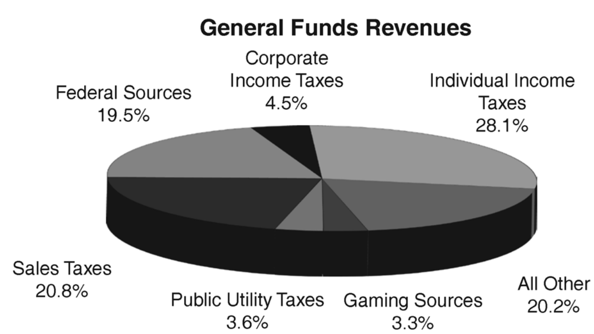
2011 Illinois Update

Corrections were made to this material through January of 2012. No subsequent modifications were made.

ILLINOIS GENERAL FUND REVENUE SOURCES

In fiscal year 2010, individual income tax revenues contributed $8.51 billion to Illinois' income, providing 28.1% of the state's $30.33 billion general fund revenue collection. Sales tax collections provided another $6.31 billion (20.8%), followed by $5.92 billion (19.5%) in federal funds, corporate income taxes of $1.36 billion (4.5%), gaming income of $1.01 billion (3.3%), and public utility taxes of $1.09 billion (3.6%). Cigarette, liquor, and inheritance taxes; insurance; short-term borrowing; and other miscellaneous sources accounted for the remaining 20.2% ($6.13 billion) of the FY 2010 general revenue funds.[1]

Illinois General Fund Revenue Sources FY 2010



1. Daniel W. Hynes, Comptroller State Budget Report, 2010 IL-1040 Instructions, page 15.

ILLINOIS TAX RATE INCREASES

It is no secret that the State of Illinois is experiencing financial difficulties. In a preliminary analysis of the state's proposed FY 2012 budget, the Center for Tax and Budget Accountability (CTBA), a nonprofit, bipartisan research and advocacy think tank, projected a carryover deficit of nearly $16 billion from FY 2011 to FY 2012.[2]

CTBA analysts reduced this startling shortfall to slightly over $13 billion after Governor Quinn signed the Taxpayer Accountability and Budget Stabilization Act on January 13, 2011.[3] In addition to reducing the initial budget hole carried over from FY 2011 by nearly $3 billion, projections call for tax-rate increases to raise state revenue by $7.25 billion in FY 2012.[4]

The act increased Illinois' **individual, trust, and estate income tax rates** by 67%, **with rates jumping from 3% to 5%** effective January 1, 2011, through December 31, 2014. The rate is scheduled to decrease to 3.75% from January 1, 2015, to December 31, 2024, and then decrease again to 3.25% starting on January 1, 2025.

The **corporate tax rate rose from 4.8% to 7%** effective January 1, 2011, through December 31, 2014. It is scheduled to drop to 5.25% between January 1, 2015, and December 31, 2024, with a reversion to 4.8% starting on January 1, 2025.

Replacement tax rates did not increase. The replacement tax remains at 2.5% for corporations and 1.5% for S corporations, partnerships, and trusts.[5]

Illinois Tax Rates

Entity Type	Prior to 1/1/2011[a]	1/1/2011 through 12/31/2014
Individual	3% income	5% income
Trust	3% income, 1.5% replacement	5% income, 1.5% replacement
Estate	3% income	5% income
C corporation	4.8% income, 2.5% replacement	7% income, 2.5% replacement
S corporation	1.5% replacement	1.5% replacement
Partnership	1.5% replacement	1.5% replacement

[a] The "prior to" rates reflected in this table apply to the three open tax years immediately preceding the recent tax hike. Illinois' first income tax debuted at a rate of 2.5% in 1969 and rose to 3% in 1989.

Although income tax rate increases are scheduled to decrease on December 31, 2014, many speculate that the rate increases will become permanent. The Governor's Office of Management and Budget estimates the state's FY 2012 proposed budget will produce an operating deficit of over $1 billion, despite spending cuts and the additional $7 billion annual increased tax revenue the state expects to collect.[6]

> Because it is likely that state tax rate increases will be permanent, tax practitioners would be wise to operate under this theory when they assist clients with tax planning.

2. Analysis of Proposed Illinois FY 2012 Budget, Center for Tax and Budget Accountability (Mar. 2011).
3. Illinois Public Act 96-1496.
4. Analysis of Proposed Illinois FY 2012 Budget, Center for Tax and Budget Accountability (Mar. 2011).
5. Illinois Public Act 96-1496.
6. Analysis of Proposed Illinois FY 2012 Budget, Center for Tax and Budget Accountability (Mar. 2011).

EFFECT OF TAX RATE INCREASE ON TAXPAYERS

Taxpayers already feel the effects of the state tax rate increase. Employers were required to begin the 5% withholding from employee wages in January 2011, and most self-employed taxpayers should have increased their 2011 estimated tax payments.

Calendar Year Filers

Calendar year taxpayers can avoid penalties on underpaid estimated installments due on or after February 1, 2011, and before February 1, 2012, by timely paying at least:

- 90% of the taxpayer's 2011 tax liability, or
- 150% of the taxpayer's 2010 tax liability.

Old Law. Payments due before February 1, 2011 (i.e., fourth quarter 2010 estimates) are exempt from penalty if the calendar year taxpayer paid 100% of the 2009 tax year liability or 90% of the 2010 tax year liability.

Fiscal Year Filers

The current tax rate increase took effect January 1, 2011, complicating calculation of tax rates for fiscal year filers. To accommodate the rate increase, fiscal year taxpayers must either specifically account for their net income or loss for the periods covered by the two different rates or apportion their income and pay at a blended rate.

Taxpayers may choose either method for determining their tax by the extended due date of their returns, but once a return is filed, the taxpayer's decision becomes **irrevocable.** To elect a specific accounting method, Schedule SA must be attached to the original tax return.

Specific Accounting Method

Schedule SA, *Specific Accounting Method of Computing Net Income of Individuals*, provides a place to divide income or loss and Illinois income modifications between the relevant periods covered by the two different tax rates.

Individual taxpayers selecting the specific accounting method should attach Schedule SA directly behind their Form IL-1040, superseding all other attachments. However, because individual taxpayers generally file on a calendar year basis, this method will not be needed by most individuals.

The Illinois Department of Revenue (IDOR) has issued four other Schedule SA forms.

- Schedule SA, *Specific Accounting Method of Computing Net Income for Corporations*
- Schedule SA, *Specific Accounting Method of Computing Net Income for Fiduciaries*
- Schedule SA, *Specific Accounting Method of Computing Net Income for Exempt Organizations*
- Schedule SA, *Specific Accounting Method of Computing Net Income for Composite Returns*

These forms should be the first attachment to the taxpayer's return.

The specific accounting method benefits fiscal year filers who received more taxable income during the lower rate period.

Apportionment Method (Blended Rate)

Under the apportionment method, fiscal year taxpayers compute their tax by dividing their net income based on the total number of days in one accounting period in equal ratio to the total number of days in the second accounting period.

The table on the following page provides a convenient blended rate calculation that taxpayers may use to compute their tax liability under the apportionment method. This table may be used to determine the tax rate for full year returns filed by individuals, trusts, estates, and corporations.

Blended Income Tax Rate Schedule (for Full-Year Return Filers Only)[7]

Start Date	End Date	Number of Days Before 01/01/2011	Number of Days After 12/31/2010	Individuals, Trusts, Estates	Corporations
02/01/2010	01/31/2011	334	31	3.1699%	4.9868%
03/01/2010	02/28/2011	306	59	3.3233%	5.1556%
04/01/2010	03/31/2011	275	90	3.4932%	5.3425%
05/01/2010	04/30/2011	245	120	3.6575%	5.5233%
06/01/2010	05/31/2011	214	151	3.8274%	5.7101%
07/01/2010	06/30/2011	184	181	3.9918%	5.8910%
08/01/2010	07/31/2011	153	212	4.1616%	6.0778%
09/01/2010	08/31/2011	122	243	4.3315%	6.2647%
10/01/2010	09/30/2011	92	273	4.4959%	6.4455%
11/01/2010	10/31/2011	61	304	4.6658%	6.6323%
12/01/2010	11/30/2011	31	334	4.8301%	6.8132%

This table **may not be used** by taxpayers filing short year returns (returns covering periods of less than 12 months) or businesses filing on a 52/53 week basis. Taxpayers falling under these exceptions should use the Apportioned Income Tax Rate Formulas found in IDOR Informational Bulletin FY 2011-09, *Illinois Income Tax Increases*.

Example 1. The Foul Fowl Gaming Corporation's full fiscal year ended on June 30, 2011. The corporation had net Illinois taxable income of \$100,000. Foul Fowl's FY 2011 Illinois income tax liability is \$5,891 (\$100,000 × 0.058910). This is the equivalent of 184 days at the pre-increase rate of 4.8% and 181 days at the new 7% rate.

(\$100,000 × 184/365 × 0.048) + (\$100,000 × 181/365 × 0.07) = \$5,891 *(rounded)*

Example 2. Foul Fowl earned \$70,000 of its FY 2011 income in calendar year 2010, and \$30,000 of its FY 2011 income in calendar year 2011. If Foul Fowl elected to use Schedule SA to specifically account for the income earned in each calendar year, the corporation's FY 2011 income tax would be \$5,460, computed as follows:

2010	\$70,000 × .048 =	\$3,360
2011	30,000 × .07 =	2,100
		\$5,460

By electing to use Schedule SA, rather than using the blended rate, Foul Fowl could save \$431 in Illinois income tax (\$5,891 – \$5,460).

Note. Schedule SA is an "opt in" method to compute tax liability. According to Illinois Informational Bulletin FY 2011-09, IDOR notes "We encourage you to use the blended rate, if possible. If you use the blended rate, you do not need to complete Schedule SA, *Specific Accounting.*"

Observation. Of course the state encourages use of the blended rate. Taxpayers will only elect to use the specific accounting method if it reduces their income tax liability.

7. *Informational Bulletin.* February 2011. Illinois Department of Revenue. [http://tax.illinois.gov/Publications/Bulletins/2011/FY-2011-09.pdf] Accessed on Aug. 30, 2011.

NET LOSS DEDUCTIONS

Public Act 96-1496 also suspends the use of a corporation's Illinois net loss deduction (NLD) for tax years ending on or after January 1, 2011, and prior to December 31, 2014. This law does not affect S corporations.

Fiscal year filers with tax years ending on or after January 1, 2011, may **not** use their Illinois NLD. The carryforward provision is extended four years for suspended losses.

