending on the job, so that travelling salesmen would apportion based on commissions earned from sales inside Illinois versus everywhere? What about the salesman's base pay? In the end, the assertion that the United States Constitution's Commerce Clause prohibits a state from

allocating 100% of the compensation paid within the state raises more questions and potentially serious problems regarding practical or workable application than it resolves. For that reason alone, it mitigates against acceptance.

Even in cases where Commerce Clause challenges were made regarding a state's apportionment of the income of a multi-state business, the United States Supreme Court has never set forth a particular apportionment method to be used by the state, recognizing that such an activity is a decidedly legislative act. *E.g.*, Jefferson Lines, Inc., 514 U.S. at 195, 115 S.Ct. at 1343 (“We have never required that any particular apportionment formula or method be used, and when a State has chosen one, an objecting taxpayer has the burden to demonstrate by clear and cogent evidence, that the income attributed to the State is in fact out of all appropriate proportions to the business transacted ... in that State, or has led to a grossly distorted result.”) (*quoting* Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159, 170, 103 S.Ct. 2933, 2942, 77 L.Ed.2d 545 (1983) and Moorman Mfg. Co. v. Bair, 437 U.S. 267, 274, 98 S.Ct. 2340, 2345, 57 L.Ed.2d 197 (1978)) (internal quotation marks omitted).

Illinois' statutory scheme of allocating compensation paid to a nonresident depending on whether that compensation is paid in Illinois reflects a simple, uniform, rational and feasible means of taxing the compensation of nonresidents, and allocating the costs of a civilized society. Goldberg, 488 U.S. at 265, 109 S.Ct. at 591; Commonwealth Edison Co., 453 U.S. at 627, 101 S.Ct. at 2958. It is both logical and reasonable for the legislature to treat compensation that is “paid in Illinois” as having been “earned or received in this State”, even if the employee performed services outside Illinois when acting for his Illinois employer. 35 **ILCS** 5/201, 5/302, 5/304(a)(2)(B)(iii).

Accordingly, I conclude that taxpayer has not shown that § 302(a) violates the second prong of the Complete Auto test, or that it unreasonably and unconstitutionally interferes with interstate commerce.

Alternative Apportionment

As part of the relief sought by this protest, taxpayers request alternative apportionment pursuant to IITA Section 304(f). By this request, it is alleged that Section 304(a)(2)(B)(iii) does not fairly represent the extent of their ("Doe's") activities in Illinois. However, Section 304(f) relief is not available to taxpayer in this instance.

Section 304(f) of the IITA provides:

§ 304. Business income of persons other than residents.

(a) In general. The business income of a person other than a resident shall be allocated to this State if such person's business income is derived solely from this State. If a person other than a resident derives business income from this State and one or more other states, then, except as otherwise provided by this Section, such person's business income shall be apportioned to this State by multiplying the income by a fraction, the numerator of which is the sum of the property factor (if any), the payroll factor (if any) and 200% of the sales factor (if any), and the denominator of which is 4 reduced by the number of factors other than the sales factor which have a denominator of zero and by an additional 2 if the sales factor has a denominator of zero.

(f) Alternative allocation. If the allocation and apportionment provisions of subsections (a) through (e) and of subsection (h) do not fairly represent the extent of a person's business activity in this State, the person may petition for, or the Director may require, in respect of all or any part of the person's business activity, if reasonable:

- (1) Separate accounting;
- (2) The exclusion of any one or more factors;

(3) The inclusion of one or more additional factors which will fairly represent the person's business activities in this State; or

(4) The employment of any other method to effectuate an equitable allocation and apportionment of the person's business income.

35 ILCS 5/304(f).

By its own terms, the Illinois General Assembly intended § 304(f) to provide relief to nonresidents who are required to allocate or apportion their business income under § 304(a)-(e). The "Does", however, do not apportion any of their income based on their business activity within Illinois, pursuant to § 304(a) through (e). That is due to the simple reason that while they are nonresidents, they are not persons who are engaged in a multi-state business that derives business income from activities they conducted within Illinois and within other states. 35 ILCS 5/304(a). Nor are they an insurance company, a financial organization, or a transportation business. 35 ILCS 5/304(b)-(e).

Rather, the only provision of the IITA which requires the "Does" to allocate any item of their income to Illinois is § 302(a), which requires that they allocate to Illinois 100% of the amount of compensation that is paid to taxpayer in Illinois. Although § 302 references § 304(a)(2)(B), it does so not for purposes of directing how to allocate nonresident compensation, but, instead, refers to that provision for the purpose of defining whether the compensation is "paid in this State", which then triggers the 100% allocation under § 302.

