

IT 19-02

TAX TYPE: INCOME TAX

TAX ISSUE: INCOME TAX FOREIGN TAX CREDIT

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

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

v.

JOHN AND JANE DOE

Taxpayers

Docket # [REDACTED]
Acct ID: [REDACTED]
Letter ID: [REDACTED]
Reporting Period: 12/13
Claim for Credit or Refund

RECOMMENDATION FOR DISPOSITION

Appearances: Matthew Crain, Special Assistant Attorney General, for the Department of Revenue of the State of Illinois; John and Jane Doe, *pro se*

Synopsis:

John and Jane Doe (“taxpayers”) filed a Form IL-1040, Individual Income Tax Return, for the year 2013 that included a Schedule CR, Credit for Tax Paid to Other States, which sought a credit in the amount of \$[REDACTED]. After receiving the return, the Department of Revenue (“Department”) notified the taxpayers that it was reducing the amount of the credit on Schedule CR to \$[REDACTED]. After several correspondences between the parties, the taxpayers filed a Form IL-1040-X, Amended Individual Income Tax Return, for the year 2013 that seeks a refund of the additional credit that the Department denied. The Department issued a Notice of Claim Denial, which denied the taxpayers’

claim for a refund, and the taxpayers timely protested the Notice of Claim Denial. An evidentiary hearing was held during which the taxpayers argued that they are entitled to a refund of \$██████, which is the difference between the amount of taxes paid to other states (\$██████) and the amount of the credit allowed by the Department (\$██████). The Department denied the additional credit on the basis that the taxpayers' Illinois income for purposes of calculating the credit was properly calculated and includes income that was earned while Mr. Doe worked in New Jersey. After reviewing the record, it is recommended that this matter be resolved in favor of the Department.

FINDINGS OF FACT:

1. The taxpayers are Illinois residents. (Taxpayers' Ex. #2; Recording)
2. On July 14, 2014, the taxpayers filed a Form IL-1040, Individual Income Tax Return, for the year 2013 that included a Schedule CR, Credit for Tax Paid to Other States. The Schedule CR sought a credit for taxes paid to other states in the amount of \$██████. (Taxpayers' Ex. #2)
3. As indicated on the Schedule CR, to calculate the credit the taxpayers took the total of the non-Illinois portion of their income (\$██████) and divided it by their total income (\$██████) to get a decimal of .██████. They multiplied .██████ with their total Illinois tax due (\$██████), which equals \$██████. The amount of taxes that they paid to other states is \$██████. Because \$██████ is less than \$██████, the taxpayers showed \$██████ as their credit on Schedule CR. (Taxpayers' Ex. #2)
4. On August 26, 2014, the Department sent the taxpayers a Return Correction Notice, which indicated that the Department was reducing the credit for taxes paid to other states to \$██████. (Taxpayers' Ex. #1, pp. 2-4)

5. The Department calculated the \$ [REDACTED] by reducing the non-Illinois portion of their income to \$ [REDACTED]. This was divided by the total income of \$ [REDACTED] to get a decimal of [REDACTED]. The Department multiplied [REDACTED] by the total Illinois tax due of \$ [REDACTED], which equals \$ [REDACTED]. Because \$ [REDACTED] is less than \$ [REDACTED] (the amount of taxes paid to other states), the Department determined the credit to be \$ [REDACTED]. (Taxpayers' Ex. #1, p. 4)
6. The difference between the amount that the taxpayers used as the total of the non-Illinois portion of their income (\$ [REDACTED]) and the amount that the Department used as the total of the non-Illinois portion of their income (\$ [REDACTED]) is \$ [REDACTED]. In other words, the Department reduced the taxpayers' non-Illinois income by \$ [REDACTED].
7. The taxpayers included with their original 2013 Form IL-1040 a W-2 from John Doe's employer, ABC, Inc. The employer's address is in [REDACTED], Texas, and the W-2 shows the total wages of \$ [REDACTED] as all Illinois wages. (Taxpayers' Ex. #3)
8. ABC, Inc. found contractual employment for Mr. Doe at oil and gas refinery projects. Mr. Doe's employment contract was with ABC, Inc. The employment contract was not for a specific location. ABC, Inc. would enter into contractual agreements with different refineries and direct Mr. Doe where to work. Mr. Doe received specific job instructions at each refinery. (Recording)
9. ABC, Inc. gave Mr. Doe his salary, benefits, and 401(k). On a weekly basis, Mr. Doe submitted a time sheet to ABC, Inc. in order for ABC, Inc. to pay his salary. ABC, Inc. would then bill the individual refinery. (Recording)

10. During 2013, Mr. Doe worked at a refinery in Illinois until the end of July. From August 1, 2013 through December 31, 2013, he worked at a refinery in New Jersey. The taxpayers relocated to New York while Mr. Doe worked in New Jersey.¹ (Taxpayers' Ex. #1, p. 19; Recording)

11. On the Return Correction Notice dated August 26, 2014, the Department explained that it reduced the credit because the taxpayers' non-Illinois income cannot include compensation paid in Illinois. The Notice further stated as follows:

If the wages were reported to Illinois in error, send us a statement from your employer, on company letterhead, stating that your wages were not sourced to Illinois. See Publication 130, Who is Required to Withhold Illinois Income Tax, for examples of compensation paid in Illinois. We will not accept a letter from a tax preparer. (Taxpayers' Ex. #1, p. 4)

12. In response to the Return Correction Notice, the taxpayers sent to the Department a copy of a letter dated September 8, 2014 from Mr. Doe's employer that included the following:

During [2013, Mr. Doe] periodically performed work in the State of New Jersey. Because the work was short-term in nature, we did not withhold New Jersey income/employment taxes. All of Mr. Doe's earnings were reported in the State of Illinois for the period listed above. The dollar amount earned while on assignment in New Jersey was \$[REDACTED]. (Taxpayers' Ex. #1, p. 6)

13. On November 21, 2014, the Department sent to the taxpayers a Taxpayer Notification Response that indicated that the Department determined that the credit for taxes paid to other states should remain \$[REDACTED]. The Taxpayer Notification Response asked the taxpayers to send a complete copy of their New Jersey return, and it also included the following:

¹ The taxpayers did not dispute the fact that they were Illinois residents during 2013. (Recording)

We received the statement from your employer. However, it does not clearly state the correct amount of wages sourced to Illinois. Please send us a new statement from your employer stating the correct amount of wages sourced to Illinois. See Publication 130, Who is Required to Withhold Illinois Income Tax, for examples of compensation paid in Illinois. We will not accept a letter from a tax preparer. (Taxpayers' Ex. #1, p. 9)

14. In January 2015, in response to the Taxpayer Notification Response, the taxpayers sent to the Department a copy of their New Jersey return and another letter from Mr. Doe's employer, this one dated January 5, 2015. In the letter, the employer reiterated most of the previously cited paragraph from the employer's letter and included the following: "The gross amount earned while working in Illinois during the time period covering 01/01/2013 – 12/31/2013 was \$[REDACTED]." (Taxpayers' Ex. #1, p. 17)

15. On January 23, 2015, the Department sent a second Taxpayer Notification Response to the taxpayers that again indicated that the Department determined that the credit for taxes paid to other states should remain \$[REDACTED]. In this second Taxpayer Notification Response, the Department included the following:

We received the statement from your employer. In general, if your job required you to work in more than one state, your compensation is considered paid in Illinois if your base of operations was in Illinois. Your base of operations is the office or business location where you usually report for work, and does not change when you are on a temporary assignment to another location.

See Publication 130, Who is Required to Withhold Illinois Income Tax, for more information and examples of compensation paid in Illinois. (Taxpayers' Ex. #1, p. 18)

16. In response to this second Taxpayer Notification Response, the taxpayers sent to the Department a third letter from Mr. Doe's employer dated September 15, 2016 that included the following:

During [2013], Mr. Doe performed work in the State of New Jersey as well as the State of Illinois. Mr. Doe relocated to [REDACTED], NY 10024 and commuted to [REDACTED] in New Jersey, which covered the dates worked from August 1, 2013, through December 31, 2013. All of Mr. Doe's earnings for the period August 1, 2013 through December 31, 2013 were reported in the State of Illinois as opposed to New Jersey which was where he relocated. The dollar amount earned while on assignment in New Jersey was \$ [REDACTED]. (Taxpayers' Ex. #1, p. 19)

17. In addition to the letter from Mr. Doe's employer, in September 2016 the taxpayers filed Form IL-1040-X, Amended Individual Income Tax Return for the year 2013 that seeks a refund of the amount of taxes paid to New Jersey. The taxpayers filed a Schedule NR, Nonresident and Part-Year Resident Computation of Illinois Tax, with the amended return. (Dept. Ex. #2)

18. On March 2, 2017, the Department issued a Notice of Claim Denial that denied the taxpayers' claim for refund for the year 2013. A copy of the Notice of Claim Denial was admitted into evidence under the certificate of the Director of the Department. (Dept. Ex. #1, p. 5)

CONCLUSIONS OF LAW:

Section 201(a) of the Illinois Income Tax Act ("Act") (35 ILCS 5/101 *et seq.*) imposes a tax on the privilege of earning or receiving income in or as a resident of Illinois. 35 ILCS 5/201(a). The tax is measured by net income, which is calculated by

starting with the taxpayers' federal adjusted gross income. 35 ILCS 5/201(a); 203. Section 203 of the Act sets forth modifications to the taxpayers' federal adjusted gross income that are used to calculate the taxpayers' base income. 35 ILCS 5/203; 86 Ill. Admin. Code §100.2470. Article 3 of the Act is titled "Allocation and Apportionment of Base Income," and the portion of the taxpayers' base income that is allocable to Illinois under the provisions of Article 3 is used to calculate the taxpayers' net income. 35 ILCS 5/202.