SALES AND USE TAX ISSUES

USE TAX

Illinois does not impose a sales tax, per se. What people often refer to as the state's sales tax is actually a combination of the transactional-based taxes described in the Illinois statutes as "occupation" and "use" taxes. **Occupation taxes** are imposed on sellers based on certain retail sales. **Use taxes** are imposed on buyers based on certain retail purchases.

However, IDOR uses the term "sales tax" to describe the combination of all state, local, mass transit, water commission, home rule occupation and use, nonhome rule occupation and use, park district, and county public safety taxes.

> **Note.** Throughout this section, the terms "use tax" and "sales tax" are used interchangeably.

Illinois' use tax actually predates the state's income tax. The Illinois General Assembly passed the Use Tax Act in 1955. Illinois did not impose an individual income tax until 1969. Legislators intended the use tax to even the playing field between in-state and out-of-state businesses and distribute the tax burden fairly among consumers.

Even though the state's use tax has been in effect for 56 years, many Illinois residents still are unfamiliar with the law. As consumer purchasing patterns have evolved away from local brick-and-mortar based retailers to catalog and Internet sales, the state has been prompted to "aggressively" pursue the collection of use tax.[8]

IDOR is employing several compliance methods to underscore its determination to collect use tax, including:

- Gathering sales tax data from other states,
- Gathering information on overseas purchases from the U.S. Customs Service, and
- Encouraging residents to pay use tax by providing a means to estimate use tax liability based on adjusted gross income. (See the section "Mechanics of Use Tax Filing.")

To demonstrate its "aggressive focus" on use tax collection, IDOR's website states:

> *The Illinois Department of Revenue can assess use tax owed by taxpayers who do not pay voluntarily. For taxpayers who do not have records to document their use tax liability, the department will estimate liability. Taxpayers have the right to refute the department's estimates by following established protest procedures.*[9]

> **Observation.** IDOR's stance seems alarmingly aggressive because it appears the department can estimate a taxpayer's use tax liability and then shift the burden of proof to the taxpayer. But how does a taxpayer produce records to prove they **didn't** buy something?

To encourage voluntary compliance, the state is offering taxpayers an amnesty program to allow use tax offenders to pay amounts owed without penalty and interest. (See the section "Amnesty.")

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8. IDOR repeatedly uses the word "aggressively" to describe its use tax collection efforts.

9. *Use Tax Questions and Answers*. [www.revenue.state.il.us/Individuals/FAQs-Use-Tax.htm] Accessed on Jun. 2, 2011.

Sales Subject to Use Tax

Illinois imposes use tax on retail purchases made for **use or consumption** within the state. The use tax applies whether items are purchased from Illinois retailers within the state or purchased from out-of-state businesses and delivered to an Illinois address or brought back to Illinois for use.

Most in-state retailers collect Illinois sales tax at the point of purchase. Buyers who purchase taxable goods from out-of-state retailers for use or consumption in Illinois must voluntarily remit the required use tax to IDOR if the retailer did not charge Illinois sales tax or if the sales tax charged was lower than the Illinois use tax rate of 6.25% for general merchandise and 1% for qualified food, drugs, and medical appliances.

Items qualifying for the 1% use tax rate include all of the following.

- Food that has not been prepared for immediate consumption, including most food sold in grocery stores but excluding hot foods, alcoholic beverages, candy, and soft drinks (See the section "Tax Increases on Candy, Soda, and Hygiene Products" for more information.)

> **Observation.** Most food purchased for immediate consumption is not subject to use tax because it will more than likely be taxed by the seller if purchased in Illinois or consumed outside the state if purchased outside of Illinois.

- Prescription medicines and nonprescription items that claim to have medicinal value, such as aspirin and cough medicine but excluding nonprescription grooming and hygiene products
- Medical appliances that replace a malfunctioning part of the human body, such as wheel chairs and hearing aids

Purchasers are allowed a credit for taxes paid to other states. If the sales tax paid to the other state is less than the Illinois use tax rate, purchasers must file a use tax return and pay the difference. No credit is allowed for foreign purchases, regardless of whether any customs duty was paid.

The following examples illustrate the types of transactions that require the payment of use tax by an Illinois resident.

- Purchase of a coat from a Wisconsin retailer that charged less than 6.25% sales tax
- Purchase of a fruit cake via the Internet when the seller did not charge sales tax of at least 1%
- Purchase of lingerie in Paris, France

Exempt Purchases

Certain purchases are exempt from Illinois sales tax. Illinois Pub. 104, *Common Sales Tax Exemptions*, lists typical types of exempt transactions, such as purchases by an exempt organization, items purchased for resale, and the purchase of certain farm machinery and equipment. A complete list of exempt items can be found in Illinois Administrative Code §130.120.[10]

Mechanics of Use Tax Filing

In an effort to increase use tax compliance, the Illinois General Assembly now requires IDOR to include a use tax collection line on Form IL-1040, *Individual Income Tax Return*.[11] Taxpayers may use this line to report their use tax liability if their annual use tax equals $600 or less. Taxpayers who owe more than $600 in a 1-year period should file Form ST-44, *Illinois Use Tax Return*.

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10. [www.revenue.state.il.us/LegalInformation/regs/part130/130-120.pdf] Accessed on Aug. 30, 2011.

11. Illinois Public Act 96-1388.

The Form IL-1040 instructions now include a detailed explanation of how to compute Illinois use tax liability. Taxpayers are advised first to examine their Internet, mail order, and other out-of-state purchase records to determine if they were charged sales tax and, if so, how much. Taxpayers must pay Illinois the difference if the tax paid to another state is less than the tax due at the appropriate Illinois tax rate(s).

If the taxpayer's records are complete, the Use Tax Worksheet (shown here) should be used to determine liability.

Taxpayers may claim a credit for any sales tax properly documented and paid to another state. Credit cannot be claimed for any taxes paid to foreign governments. Foreign purchases are taxed at the full Illinois use tax rate.

Use Tax (UT) Worksheet

Complete this worksheet to report and pay your use tax on Form IL-1040. If your annual use tax liability is over $600, you must file and pay your use tax with Form ST-44.

Note Do not include any

- items for which you paid sales tax in another state (but not in another country) of
  - 6.25% or more on Line 1a and
  - 1% or more on Line 2a.
- sales tax you paid in another state, on Line 4, for items not included in Lines 1a or 2a.

1a	Write the total cost of general merchandise you purchased to use in Illinois on which you did not pay the required amount of Illinois Use Tax.	**1a** _______ .00	
1b	Multiply Line 1a by 6.25% (.0625). Round the result to whole dollars.		**1b** _______ .00
2a	Write the total cost of qualifying food, non-prescription drugs, and medical appliances you purchased to use in Illinois on which you did not pay the required amount of Illinois Use Tax.	**2a** _______ .00	
2b	Multiply Line 2a by 1% (.01). Round the result to whole dollars.		**2b** _______ .00
3	Add Lines 1b and 2b. **This is your use tax on purchases.**		**3** _______ .00
4	Write the amount of sales tax you paid in another state (not in another country) on the items included on Lines 1a and 2a.		**4** _______ .00
5	Subtract Line 4 from Line 3. **Write the result here and on Form IL-1040, Line 22** (if the result is less than zero, write zero). →		**5** _______ .00

Note **Be sure to keep this worksheet with your income tax records. You must send us this information if we request it.**

Taxpayers with incomplete records are instructed to reference the following Use Tax Table to estimate the cost of the taxpayer's use tax liability for minor purchases.

2010 Use Tax (UT) Table

AGI	Use Tax
$0–$10,000	$ 3
10,001–20,000	9
20,001–30,000	15
30,001–40,000	21
40,001–50,000	27
50,001–75,000	38
75,001–100,000	52
Above $100,000	Multiply AGI by 0.06% (0.0006)

Taxpayers should add the amount from the use tax column corresponding to their federal adjusted gross income (AGI) to the amount of any use tax due on major purchases. (The AGI figure should match the amount entered on the taxpayer's Form IL-1040, line 1.)

The resulting use tax liability should be reported on the appropriate line of the taxpayer's Form IL-1040, and the tax should be remitted to the State of Illinois by April 15 of the year following the year in which the liability arose.

Taxpayers who do not have any use tax liability, or those who file Form ST-44 because their liability exceeds $600, should write "0" on the use tax liability line of their Form IL-1040.

Note. Entering "0" on the use tax line of Form IL-1040, if appropriate, is an important step because IDOR has indicated it will assess use tax, penalties, and interest based on routine audits of third-party information.

Observation. Who is ultimately liable for the tax — the purchaser or the user? If it is a use tax, presumably one could argue that the user is liable. However, the records of sale will be in the purchaser's name. It will be interesting to see who IDOR finds liable for use tax in the event that someone purchases an item for use by another. For instance, what if an Illinois resident purchases a computer online as a gift for a friend who lives in Texas and the friend will be using the computer there? What if a parent makes a major online purchase for a child living in another state because the child either does not have a credit card or the child's credit card limit is less than the purchase amount?

Example 3. Julie Cartwright, an Illinois resident, purchased a $1,000 camera when she was vacationing in Wisconsin and paid Wisconsin sales tax of $50 (5%) on the purchase. She also purchased a $500 lens for her camera while in Tennessee, where she paid a 7% sales tax of $35. She purchased $300 of cheese while in Wisconsin. She gave $100 of the cheese to her neighbors and sent $100 worth to her son in Michigan for a party he was hosting there. She and her husband ate the rest. Julie did not pay any Wisconsin sales tax on her food purchases.

Julie's husband purchased a laptop from an online retailer for $800. The seller did not charge sales tax on the purchase. He also purchased $200 of office equipment at his neighbor's garage sale. He purchased the laptop and equipment for his home office. All purchases were made in 2011 and there were no other out-of-state or foreign purchases. The Cartwrights' 2011 AGI is $74,000.

Question 3A. What is the Cartwrights' Illinois use tax liability for 2011?

Answer 3A. Because the Cartwrights have complete records of their use tax transactions for 2011, they will use the Use Tax Worksheet to compute their liability, as follows.

Line 1a: General merchandise total of purchases with sales tax below 6.25% paid

Camera	$1,000
Laptop	800
Total	$1,800

Note. The camera lens is not included in the worksheet calculations because Tennessee's sales tax of 7% exceeds Illinois' 6.25% use tax rate. The office equipment is not included in the general merchandise total because it was purchased at a garage sale.