Since the "Does" have not allocated any items of income pursuant to those subsections of 304, the relief authorized by § 304(f) clearly does not apply to the compensation at issue here. Id.; Rockwood Holding Co. v. Department of Revenue, 312 Ill.App.3d 1120, 1126, 728 N.E.2d 519, 526 (1st Dist. 2000) (§ 304(f) should be applied

under the circumstances set forth in the statute itself, and not "... broadly, so as to correct glitches that were not foreseen at the time of enactment.") (internal quotation marks omitted).

My recommendation must be that the alternative apportionment requested by the taxpayers be denied for the reasons stated above. Assuming for the sake of argument, however, that taxpayer can properly invoke relief under § 304(f), I find that such relief is not warranted. Taxpayer has requested alternative apportionment because he alleges that Section 304(a)(2)(B)(iii) does not fairly represent the extent of taxpayer's activities in Illinois. The taxpayer argues that his compensation should be allocated according to a duty-day formula found in Department regulation 86 Ill. Admin. Code § 100.3100(e), effective for tax years ending on or after December 31, 1992. This regulation is retaliatory in nature, (*see e.g.* IT 00-0063) and only applies to residents of states that impose a comparable tax liability on persons who are members of professional sports teams that are residents of this State and is in no way a concession that Illinois cannot tax 100% of taxpayer's compensation.

For the reasons discussed above with respect to taxpayer's constitutional arguments, Illinois' allocation of compensation under Section 304(a)(2)(B)(iii) does not result in gross distortion. In determining whether Illinois has the power to tax "Doe's" compensation, the focus should not rest solely on when and where taxpayer physically plays baseball. Instead, since his compensation is based upon a contract outlining duties and liabilities, the taxpayer's total professional employment relationship with the Cubs and the benefits and protections afforded thereto by Illinois must be recognized. Illinois' allocation methodology fairly represents that taxpayer's compensation is received for all

of the services and promises made by "Doe" under the contract and in the scope of his employment as a professional athlete with the Cubs.

Penalties

Taxpayer has requested abatement of the Section 1005 penalties due to reasonable cause based upon three grounds: 1) taxpayer reasonably relied upon a paid tax preparer; 2) Illinois law did not clearly allocate *all* compensation of an Illinois nonresident professional athlete who plays for an Illinois-based team to Illinois; and 3) taxpayer's position was consistent with the laws of other states. As I agree that penalties should be abated under the first argument, I need not consider the remaining defenses presented.

Taxpayer advocates that the penalties should be abated due to reasonable cause because he relied upon a paid tax professional to prepare and file his Illinois personal income tax returns for 1991 and 1992. In response, the Department asserts that the taxpayer's reliance on Hendrick's Management Co. to prepare his returns was not reasonable. This is based on the assumption, without proof, that taxpayer "was sophisticated enough to know that different states have different laws with respect to the sourcing of athlete's incomes" and because taxpayer had "no excuse for not researching Illinois law." Dept. Brief at 31.

Based upon a review of this record, it is my recommendation that the penalties should be abated due to reasonable cause. Taxpayer hired Hendrick's Management Co., a sports agency, to prepare his state income tax return and the returns reflect that the paid tax preparers in question were certified public accountants. Stip. Exs. R & S. "Doe", a professional athlete, exercised reasonable business care and prudence in hiring and relying upon a tax professional to research the applicable law and prepare the returns in

this matter. *See, e.g. Rohrabough v. United States*, 611 F.2d 211 (7th Cir. 1979). There is no evidence to show nor any inference thereof that he knew or should have known or even suspect that the advice and counsel given by professional tax preparers on these matters might rest on unsafe ground.

Summary:

On the basis of the facts and law presented and in full consideration of the arguments of the parties herein, it my recommendation that this matter be resolved as follows:

1. The signing bonus and the option year buy-out provision should not be considered remuneration for services performed and thus should not be allocated to Illinois under 35 **ILCS** 5/304(a)(2)(B). *See*, 35 **ILCS** 5/302(a).
2. That Section 304(a)(2)(B) of the IITA does not violate various provisions of either the Illinois or U.S. Constitution.
3. That the notice of deficiency, insofar as it purports to tax 100% of taxpayer's compensation or base salary paid by the Chicago Cubs should be upheld and finalized accordingly.
4. Taxpayer's request for alternative apportionment should be denied on the basis that they have no legal access to such relief under the circumstances presented by this record.
5. That applicable penalties should be abated due to reasonable cause.

Date: 3/23/2001

Respectfully submitted:

Richard L. Ryan
Chief Administrative Law Judge

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