Once the taxpayers' net income is calculated and the tax is determined, the Act allows a credit for certain taxes paid to other states. The taxpayers in the present case are seeking a credit for taxes that they paid to New Jersey. This type of credit is set forth in section 601(b)(3) of the Act, which provides, in relevant part, as follows:

(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. . . . *For taxable years ending on or after December 31, 2009, the credit provided under this paragraph for tax paid to other states shall not exceed that amount which bears the same ratio to the tax imposed by subsections 201(a) and (b) otherwise due under this Act as the amount of the taxpayer's base income that would be allocated or apportioned to other states if all other states had adopted the provisions in Article 3 of this Act bears to the taxpayer's total base income subject to tax by this State for the taxable year.* . . . Emphasis added; 35 ILCS 5/601(b)(3).

In other words, as explained in the Department's regulation, the credit allowed under this provision is "the smaller of either the total amount of taxes paid to other states for the year or the product of Illinois income tax otherwise due (before taking into account any Article 2 credit or the foreign tax credit allowed under IITA Section 601(b)(3)) multiplied by a fraction equal to the amount of the taxpayer's base income that is sourced outside

Illinois using the allocation and apportionment provisions of Article 3 of the IITA, divided by the taxpayer's Illinois base income.” 86 Ill. Admin. Code §100.2197(e). In the present case, the credit is the smaller of either \$ [REDACTED] (the total amount of taxes paid to other states for the year) or the product of \$ [REDACTED] (Illinois income tax otherwise due) multiplied by a fraction equal to “the amount of the taxpayer’s base income that is sourced outside Illinois using the allocation and apportionment provisions of Article 3 of the IITA” divided by \$ [REDACTED] (the taxpayers’ Illinois base income).

The parties disagree on the amount of the taxpayer’s base income that is sourced outside of Illinois. The dispute concerns the amount of income that Mr. Doe earned while he was working in New Jersey, \$ [REDACTED].² The Department contends that the New Jersey income was properly excluded from the non-Illinois income because the taxpayers’ base of operations is in Illinois, and the income is considered to be Illinois income. The taxpayers contend that this amount should be included as income sourced outside of Illinois because it was earned in New Jersey.

In order to determine the amount of the taxpayers’ base income that is sourced outside Illinois, the allocation and apportionment provisions of Article 3 of the IITA must be used. The relevant statutory provision is section 304(a)(2)(B), which provides, in relevant part, as follows:

(B) Compensation is paid in this State if:

(i) The individual's service is performed entirely within this State;

² The Department actually reduced that taxpayers’ non-Illinois income by \$ [REDACTED], which is \$ [REDACTED] more than what Mr. Doe earned while working in New Jersey. The Department did not explain anything concerning the deduction. The \$ [REDACTED] difference results in a credit of less than one dollar, so the difference will be considered immaterial.

- (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.*
- (iv) Compensation paid to nonresident professional athletes. ...

Emphasis added; 35/ILCS 5/304(a)(2)(B); see also 86 Ill. Admin. Code §100.3120(a)(1), §100.7010(a)(1).

The Department's regulation defines "base of operations" as follows:

The term "base of operations" refers to the place or fixed center from which the individual works. An individual's base of operations may be his business office (which may be maintained in his home), or his contract of employment may specify a place at which the employee is to receive his directions and instructions. In the absence of more controlling factors, an individual's base of operations may be the place to which he has his business mail, supplies, and equipment sent or the place where he maintains his business records. 86 Ill. Admin. Code §100.7010(d)(2).

In the present case, the fixed center from which Mr. Doe worked was in both Illinois and New Jersey, and there was no one base of operations. Nevertheless, the place from which his service was directed or controlled was in Texas. Mr. Doe's employment contract was with ABC, Inc., which is based in ██████████, Texas. The employment contract was not for a specific location; he would work wherever his employer was able to find him work. The ██████████ office provided his benefits, his 401(k), and his salary. On a weekly basis, Mr. Doe submitted a time sheet to the ██████████ office, and ABC, Inc. would then bill the individual refinery. The ██████████ employer would find work for Mr. Doe and direct him where to go. The permanent office from which he was directed or controlled was in ██████████, Texas.

During 2013 Mr. Doe's residence was in Illinois, his services were performed in both Illinois and New Jersey, and the place from which he was directed or controlled was in Texas. Under section 304(a)(2)(B)(iii), if the place from which service is directed is Texas, then the income is Illinois income because the place from which his service is directed is not in any state in which some part of the service was performed, but Mr. Doe's residence is in Illinois. In other words, the compensation is paid in Illinois because during 2013 Mr. Doe was an Illinois resident, some of the service was performed in Illinois, and no service was performed in Texas. Under section 304(a)(2)(B)(iii), the income that Mr. Doe received for working in New Jersey is compensation paid in Illinois. This income must be excluded from the taxpayers' non-Illinois income. The Department properly excluded this income when calculating the credit for taxes paid to another state.

Recommendation:

For the foregoing reasons, it is recommended that the Notice of Claim Denial be upheld.

Linda Olivero
Administrative Law Judge

Enter: February 5, 2019