Line 1b: $1,800 × 0.0625 = $113 (rounded to the nearest whole dollar)

Line 2a: Food purchased for consumption in Illinois with sales tax paid below 1%

Cheese	$200

Note. The cheese Julie sent to her son in Michigan is not included in the worksheet calculations because it was purchased in Wisconsin and consumed in Michigan.

Line 2b: $200 × 0.01 = $2

Line 3: Sum of Lines 1b and 2b: $113 + $2 = $115

Line 4: Sales tax paid to other states on purchases included on Lines 1a and 2a

Wisconsin sales tax = $50

Line 5: Net use tax due Illinois (Line 3 minus Line 4): $115 – $50 = **$65**

Use Tax (UT) Worksheet

Complete this worksheet to report and pay your use tax on Form IL-1040. If your annual use tax liability is over $600, you must file and pay your use tax with Form ST-44.

Note Do not include any

- items for which you paid sales tax in another state (but not in another country) of
  - 6.25% or more on Line 1a and
  - 1% or more on Line 2a.
- sales tax you paid in another state, on Line 4, for items not included in Lines 1a or 2a.

1a	Write the total cost of general merchandise you purchased to use in Illinois on which you did not pay the required amount of Illinois Use Tax.	1a	1,800 .00		
1b	Multiply Line 1a by 6.25% (.0625). Round the result to whole dollars.			1b	113 .00
2a	Write the total cost of qualifying food, non-prescription drugs, and medical appliances you purchased to use in Illinois on which you did not pay the required amount of Illinois Use Tax.	2a	200 .00		
2b	Multiply Line 2a by 1% (.01). Round the result to whole dollars.			2b	2 .00
3	Add Lines 1b and 2b. **This is your use tax on purchases.**			3	115 .00
4	Write the amount of sales tax you paid in another state (not in another country) on the items included on Lines 1a and 2a.			4	50 .00
5	Subtract Line 4 from Line 3. **Write the result here and on Form IL-1040, Line 22** (if the result is less than zero, write zero). →			5	65 .00

Note **Be sure to keep this worksheet with your income tax records. You must send us this information if we request it.**

Question 3B. What is the Cartwrights' 2011 Illinois use tax liability, assuming the Cartwrights did not keep complete records of their 2011 out-of-state purchases?

Answer 3B. Because the Cartwrights did not keep accurate records, they would reference the Use Tax Table to compute their use tax liability. Based on their $74,000 AGI, they would owe **$38** in use tax.

However, if they had major purchases, they would be required to add their major purchase costs to their estimated costs for other purchases and complete the Use Tax Worksheet. IDOR does not define the term "major purchase" in the instructions. If the Cartwrights had records of the laptop and camera purchases, they would presumably compute their Use Tax using these purchases and estimate any other applicable purchases.

Observation. Given the difference between owing $65 and owing $38, it might be tempting for the Cartwrights to claim they have incomplete records and use the use tax table to compute their liability based on their AGI. However, IDOR might surprise them someday with a bill for additional tax, interest, and penalties if the agency uncovers records of out-of-state purchases the Cartwrights "forgot" they made.

Form ST-44, *Illinois Use Tax Return*

Taxpayers with a use tax liability **over $600** must file Form ST-44, *Illinois Use Tax Return*. The use tax must be paid in full by the **last day of the month** following the month in which the purchase(s) were made.

If the total use tax due is **$600 or less** for the entire calendar year, the taxpayer should report the liability directly on the appropriate line of Form IL-1040 and pay the full amount due on or before **April 15** of the following year.

IDOR will assess late filing and late payment penalties if taxpayers fail to file and pay use tax in a timely manner.

> **Observation.** Although the instructions seem vague, it appears taxpayers must start paying use tax by the last day of the month following the month in which their purchases subject to use tax reach $9,600 ($600/.0625) during the calendar year.

Other Sales and Use Tax Forms

The following forms may be required in lieu of Form ST-44 to report and pay use tax in certain situations.

- **Form ST-1, *Sales and Use Tax Return*.** This form should be used by registered Illinois retailers and servicepersons who are otherwise required to file this form. Businesses that purchase items for which use tax is due should report these purchases during the liability period corresponding to the purchase date of the items. Businesses that purchase items tax free for resale and later remove these items from inventory for use or consumption in Illinois should file and pay use tax on the return covering the period corresponding to the date the item was removed from inventory.
- **Form RC-44, *Illinois Cigarette Use Tax Return*.** Illinois residents who purchase cigarettes out of state should file this form.

Vehicles, boats, airplanes, and other items that are required to be titled or registered with a state agency should be reported on the following forms instead of Form ST-44.

- **Form RUT-25, *Vehicle Use Tax Transaction Return*.** Taxpayers should use this form to report purchases of motor vehicles, watercraft, aircraft, or trailers from any out-of-state dealers, lending institutions, leasing companies or retailers, or from any unregistered Illinois lending institutions or leasing companies. This return is due within 30 days of the date the item was brought into Illinois.
- **Form RUT-50, *Private Party Vehicle Tax Transaction Return*.** Illinois residents must file Form RUT-50 to report the transfer of a motor vehicle from a private party, whether by gift or by purchase. This return is due within 30 days from the date of acquiring the vehicle if acquired in Illinois, or within 30 days of bringing it into Illinois if acquired outside of the state.
- **Form RUT-75, *Aircraft/Watercraft Use Tax Transaction Return*.** Illinois residents must file RUT-75 to report the acquisition of an aircraft or watercraft, whether by gift, donation, transfer, or nonretail purchase. This return is due within 30 days from the date of acquiring the aircraft or watercraft if acquired in Illinois or within 30 days of bringing it into Illinois if acquired outside Illinois.

Forms RUT-25, RUT-50, and RUT-75 are multi-part carbon forms and cannot be faxed or downloaded. Purchasers may request copies of these forms via the following methods.

1. Email: Don.Witte@illinois.gov
2. Phone: 1-800-356-6302 (IDOR's 24-hour forms order hotline number)
3. Directly from the appropriate state agency
   - Motor vehicles: Office of the Illinois Secretary of State
   - Watercraft: Illinois Department of Natural Resources
   - Aircraft: Illinois Department of Transportation, Division of Aeronautics

Amnesty

The state conducted a use tax amnesty program that allowed taxpayers to voluntarily file Form ST-44 and pay any use tax owed for prior years without penalty and interest. The amnesty period extends to purchases made from July 1, 2004, through December 31, 2010.

Taxpayers participating in this offer must write "Amnesty" at the top of their Form ST-44. The return and tax were due by October 15, 2011, to qualify for this penalty and interest waiver.

IDOR's Monthly Revenue Report for April 2011 (released in June 2011) shows the state had already received $163.4 million in fiscal year-to-date payments related to this amnesty offer.

> **Note.** To protect against erroneous assessments of estimated use tax liability, it may be good practice to advise clients to keep **all** records of purchases — not just those related to business purchases or itemized deductions. However, given that the state extended the use tax amnesty period back six years, it appears there is no statute of limitations regarding when the state can assess and collect use tax.

TAX INCREASES ON CANDY, SODA, AND HYGIENE PRODUCTS

Effective September 1, 2009, Illinois raised the sales tax rate on candy, soft drinks, and personal grooming and hygiene products. This change reclassified these products from food and medicine items taxed at the state rate of 1% to general merchandise items taxed at the state rate of 6.25%.

Legislature Defines "Candy"

The state defines candy as "a preparation of sugar, honey, or other natural or artificial sweeteners, in combination with chocolate, fruits, nuts, or other ingredients, or flavorings in the form of bars, drops, or pieces."[12]

To carve out an exception to keep baked goods from being taxed at the higher rate, legislators included a provision that states, "items that contain flour or require refrigeration are not considered candy."[13]

This exception creates a bookkeeping nightmare for merchants. To illustrate the problem, take the following quiz:

Categorize each of the following items as candy/not candy under the new law.

A. Milky Way candy bar	Candy	Not candy
B. Twizzlers licorice	Candy	Not candy
C. Yogurt-covered fruit	Candy	Not candy
D. Yogurt-covered pretzels	Candy	Not candy
E. Honey-glazed peanuts	Candy	Not candy

12. IDOR Informational Bulletin FY 2010-01, *Recent Sales and Use Tax Changes Affecting Candy, Personal Grooming and Hygiene Products, and Soft Drinks* (July 2009).

13. Ibid.

Answers:

A. Milky Way candy bar		Not candy (contains flour)
B. Twizzlers licorice		Not candy (contains flour)
C. Yogurt-covered fruit	Candy (contains sugar/sweetener, no flour, does not have to be refrigerated)	
D. Yogurt-covered pretzels		Not candy (contains flour)
E. Honey-glazed peanuts	Candy (contains honey, no flour, does not have to be refrigerated)	

As this quiz illustrates, the definition of candy is not intuitive, and it bears little relation to the healthiness of the snack.

To determine the correct sales tax on any item that contains sugar, honey, or sweeteners, merchants must examine labels for the words "flour" or "refrigeration." As the following ingredient list shows, exceptions sometimes appear in fine print:

MILKY WAY® Bar ingredients: milk chocolate (sugar, cocoa butter, skim milk, chocolate, lactose, milkfat, soy lecithin, artificial flavor), corn syrup, sugar, partially hydrogenated soybean oil, skim milk, less than 2% milkfat, cocoa powder processed with alkali, lactose, malted barley, ***wheat flour****, salt, egg whites, artificial flavor.*

Note. To confuse the issue further, original Milky Way candy bars contain flour, while Milky Way Midnight candy bars do not.

Soft Drink Definition Changed

The state also changed its definition of "soft drink" to coincide with this tax increase. As of September 1, 2009, soft drinks are considered to be any nonalcoholic beverages containing natural or artificial sweeteners, including sodas, sports drinks, energy drinks, sweetened teas, sweetened waters, and beverages containing 50% or less fruit or vegetable juice.

The following beverages are excepted from the definition of soft drinks.

- Any beverage containing milk or milk products, soy, rice, or similar milk substitutes
- Unsweetened teas
- Drinks containing greater than 50% of vegetable or fruit juice by volume
- Carbonated or uncarbonated water that contains no natural or artificial sweeteners

The total cost to the consumer of store-bought sweet tea, Red Bull, Gatorade, and some flavored waters increased as a result of this change.

Note. All beverages sold at a restaurant are taxed at the higher general merchandise rate.

Sweeteners

Again, lawmakers make it difficult for merchants to determine which items are subject to the higher tax rate because natural and artificial sweeteners come in many different varieties.

To help decode labels when determining which candy and soft drink items may be subject to the higher general merchandise tax, a nonexclusive list of possible sweeteners is reprinted here.[14]

Caloric Sweeteners	Artificial Sweeteners	Sugar Alcohols / Polyols
Dextrose	Saccharin	Sorbitol
Glucose syrup	Aspartame	Mannitol
Crystalline fructose	Acesulfame-K	Xylitol
High fructose corn syrup	Sucralose	Erythritol
Honey	Neotame	D-Tagatose
Sugar		Isomalt (Palatinat)
Fruit juice concentrates		Lacititol
Maltodextrin		Maltitol
Trehalose		HSH Hydrogenated starch hydrolysates
Stevia		Maltito
		Glycerol
		Polydextrose

For more information, refer to IDOR Informational Bulletin FY 2010-01 (July 2009).

INTERNET SALES TAX

IDOR estimates the state loses between $153 and $170 million in revenue each year from uncollected Internet sales tax.[15]

Many Internet retailers charge sales tax only to residents of the seller's state. However, just because sales tax is not charged does not mean sales tax is not due. Illinois buyers are responsible for remitting sales tax directly to the state if the seller does not collect Illinois sales tax on the transaction. As noted earlier in this chapter, Illinois charges consumers a "use" tax. That is, Illinois imposes a tax for the privilege of using tangible personal property in the state of Illinois if that property has been purchased at retail regardless of where purchased.[16] Yet, despite the recent enforcement efforts and the amnesty program, many Illinois consumers still fail to voluntarily pay use tax.

Even though use tax is designed to encourage fair competition, a 1992 U.S. Supreme Court decision skewed this competition. In *Quill v. North Dakota*,[17] the Court ruled that states cannot make retailers collect state sales tax unless the retailer's company has a physical presence in that state. The Court reasoned that collecting state and local sales taxes would impose an undue burden on interstate retailers because of the complexity involved in tracking the various state rates.

The *Quill* decision gave online retailers a competitive advantage. Illinois Governor Pat Quinn evened the playing field in March 2011 when he signed the Main Street Fairness Act, also known as the Amazon Tax, or the Click-Through Nexus Tax. This new law requires certain online retailers to collect Illinois sales tax on Internet sales.

14. [www.sugar.org] Accessed on Jul. 26, 2011.

15. [www.theshriverbrief.org/2011/03/articles/budget-and-taxes/the-amazon-battle-continues-governor-quinn-signs-the-illinois-internet-sales-tax-law] Accessed on Jun. 2, 2011.

16. 35 ILCS 105/3.

17. *Quill Corp. v. North Dakota,* 112 S.Ct 1904 (May 26, 1992).

Under *Quill*, only merchants with physical nexus in Illinois were required to charge Illinois sales tax. However, determining which virtual retailers had nexus was complicated. IDOR issued a general information letter in 2000 in response to a question regarding nexus for Internet sales. An excerpt of the department's answer follows (emphasis added):

> *The Supreme Court has set out a 2-prong test for nexus. The first prong is whether the Due Process Clause is satisfied. Due process will be satisfied if the person or entity purposely avails itself or himself of the benefits of an economic market in a forum state.*
>
> *The second prong of the Supreme Court's nexus test requires that, if due process requirements have been satisfied, the person or entity must have physical presence in the forum state to satisfy the Commerce Clause.* ***A physical presence is not limited to an office or other physical building.***
>
> ***Under Illinois law, it also includes the presence of any agent or representative of the seller.*** *The final type of retailer is the out-of-state retailer that does not have sufficient nexus with Illinois to be required to submit to Illinois tax laws. A retailer in this situation does not incur Retailers' Occupation Tax on sales into Illinois and is not required to collect Use Tax on behalf of its Illinois customers.*
>
> *However, the retailer's Illinois customers will still incur Use Tax on the purchase of the out-of-state goods and have a duty to self-assess their Use Tax liability and remit the amount directly to the state.*[18]

Prior to the passage of the Amazon tax, a virtual retailer was required to collect Illinois sales tax from customers who lived in Illinois only if the company had a "brick and mortar" facility in the state or had agents or representatives located in the state.

Under *Quill*, online retailers like Old Navy, which has stores located in Illinois, were required to collect and remit Illinois sales tax on sales made to customers living in Illinois. However, companies without nexus, like Amazon, were not required to collect Illinois sales tax. Online retailers without nexus could voluntarily collect and remit the state tax if they wanted to do so. Most did not.

At the time of the *Quill* decision, many merchants still relied on catalogs to conduct remote sales. There were fewer than 30 websites estimated to be accessible in 1992, and e-commerce was practically nonexistent. By 2010, there were an estimated 249 million websites and e-commerce sales were at $202.6 billion.[19]

States are now trying to catch up with consumers' online shopping habits in order to preserve their cut of sales tax on these transactions.

18. ST 00-0153-GIL (Jul. 24, 2000).

19. Selling the Main Street Fairness Act: A Viable Solution to the Internet Sales Tax Problem. *National Law Forum*. Jun. 6, 2011. Payne, Michael J. [http://nationallawforum.com] Accessed on Jul. 26, 2011.

New Amazon Tax Law

Illinois' new Internet sales tax law, which received strong support in the General Assembly, expands the definition of physical presence to include online "affiliates" as agents or representatives of a company. This provision extends the requirement to collect Illinois sales tax to online retailers with Illinois affiliate partners who drive business to the retailers' sites.

Example 4. Rick was interested in attending a book club at Jumpin' Joe's Coffee Shop in Pana, Illinois. While on Jumpin' Joe's website, he clicked through a link to Amazon and purchased his book club book, shipping it to his Illinois home. Jumpin' Joes received a small commission on this sale, because it directed Rick to Amazon.

Under *Quill*, Amazon would not have to collect sales tax on this transaction because Amazon does not have a brick and mortar facility in Illinois and it did not have agents or representatives in the state.

Under the Main Street Fairness Act, Amazon is required to collect Illinois sales tax on the book purchase because the act extends the definition of "agent or representative" to include affiliates. In this example, Jumpin' Joe's is an Illinois-based affiliate of Amazon, and Rick is an Illinois resident.[20]

Note. It is important to note that the new law does not increase any tax on this transaction, because Rick would have been liable for use tax on his purchase anyway. Instead, it shifts the burden of tax reporting and remittance from the consumer to the retailer.

Small Seller Exemption. The affiliate law contains an exemption to relieve small sellers from the burden of multistate sales tax collection. Merchants who sell $10,000 or less in the preceding four quarterly periods ending on the last day of March, June, September, and December are not required to collect Illinois sales tax.

Economic Effect of Amazon Tax

Illinois Senate President John Cullerton, a chief proponent of this new law, projected the Main Street Fairness Act would add $150 million to the state's coffers.[21] His press release stated the law "will help spur economic activity and job growth within the state by leveling the playing field for Illinois' small businesses."

Some small businesses may be economically harmed by this law. Rebecca Madigan, executive director of Performance Marketing Association, reports affiliate revenues dropped 25% to 30% in other states where similar legislation was passed.[22]

Reacting to the legislation, Amazon.com and Overstock.com cut ties with their Illinois affiliates shortly after the new law was enacted. On April 15, 2011, Amazon sent the following excerpted notice to its Illinois affiliates.

> *We had opposed this new tax law because it is unconstitutional and counterproductive. It was supported by national retailing chains, most of which are based outside Illinois, that seek to harm the affiliate advertising programs of their competitors. Similar legislation in other states has led to job and income losses, and little, if any, new tax revenue. We deeply regret that its enactment forces this action.*
>
> *As a result of the new law, contracts with all Illinois affiliates of the Amazon Associates Program will be terminated and those Illinois residents will no longer receive advertising fees for sales referred to Amazon.com, Endless.com, or SmallParts.com.*

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20. This example is for illustration purposes only. Amazon is no longer required to collect sales tax from Illinois customers because it severed ties with all of its Illinois affiliates.

21. Illinois Amazon tax: Gov. Quinn signs controversial measure taxing online retailers. (Mar. 10, 2011). *Huffington Post*.

22. Online Retailers Dump Ill. Partners over Tax Law. (Mar. 11, 2011). *Bloomberg Businessweek*.

According to Performance Marketing Association, Illinois had 9,000 Internet retail affiliates, ranging from individuals to small industries. Illinois led the nation with nine "super affiliates," each employing between 75 to 100 employees. These super affiliates include FatWallet, Coupon Cabin, and Mr. Rebates.

Film critic Roger Ebert is an example of an individual affiliate, since he occasionally promoted Amazon products via his Twitter account. Ebert wrote that Amazon is dropping him "in order to evade fair and just Illinois taxes."

> **Observation.** What is not stated in Senate President Cullerton's announcement is the effect the new Amazon Tax will have on income tax collections. Because Amazon and other virtual retailers have dropped Illinois affiliates from their programs, Illinois is losing the income tax revenues from the commissions that Illinois affiliates would have received. It is too early to predict what effect this change will have on state coffers.

Governor Quinn plans to use his office to help former Amazon and Overstock affiliates connect with new Internet companies, such as Sears, Wal-Mart, and Barnes & Noble. Because these companies have established brick and mortar stores in Illinois, they have always been required to collect and remit Illinois sales tax on their sales to Illinois residents.

Amazon's termination notification to its former Illinois affiliates invited them to apply for reinstatement if they relocated from Illinois. At least one Illinois affiliate has moved out of state in order to reestablish its ties with Amazon. FatWallet.com is moving its headquarters from Rockton, Illinois, to Beloit, Wisconsin, to preserve its revenue stream. The 3-mile move is expected to stem a 30% to 40% revenue loss that the company projected it would suffer as a result of the severed affiliation with Amazon.

The new law took effect July 1, 2011.

Federal Legislation

On July 29, 2011, Senator Dick Durbin (D-IL) and Representative John Conyers (D-MI) introduced federal legislation to simplify the administration of multistate sales and use tax. The Main Street Fairness Act (H.R. 2701 and S.1452) was introduced in both the U.S. House of Representatives and the U.S. Senate.

This act would require all online sellers not qualifying for a small seller exception to collect and remit sales and use taxes on remote sales owed to each state that is a party to the Streamlined Sales and Use Tax Agreement.

> **Note.** Although originally introduced as H.R. 5660 on July 1, 2011, the Main Street Fairness Act was reintroduced on July 29, 2011 as H.R. 2701. To see the current status of this bill, go to **http://thomas.loc.gov**.

SALES TAX AVOIDANCE

As discussed earlier in this chapter, the state imposes a sales tax — or more correctly, the state imposes a retailer's occupation tax or a use tax — on purchases made within the state or for use or consumption within the state. Illinois' "sales" tax rate is 6.25% for general merchandise. Each local taxing district may impose taxes in addition to this state rate.

These additional sales taxes can increase the total sales tax rate to over 10% on purchases in some areas of Illinois. Taxes tend to run higher in suburban areas around Chicago.

For nearly 50 years, savvy business owners have been bypassing these higher local sales taxes by creating their own "tax havens" in downstate Illinois. These merchants avoid higher local taxes by setting up purchasing offices in rural locations that impose no local or county sales taxes. These offices often are staffed by a single employee with a fax machine. Purchases received through these offices are taxed at the local rate.

Hartney Fuel Oil Company (Hartney), a firm based in Cook County, established a sales office in Mark, Illinois. Mark, population 500, is located in Putnam County. Neither Mark nor Putnam County imposes local sales tax on purchases. Hartney did not pay Cook County taxes on purchases made through its Mark office.

IDOR maintained that Hartney owed sales taxes at the Cook County rate. The case went to court in January 2011. A Putnam County judge ruled against IDOR, deciding that Cook County could not tax purchases made through the Mark office.

Legislation was quickly introduced in Springfield to preserve this decision, so that all merchants would have the right to set up downstate tax havens. However, the move to codify this tax-avoidance scheme backfired by shedding unwanted light on the practice.

The bill's opponents are formidable, including Cook County, the City of Chicago, and the Regional Transportation Authority. These entities stand to lose substantial tax revenue if the measure passes. State Senator Steve Landek, who represents Cook County, opposes the bill. Landek's district is home to the new Chicago Fire soccer stadium, which reportedly used a downstate office to avoid paying sales tax on the stadium's construction materials.

Proponents of the bill have threatened to move their companies' headquarters from the Chicago area if the legislation fails. An April 25, 2011, *Illinois Times* article reported that a lobbyist claimed that out of five businesses that underwent audits on this issue, four moved from Cook County after the state ruled against them. One company relocated to Indiana.[23]

Several of the bill's original proponents, including the Chicagoland Chamber of Commerce, withdrew support for the bill under political pressure.

A counter bill in the Senate is expected to propose eliminating this tax-avoidance practice. The issue remains unresolved at the time this workbook went to press.

CIVIL UNION LAW AND ILLINOIS INCOME TAX

Governor Quinn enacted the Illinois Religious Freedom Protection and Civil Union Act on February 1, 2011, with an effective date of June 1, 2011.[24] This act permits both same sex and opposite sex couples to enter into civil unions. Parties to civil unions are granted the same legal obligations, responsibilities, protections, and benefits as married couples under Illinois law.

JOINT RETURNS

A civil union is not the equivalent of marriage. As such, it does not affect the filing of joint Illinois tax returns. The Illinois Income Tax Act (IITA) permits the filing of joint state returns only by couples who file joint federal returns.[25] Parties to civil unions are prohibited from filing joint federal returns under the federal Defense of Marriage Act (DOMA).

DOMA is currently being challenged in court. President Obama instructed the Department of Justice to cease defense of DOMA in February 2011, because of his belief that the definition of marriage as a union between a man and a woman is unconstitutional. However, Congress is allowed to take up the defense of DOMA in place of the executive branch and plans to do so.

23. [www.illinoistimes.com/Springfield/article-8600-bill-to-protect-sales-tax-havens-backfires.html] Accessed on Jul. 17, 2011.

24. Illinois Public Act 96-1513.

25. Illinois Income Tax Act Section 502(c).

CHANGES TO EXEMPTIONS

Illinois' Civil Union Act initiates changes regarding who can be claimed as an exemption on an Illinois taxpayer's **federal and state** returns.

Prior to the enactment of the civil union law, any person who openly engaged in sexual activity "with another not his spouse" was in violation of Illinois' fornication statute.[26] IRC §152(f)(3) disallows a dependency deduction for an otherwise qualified dependent if the taxpayer's relationship with the dependent violates local law.[27]

Because parties to a civil union are now afforded the same status as spouses under state law, these relationships (both same sex and opposite sex) are no longer illegal in Illinois. This opens the door for parties to civil unions to claim a federal dependency deduction for their partners, provided the partner meets the other dependency requirements. Illinois follows suit by allowing a state exemption for every exemption allowed on the taxpayer's federal return.[28]

Parties to a civil union with partners who are age 65 or over and/or blind now may be able to receive additional deductions on their Illinois returns. An Illinois taxpayer may claim the age and blindness exemptions for a spouse if the spouse is claimed as a **dependent** on the return.[29] However, these deductions apply only if the spouse has no gross income and cannot be claimed as a dependent on another return. According to IDOR's website, the definition of spouse in this case extends to civil union partners.[30]

RECENT ILLINOIS COURT CASES

WIRTZ V. QUINN, ILLINOIS SUPREME COURT, DOCKET NO. 111903 (JUL. 11, 2011)

Facts

In 2009, W. Rockwell "Rocky" Wirtz, president of Wirtz Corporation (and chairman of the Chicago Blackhawks), filed suit in Illinois circuit court on behalf of Wirtz Beverage Illinois, LLC, and Illinois taxpayers against Governor Pat Quinn and a host of other state officials for violating the Illinois Constitution when enacting Public Acts 96-34, 96-35, 96-37, and 96-38. These bills were signed into law on July 13, 2009, and are collectively referred to as the Capital Projects Acts. Public Act 96-34 originated in January 2009 as House Bill 255, a 5-page bill amending the Illinois estate and generation-skipping transfer tax. The House passed this bill to the Senate, which then gutted everything after the enacting clause, replacing it with a 280-page bill that does the following.

1. Amends the State Finance Act to:
   - **a.** Create the Capital Projects Fund, to be used for capital projects and debt service and require transfers to the General Revenue Fund;
   - **b.** Create the Local Government Video Gaming Distributive Fund; and
   - **c.** End all diversions from the Road Fund to the Secretary of State and State Police (Section 905).
2. Amends the Use Tax Act and Retailers' Occupation Tax Act to increase the state sales tax rate on candy, certain beverages, and grooming and hygiene products from 1% to 6.25% and to require deposit of this increased revenue into the Capital Projects Fund (Section 910 and 925)
3. Amends the Liquor Control Act of 1934 to increase the tax on wine, beer, and alcohol and spirits (Section 945)

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26. 720 ILCS 5/11-8.
27. In *Burnell*, 59 TCM 507 (1990), the Tax Court allowed dependency exemptions for the taxpayer's live-in girlfriend and her two children.
28. IITA Section 204(c).
29. IITA Section 204(d).
30. [www.revenue.state.il.us/Announcements/CivilUnions.htm] Accessed on Jun. 2, 2011.

4. Amends the Illinois Vehicle Code to increase various fees and fines and to make changes concerning truck load and weight restrictions (Section 955)
5. Creates the Video Gaming Act, allowing video gaming at licensed establishments, including retailers serving liquor, fraternal and veterans' establishments, and truck stops (Article 5)
6. Amends the Illinois Lottery Law to allow a private management firm to conduct the state lottery and to authorize a pilot program allowing the purchase of Illinois Lottery tickets on the Internet (Section 900)
7. Creates the Capital Spending Accountability Law, requiring the Governor's Office of Management and Budget to report quarterly on the state's capital project expenditures (Article 800)
8. Amends the University of Illinois Act to require the university to conduct a study on the effect of lottery ticket purchases on Illinois families (Section 935)

Public Act 96-37, also known as the FY 2010 Budget Implementation Act (or BIMP), contains the following provisions that are contingent upon P.A. 96-34 becoming law.

- Amends provisions of P.A. 96-34, including those pertaining to the private management of the lottery and to the central communications system for the video gaming program
- Creates a new section in the Video Gaming Act, making its provisions severable under section 1.31 of the Statute on Statutes
- Clarifies that only proceeds from the new liquor tax in P.A. 96-34 are to be deposited into the Capital Projects Fund, while proceeds from the previously existing liquor tax are to be deposited into the General Revenue Fund, and makes the additional tax severable

Public Act 96-38, also known as the Trailer Bill, was written contingent to P.A. 96-34 becoming law. P.A. 96-38 contains the following provisions.

- Changes the effective date for the increase in taxes on candy, certain beverages, and grooming and hygiene products from August 1, 2009, to September 1, 2009
- Amends the Video Gaming Act by changing the residency requirements for licensing, clarifying that the 50% split of the after-tax profits from a video gaming terminal is mandatory "notwithstanding any agreement to the contrary" between the licensed establishment and the video gambling operator, and adding a severability clause

Public Act 96-35, also known as the Appropriations Bill, provides appropriations for public funds for projects provided by P.A. 96-34 and the BIMP. This bill contains a provision stating that the Appropriations Bill "does not take effect at all unless [Public Act 96-34], as amended, becomes law." The Appropriations Bill also includes the following provisions.

- Provides that "[n]o contract shall be entered into or obligation incurred for any expenditures for appropriation in Sections 5 and 10 of this Article until after the purposes and amounts have been approved in writing by the Governor"
- Creates a grant program for the Environmental Protection Agency for wastewater compliance

Wirtz claimed that these four pieces of Illinois legislation were enacted in violation of the Illinois Code of Civil Procedure. He alleges the acts contain violations of the **single subject rule,** the uniformity clause, the requirement that an appropriations bill be confined to the subject of appropriation, the requirement that public funds be used only for public purposes, and the requirements of separation of powers and effective date of laws.

Wirtz sought to enjoin state officials, including the state comptroller and the state treasurer, from disbursing public funds raised in connection with the Capital Projects Acts.

On October 20, 2009, the circuit court denied Wirtz leave to file the complaint and the motion to reconsider, finding that there were no reasonable grounds for filing the action.

Explaining the court's position, the circuit court judge stated:

> *. . . the language [legislators] used in the submissions before the court clearly is not the language of common everyday conversation, which is clearly evidenced by the discussion of the single subject rule that perhaps only lawyers or legislative analysts would conceive or define in the way that our courts have defined in a very, very broad, liberal sense, quite differently than most people on the street would define 'single subject.'*

Wirtz appealed. The 3-judge panel of the appellate court reversed the circuit court decision and held that P.A. 96-34 was enacted in violation of the single subject requirement of the Illinois constitution and thus was void in its entirety. Subsequently, the court also voided Public Acts 96-35, 96-37, and 96-38 because they each were contingent on the enactment of P.A. 96-34.

The state appealed this decision to the Illinois Supreme Court.

Issue

Whether the Illinois legislature violated the single subject rule when passing P.A. 96-34 and its contingent bills.

Analysis

The Illinois Constitution states, "Bills, except bills for appropriations and for the codification, revision or rearrangement of laws, shall be confined to one subject."[31] This principle was established to prevent "logrolling," which is the practice of piggybacking legislation that cannot stand on its own legs with a bill that has a better chance of running through the legislature. Limiting the subject matter of a bill to a single topic also helps legislators better understand and debate legislation.

Courts generally lean in favor of lawmakers when considering the constitutionality of legislation and construe the subject matter of bills liberally. However, the court previously ruled that the provisions of a bill must have "a natural and logical connection."[32] In determining whether a bill violates the single subject rule, the court looks to the bill's content rather than its length.

The Wirtz court relied on a previous court's[33] definition of revenue taken from Black's Law Dictionary, which defines revenue as "[g]ross income or receipts" and general revenue as "[t]he income stream from which a state or municipality pays its obligation unless a law calls for payment from a special fund."

The appellate court found no natural or logical connection between the topic of revenue and P.A. 96-34 Section 935, which required the University of Illinois to conduct a study on the effect of lottery ticket purchases on Illinois families. Nor did it find that the requirement that the Governor's Office of Management and Budget prepare quarterly reports on state expenditures related to the subject of revenue (the court noted the distinction between revenue and expenditures). The appellate court further found a relationship lacking between the subject of revenue and P.A. 96-34's amendment to the Illinois Vehicle Code concerning truck load and weight restrictions.

In its decision, the Illinois Supreme Court noted that "the substantive provisions in Public Act 96-34 clearly are connected to capital projects in that they establish increased revenue sources to be deposited into the Capital Projects Fund. The few provisions that do not directly raise revenue are still related to the overall subject of the Act in that they help to implement the other provisions."

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31. Ill. Const. 1970, art. IV, §8(d).
32. *People v. Reedy,* 186 Ill.2d (1999).
33. *People v. Olender,* 222 Ill.2d (2005).

The Supreme Court further stated that P.A. 96-34 was reached through compromise, with the goals of employment and improving the state's infrastructure. The court noted that there is a difference between impermissible logrolling and the normal compromise which is inherent in the legislative process.

Holding

The Illinois Supreme Court ruled that P.A. 96-34 is a constitutionally legitimate enactment encompassing one subject. Accordingly, they reversed the decision of the appellate court.

IRWIN INDUSTRIAL TOOL COMPANY V. ILLINOIS DEPARTMENT OF REVENUE, ILLINOIS SUPREME COURT, DOCKET NO. 109300 (SEP. 23, 2010)

Facts

Irwin Industrial Tool Company (Irwin), a multinational tool manufacturer and distributor formerly known as American Tool Companies, Inc., was headquartered in Lincoln, Nebraska. The corporation had an office in Hoffman Estates, Illinois, where four of the corporation's seven officers were located. Two of the corporation's four directors also had offices in Illinois.

ATC Air, a wholly owned subsidiary of Irwin, provided exclusive air service to Irwin and its affiliated companies. ATC Air operated out of Lincoln, Nebraska, and all seven of its employees lived and worked in Nebraska. ATC Air's CEO, general counsel, and sole director worked from Illinois.

On April 12, 2000, ATC Air purchased an airplane for $7.6 million (plus trade-in) from a Kansas company. The contract, promissory note, guaranty, security agreement, trade-in agreement, and bill of sale listed Irwin's Hoffman Estates address. The Federal Aviation Administration (FAA) registration and bill of sale also listed Irwin's Illinois address. The FAA documents were later amended to change ATC Air's address of record to Lincoln, Nebraska.

ATC Air took possession of the plane in Arkansas and it was hangared in Nebraska. The plane flew throughout the United States, Canada, and Mexico. On 143 of the 290 total days it was flown, or 49.3% of its total flight days, the airplane flew to and/or from Illinois to transport Irwin's executives — often flying empty for one leg of the journey. The plane's flight log reflected that the plane was on the ground in Illinois for 3.65% of its time used and it was kept in Illinois overnight on 25 occasions.

ATC Air claimed an exemption for the plane on its Nebraska personal property tax return. The airplane also was exempt from Nebraska sales and use taxes. ATC Air did not file an Illinois use tax return to report the plane's purchase.

The plane was sold in 2002. ATC Air dissolved then and Irwin assumed its liabilities.

Illinois later assessed Irwin $813,320 ($536,950 in use tax, $500 in penalties, and $275,870 in accrued interest) on the purchase of ATC Air's plane. IDOR asserted the airplane had sufficient nexus with Illinois to warrant use tax because its Illinois use was "repeated and prevalent."

Irwin paid under protest (plus $6,597 in additional accrued interest) but filed for reimbursement claiming the airplane was not subject to Illinois use tax because it had no substantial nexus to Illinois. Irwin argued that even if the court construed there was substantial nexus, the use tax was not "fairly apportioned" under the U.S. Commerce Clause because Illinois assessed a use tax on the plane's entire purchase price, rather than on the portion of time the plane was used in Illinois.

IDOR alleged the commerce clause was designed to prevent "multiple taxation by different states." Because Illinois allows a use tax credit for taxes paid to other states, IDOR maintained the commerce clause was not violated. Because Nebraska did not tax the plane's purchase price, IDOR claimed the state was not required to apportion the tax.

An Illinois circuit court found substantial nexus existed between the airplane and Illinois but apportioned the tax at 4% of IDOR's assessment, finding that the plane was only on the ground in Illinois for approximately that percentage of time. Neither party liked the circuit court's decision. Both appealed.

The appellate court also found sufficient nexus to substantiate Illinois use tax on the plane's purchase, but held that the entire purchase price was subject to Illinois tax. Irwin appealed to the Illinois Supreme Court and the court accepted the case.

Issues. The issues presented in this case are as follows.

1. Whether there is substantial nexus between Irwin's airplane purchase and Illinois
2. Whether Irwin is subject to use tax on the airplane's entire purchase price if the airplane was used only part of the time in Illinois

Analysis

Issue 1. The court noted that use tax is designed to protect Illinois retailers from losing business to out-of-state retailers by preventing avoidance of Illinois' sales tax by consumers making out-of-state purchases. It cited both the *Quill* decision,[34] which established that more than a slight physical presence is needed to establish nexus, and the *Brown's Furniture v. Wagner* decision,[35] which established that a substantial physical presence is not necessary but that presence must be more than slight to trigger Illinois use tax.

In the *Irwin* case, the court found the airplane's purpose related substantially to Illinois because it was used primarily to transport Irwin's top executives and directors, most of whom were located in Illinois. Because the plane flew to Illinois "frequently and regularly," the court deemed it had a significant presence in Illinois. The court also found it noteworthy that the airplane's initial bill of sale and registration listed an Illinois address.

Issue 2. The U.S. Commerce Clause prevents multiple states from unfairly taxing the same transaction. The federal Supreme Court set forth tests for determining the fair apportionment of interstate transactions. These tests examine both internal and external factors.

The test for internal consistency looks at whether a tax is structured "so that if every State were to impose an identical tax, no multiple taxation would result."[36] The test for external consistency looks at whether each state taxed only the portion of the transaction that "reasonably reflects the in-state component of the activity being taxed."[37] States that give a credit for taxes paid to other states on the same transaction satisfy the fair apportionment requirement of the commerce clause.

Archer Daniels Midland Company (ADM), based in Decatur, Illinois, lost a 1988 appeal to exempt the purchase of three airplanes bought outside Illinois from Illinois use tax.[38] ADM argued that use tax on the planes should be based on the proportion of Illinois take-offs and landings compared to each airplane's total take-offs and landings. In this case, the appellate court agreed with IDOR's argument that ADM owed use tax on the full purchase price of the airplanes because ADM did not pay tax to any other state on the purchases.

The ADM court explained:[39]

> *The sales tax is measured by the purchase price of an item, without regard to the amount of use the item will receive, and so is the use tax. Nor is the use tax a precise charge for benefits provided by the State. [The corporation] enjoys the protection of Illinois laws, access to its legal system, and innumerable other services. Because [the corporation] receives all these benefits, it is properly subject to taxation in this State.*

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34. *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).
35. *Brown's Furniture, Inc. v. Wagner*, 171 Ill.2nd 410 (1996).
36. *Goldberg v. Sweet*, 488 U.S. 252 at 260-61(1989).
37. *Goldberg v. Sweet*, 488 U.S. 252 at 262 (1989).
38. *Archer Daniels Midland Co. v. Department of Revenue*, 170 Ill.App.3d 1014 (1988).
39. *Archer Daniels Midland,* 170 Ill.App.3d at 1022-23.

Based on precedent set by the *ADM* court, the present court ruled that Illinois use tax on the full purchase price of Irwin's airplane was fairly apportioned.

Holding

The Supreme Court upheld the appellate court decision, finding that Irwin was liable for Illinois use tax on the entire purchase price of the airplane because no tax was paid to any other state on the airplane's purchase.

IDOR OPERATIONAL UPDATE

CUSTOMER CORRESPONDENCE IMPROVEMENTS

IDOR has partnered with Napersoft, Inc., to manage communications with Illinois taxpayers on retailers' occupation tax issues.

IDOR's Bureau of Information Processing has integrated Napersoft's customer correspondence software with the state's Exceptions Processing Systemto produce and distribute taxpayer communications regarding return errors, interest and penalty notices, and adjustments. The system generates over 5,000 documents per week.

Napersoft electronically archives taxpayer correspondence, which allows IDOR employees to access documents more readily. This process saves the state time, money, and storage space and allows taxpayers to get up-to-date information from IDOR.

This collaboration also allows IDOR to generate detailed Statement of Account documents that capture all actions, payments, and credits on a taxpayer's account. This information alerts IDOR to withhold refund checks from taxpayers who owe the state money.[40]

ELECTRONIC FILING NEWS

Paid Preparer Mandate

Effective January 1, 2011, Illinois began requiring paid preparers who file more than 100 Illinois individual income tax returns to file those returns electronically. This mandate does not apply to amended returns, trust or estate returns, or to any return that IDOR has announced cannot be e-filed.[41]

Electronically filed returns are processed more quickly, resulting in fewer errors and faster refunds to taxpayers. Over 3.6 million Illinois taxpayers already file electronically, representing 62% of all filers.

Opt-Out Information

In the event that a client refuses to allow their return to be electronically filed, paid preparers can comply with the law by having the client complete and sign Form IL-8948, *Electronic Filing Opt-Out Declaration*.

IDOR does not require Form IL-8948 to be submitted. However, preparers must retain the form on file for three years. IDOR may request copies of these forms at any time.

40. [http://government.napersoft.com/pdf/Napersoft%20Customer%20-%20Illinois%20Dept%20of%20Revenue%202011-03-23.pdf] Accessed on Jul. 17, 2011.

41. Illinois Department of Revenue Regulations, Title 86, Part 760, Section 760.100.

E-File Illinois Corporate Returns

The state began accepting electronically filed corporate income tax and replacement tax returns effective March 15, 2011. Returns that are excluded from federal Form 1120 electronic filing are also excluded from e-filing in Illinois.

Electronically accepted Illinois forms include the following.

- IL-1120, *Corporation Income and Replacement Tax Return*
- Schedule 80/20, *Related Party Expenses*
- Schedule K-1-P, *Partner's or Shareholder's Share of Income, Deductions, Credits, and Recapture*
- Schedule K-1-T, *Beneficiary's Share of Income and Deductions*
- Schedule M (for IL-1120 filers), *Other Additions and Subtractions*
- Schedule 1299-B, *Enterprise Zone or Foreign Trade Zone (or Sub-Zone) Subtractions*
- Schedule J, *Foreign Dividends*
- Schedule NB, *Nonbusiness Income*
- Schedule NLD, *Illinois Net Loss Deduction* (2010 calendar filers only; see "Net Loss Deduction" under "Illinois Tax Rate Increases" section)
- Schedule 4255, *Recapture of Investment Tax Credits*
- Form IL-4562, *Special Depreciation*
- Form IL-477, *Replacement Tax Investment Credits*
- Schedule 1299-D, *Income Tax Credits*
- Form IL-2220, *Computation of Penalties for Businesses*
- Schedule INS, *Tax for Foreign Insurers*
- Schedule UB, *Combined Apportionment for Unitary Business Group*
- Schedule UB/INS, *Tax for a Unitary Business Group with Foreign Insurer Members*
- Schedule UB/NLD, *Unitary Illinois Net Loss Deduction (2010 calendar filers only)*
- Schedule SA, *Specific Accounting Method of Computing Net Income for Corporations*
- Copies of federal forms as required by IL-1120 Instructions

Corporate Signature Requirement

The electronic signature requirement for Form IL-1120 is satisfied by including specific data in the transmission, including a perjury statement. It is not necessary to file Form IL-8453, *Individual Income Tax Electronic Filing Declaration,* or any other signature authorization form.

Tax preparation software should include a perjury statement checkbox by which the specified corporate officer can signify that they have examined the return and acknowledge that it is true, correct, and complete.

BACKUP WITHHOLDING FOR PASS-THROUGH ENTITIES

Prior to 2008, Illinois had a difficult time collecting tax owed by nonresidents on Illinois income sourced from pass-through entities, including partnerships, S corporations, and trusts. Legislators then devised a plan to place the burden for tax collection on the entities themselves.

For tax years ending on or after December 31, 2008, Illinois requires targeted pass-through entities to compute and remit any Illinois tax due on behalf of their nonresident partners, shareholders, and beneficiaries. Nonresident taxpayers then receive an Illinois income tax credit for the amount remitted on their behalf.[42]

If the amount of the tax remitted on behalf of the partner, shareholder, or beneficiary is sufficient to cover their tax liability, the nonresident **individual** taxpayer is not required to file an Illinois tax return.[43] However, the taxpayer may wish to file an Illinois return voluntarily in order to provide documentation to their home state of the nonresident tax paid to Illinois.

> **Note. Nonindividual** partners and shareholders must still file Illinois tax returns. That is, if a nonresident entity owner is also a pass-through entity, it is not relieved of the responsibility to file an Illinois tax return to report its Illinois income. These situations are referred to as "tiered partnerships" and "distributions."

Although the tax withheld is paid to the state by the entity, it is important to remember the paying entity is not allowed a deduction. The entity is merely paying the tax liability of the owners (partner, shareholder, beneficiary) similar to the entity withholding and remitting the employee's share of FICA. Therefore, the payment by the entity should be considered a distribution to the owner. In order to avoid disproportionate distributions, the entity should either make proportionate distributions to the resident owners or make the correction later in the year with the next distribution.

While a disproportionate distribution to S corporation shareholders is construed as the corporation having two classes of stock, **this is not the case if the distribution is required by the state for payment or withholding of state income taxes.**[44] However, all shares must confer identical rights to distribution and liquidation proceedings. A difference in timing between the constructive distributions and the actual distributions to the other shareholders does not cause the corporation to be treated as having more than one class of stock.

Example 5. Rodney (Illinois resident) and Douglas (nonresident) respectively own 75% and 25% of XYZ Corporation, an S corporation. On March 15, 2011, XYZ Corporation makes a $2,000 pass-through entity payment to Illinois on behalf of Douglas for calendar year 2010. The corporation also should make a proportionate distribution to Rodney for $6,000. However, this need not be in the same year.

Although this backup withholding process requires additional effort on the part of pass-through entities, the benefits of this requirement outweigh its burden. Pass-through entity withholding relieves individual taxpayers of the requirement to file out-of-state tax returns, reduces IDOR's administrative expenses, creates a taxpayer-friendly alternative to filing complex composite returns, and results in the collection of more Illinois income tax.

42. 35 ILCS 5/709.5(b).

43. 35 ILCS 5/502(a).

44. Treas. Reg. §1.1361-1(l)(2)(ii) and (vi) Example 7.

ENTITIES AFFECTED BY PASS-THROUGH ENTITY PAYMENTS

Affected Entities

The following pass-through entities must remit payments on behalf of their respective nonresident partners, shareholders, and beneficiaries (nonresident owners).

- Partnerships, other than publicly traded partnerships under IRC §7704 and investment partnerships[45]
- S corporations
- Trusts

Affected Owners

Affected entities must remit payments on behalf of all nonresident partners, shareholders, and beneficiaries, **except:**

- **Individuals** included on composite income and replacement tax returns, and
- **Nonindividual** owners who certify that they will file an Illinois tax return and pay any tax due by completing Form IL-1000-E, *Certificate of Exemption for Pass-through Entity Payments*, and submitting it to the pass-through entity.

> **Note.** Only **nonindividual** owners can file Form IL-1000-E. **Individuals** may not claim exemption from pass-through entity payments.[46]

Pass-through entities should keep Form IL-1000-E on file. IDOR does not require this form to be submitted unless requested.

Pass-Through Entity Obligations

Affected pass-through entities with nonexempt, nonresident owners must:

- File Form IL-1000, *Pass-through Entity Payment Income Tax Return;*
- Calculate and remit required payments on behalf of nonresident owners; and
- Notify affected nonresident owners of the amount of pass-through entity payments made on their behalf via Illinois Schedule K-1-P, *Partner's or Shareholder's Share of Income Deductions, Credits, and Recapture,* or Illinois Schedule K-1-T, *Beneficiary's Share of Income and Deductions.*

Nonresident Owner Obligations

Individual taxpayers for whom pass-through entity payments have been made are not required to file an Illinois income tax return if the payments made on their behalf cover their entire Illinois individual income tax liability.

Nonresident pass-through entities and individuals who are otherwise required to file an Illinois tax return must report income derived from the pass-through entity on their Illinois income tax returns and claim credit for payments made on their behalf by the pass-through entity. If the nonresident owner is also a pass-through entity, it can claim the payment either on its Illinois income tax return or Form IL-1000.

Taxpayers must attach the Schedule K-1-P or K-1-T received from the pass-through entity to their Illinois tax returns to support any claim for the payments.

45. For taxable years ending on or after December 31, 2004, an "investment partnership" is exempt from Illinois income taxation. (35 ILCS 5/205(b)).

46. 35 ILCS 5/709.5.

THE MECHANICS OF PASS-THROUGH ENTITY PAYMENTS

Calculating the Payment

The amount pass-through entities are required to remit to the state equals the sum of each nonexempt, nonresident owner's Illinois-apportioned income multiplied by the Illinois tax rate applicable to each nonresident owner.

> **Note.** Fiscal year entities should pay close attention to the relevant rates because Illinois tax rates increased effective January 1, 2011.

Form and Due Date. Payments are remitted to the state with Form IL-1000, *Pass-through Entity Payment Income Tax Return*. Form IL-1000 and payments are due no later than the unextended due date of the pass-through entity's Illinois income tax return.

Compliance Problems. The due date for a pass-through entity's Form IL-1000 can fall on the same date or later than the due date for the nonresident owner's return. This may present a compliance problem when there are tiered partnerships and distributions or when the pass-through entity has filed an extension and cannot compute the amount of the nonresident shareholder's tax liability.

IDOR addressed these concerns with Prop. Reg. §100.7035(f)(2). This regulation exempts a **nonresident owner** from penalty and interest if the pass-through entity fails to pay the owner's tax on time but only if the nonresident owner did not cause the pass-through entity payment to be late.

When the pass-through entity has filed an extension for time to complete the entity's income tax return, the entity is advised to use a best-guess estimate in calculating the amount of the pass-through entity payment on behalf of nonresident owners.

Amended Payments. Underpayments can be corrected by filing Form IL-1000-X, *Amended Pass-through Entity Payment Income Tax Return.* **Pass-through entities cannot claim a refund for any overpayments.** Amounts overpaid in error can only be recovered by the nonresident owner on whose behalf the payment was made.

Example 6. Able Partnership has business income of $100,000 and an Illinois apportionment factor of 40%, for total Illinois-sourced income of $40,000. Its two equal partners are:

- Melba Able, an Indiana resident; and
- Bam Partnership, which does business only in Indiana. Bam has not submitted an IL-1000-E. It has two equal partners, John George and Meredith Beck, both of whom are individual taxpayers who reside in Ohio.

Able Partnership must file an IL-1000 and make a total pass-through entity payment of $1,300, which is calculated as follows.

Partner	Residency/Status	IL Income	Rate	Payment
Melba Able	Nonresident individual	$20,000	5.0%	$1,000
Bam Partnership	Nonresident partnership	20,000	1.5%	300
Total		$40,000		$1,300

Bam Partnership must file an IL-1000 and make $1,000 in pass-through entity payments on the $20,000 of Illinois business income that passed through to it from Able Partnership. The pass-through entity payments are calculated as follows.

Partner	Residency/Status	IL Income	Rate	Payment
John George	Nonresident individual	$10,000	5%	$ 500
Meredith Beck	Nonresident individual	10,000	5%	500
Total		$20,000		$1,000

Bam Partnership must also file an IL-1065 and pay replacement tax on the $20,000 of income from Able Partnership. It may claim credit for the $300 of pass-through entity payments which were made on its behalf by Able Partnership on either its Form IL-1000 or Form IL-1065.

Note. If Bam Partnership submits an IL-1000-E to Able Partnership, Able is not required to make a pass-through entity payment on the $20,000 distributable to Bam. However, Bam must pay replacement tax and make pass-through entity payments on its $20,000 of income.

MISCELLANEOUS PASS-THROUGH ENTITY PAYMENT ISSUES

IDOR produced a comprehensive Tax Talk publication on the topic of pass-through entity payments. This question-and-answer style document is available on IDOR's website.[47]

Highlights from this Tax Talk include the following.

- Pass-through payments do **not** have to be remitted on income that is not allocable to Illinois — that is, nonbusiness income that is properly allocated to the owner's state of residency such as interest and dividends. (See the publication for a discussion on the classification of rental income and other business versus nonbusiness income issues.)
- There is no exception from pass-through entity payments for cash-strapped entities.
- Pass-through entities are assessed a **10% penalty** if they fail to submit pass-through payments, and late-filing penalties may also apply to the pass-through entities (not to the nonresident owners).
- IDOR cannot respond to federal tax issues on the topic of disproportionate distributions for S corporation shareholders arising from state-mandated payments on behalf of certain shareholders.

47. *Tax Talk Pass-Through Entity Payments Q & A — 11/18/2008* [www.revenue.state.il.us/AboutIdor/TaxTalk/MoreTaxTalk.htm] Accessed on Jun. 27, 2011.

ILLINOIS SPECIAL DEPRECIATION

Illinois piggybacks off the federal Code, so when the federal government passes income tax laws that impact the computation of a taxpayer's AGI, Illinois taxable income generally is affected. However, the state legislature occasionally "decouples" from the federal Code by passing legislation that specifically addresses federal changes.

When the federal government enacted the Job Creation and Worker Assistance Act in 2002, it created the concept of "bonus depreciation." Under bonus depreciation, a taxpayer could accelerate the deduction of capital asset costs by deducting 30% of the expense of purchasing certain items in the first year they were placed in service. The remaining 70% of cost was depreciated over the asset's applicable depreciation period. This "30% bonus depreciation" provision applied to "qualified property," generally new MACRS property with a recovery period of 20 years or less, acquired after September 10, 2001, and before September 11, 2004, and placed in service before January 1, 2005. Certain property considered to have a "longer production period" must have been placed in service before January 1, 2006.

Illinois stood to lose substantial upfront revenue in the years affected by bonus depreciation. To stem this loss, the legislature introduced Senate Bill 1543, which decoupled Illinois from the federal bonus depreciation rules.[48] Decoupling reversed federal bonus depreciation by requiring Illinois taxpayers to add back the 30% bonus depreciation to their Illinois taxable income and recompute the depreciation as if the bonus amount had not been claimed.

Taxpayers were required to recompute their Illinois depreciation deduction on Form IL-4562, *Special Depreciation*, for each year the asset remained in service.

This process created two different bases for each bonus depreciation asset — one for the federal and one for the state — which in turn affected the gain or loss reported on the sale or disposition of the asset. To counteract this difference, Illinois taxpayers must reverse all changes in the year in which the disposition of the asset occurs.

To complicate matters further, Illinois decoupled from the federal 50% bonus depreciation enacted under the federal Economic Stimulus Act of 2008 and the American Recovery and Reinvestment Act of 2009.

However, **Illinois did not decouple from the recent 100% bonus depreciation** enacted under the federal Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010. **No Illinois adjustments are necessary for these assets,** which may be depreciated in full under the federal Code.

> **Note.** IDOR supported decoupling from the 100% bonus depreciation rules. It is unclear why Illinois lawmakers did not pass legislation to decouple this time.

48. SB 1543 was enacted under Illinois Public Act 92-603.

DIRECTORY OF IDOR INFORMATIONAL BULLETINS FOR FY 2011

IDOR periodically issues informational bulletins on subjects of interest to Illinois taxpayers and tax practitioners. These bulletins may be accessed online through IDOR's website.[49] Topics for bulletins issued in fiscal year 2011, along with their release dates, are as follows.

- **FY 2011-01 (July 2010) —** *New Electronic Payment Requirements*
- **FY 2011-02 (July 2010) —** *Changes in the Motor Fuel Tax Law Effective July 29, 2010*
- **FY 2011-03 (October 2010) —** *Simplified Municipal Telecommunications Tax Rate Changes Effective January 1, 2011*
- **FY 2011-04 (October 2010) —** *Prepaid Sales Tax Rate Changes Beginning January 1, 2011* (This bulletin is addressed to all distributors, suppliers, motor fuel retailers, and other resellers of motor fuel.)
- **FY 2011-05 (October 2010) —** *Sales Tax Rate Change Summary* (This is for all retailers and servicepersons conducting business in taxing jurisdictions whose sales tax rate is changing, effective January 1, 2011.)
- **FY 2011-06 (December 2010) —** *Change in the Motor Fuel Use Tax Rate* (This information applies to all licensed interstate motor carriers.)
- **FY 2011-07 (December 2010) —** *What's New for Illinois Income Tax* (This covers changes for tax year 2010.)
- **FY 2011-08 (January 2011) —** *Withholding Tax Rate Changes*
- **FY 2011-09 (February 2011) —** *Illinois Income Tax Increase* (This bulletin is for all tax practitioners and individuals and businesses required to pay Illinois income tax.)
- **FY 2011-10 (March 2011) —** *New Computer System Expands* (This contains information for all tax professionals and taxpayers who file Illinois excise taxes or fees.)
- **FY 2011-11 (March 2011) —** *Simplified Municipal Telecommunications Tax Rate Changes Effective July 1, 2011*
- **FY 2011-12 (May 2011) —** *Sales Tax Rate Change Summary* (This is for all retailers and servicepersons conducting business in taxing jurisdictions whose sales tax rate is changing, effective July 1, 2011.)
- **FY 2011-13 (May 2011) —** *Changes for Liquor Nonbeverage Users or Distributors*
- **FY 2011-14 (June 2011) —** *Important Notice of Changes for Out-of-State Retailers*

49. [www.revenue.state.il.us/Publications/Bulletins/2011/index.html] Accessed on Jun. 27, 2011.

ILLINOIS SMALL BUSINESS JOBS CREATION TAX CREDIT

Illinois initiated the small business jobs creation tax credit[50] in April 2010 in the hopes it would spur creation of up to 20,000 Illinois jobs.[51] This tax credit was expanded by Public Act 96-1498, which was signed by Governor Quinn on January 17, 2011. The total amount of tax credits issued by Illinois is capped at $50 million.

There are two categories of businesses that are eligible for this credit.[52]

1. A small business with 50 or fewer employees on June 30, 2010
2. A business of any size that hires a 2010 worker-trainee under the Put Illinois to Work Program

The credit can be taken against a company's withholding tax liability. The amount of the credit depends on the category of the business, as follows.[53]

- For a small business with 50 or fewer employees, the credit is $2,500 per job if the position is filled for one year.
- For a business that hires workers-trainees under the Put Illinois to Work Program, half the credit ($1,250) is allowable if the employee works for at least six months after the date of hire. The business may claim the other half of the credit if the employee works for at least 12 months after the date of hire.

The credit applies to each new Illinois job that meets the following conditions.

1. The job was created between July 1, 2010, and June 30, 2011.
2. The job must pay at least $10 per hour, or the equivalent annualized salary of $18,200.
3. Depending on the category of the business, the job must be created and sustained for a certain period of time.
   a. For small businesses, eligibility for the credit does not require that a particular individual employee is retained for one year, but rather that a new, full-time Illinois job is created and sustained for one year.
   b. For businesses that hire workers-trainees under the Put Illinois to Work Program, the individual hired into a full-time position must be employed for at least six months to be eligible for half of the credit. That same individual must be employed for at least 12 months for the business to qualify for the second half of the credit.
4. The position must average at least 35 hours per week, or pay a full-time salary.

To receive the credit, qualified businesses and nonprofits must have registered with the Illinois Department of Commerce and Economic Opportunity (DCEO) **on or before June 30, 2011.** DCEO administers the program and began issuing credit certificates July 1, 2011, to qualified businesses. Eligible businesses claim the credit on their Form IL-941, *Illinois Withholding Income Tax Return.*

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50. Illinois Public Act 96-888, codified at 35 ILCS 25.

51. This figure provided by the Illinois Department of Commerce and Economic Development at www.ildceo.net/dceo/jobstaxcredit. (Accessed on Jul. 17, 2011).

52. [http://jobstaxcredit.illinois.gov/faq.pdf] Accessed on Aug. 31, 2011.

53. Ibid.

ESTATE TAX

The estate tax is a transfer tax, not an income tax. Estate tax is imposed on the value of property "transferred" by a decedent upon death.

The federal estate tax temporarily expired in 2010, but Congress resurrected a modified estate tax at the end of 2010 under the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010. This act was signed into law on December 17, 2010.

Illinois tax law generally follows federal law, unless the Illinois legislature specifically deviates from federal tax law by statute. Illinois deviated, or "decoupled," from the federal estate tax exemption in 2009, lowering the state exemption to $2 million per person from the federal exemption level of $3.5 million.

In 2010, Illinois had no estate tax. However, **Illinois reinstated its estate tax for decedents dying after December 31, 2010.**[54] The Illinois estate tax applies to every Illinois resident as well as those who own property in the state.

ESTATE TAX EXEMPTION

In 2011 and 2012, the **federal** estate tax exclusion is $5 million.

The Illinois estate tax exemption is $2 million, based on the "state death tax credit" calculated under IRC §2011, as it would have been computed on December 31, 2001.

Because the federal estate tax exclusion is now $5 million, estates transferring between $2 million and $5 million may be exempt from federal estate tax but liable for Illinois estate tax in 2011 and 2012.

Illinois estates valued at over $2 million must file Illinois Form 700, *Estate & Generation Skipping Transfer Tax Return*. The Illinois return must include a copy of the estate's federal Form 706, *United States Estate (and Generation-Skipping Transfer) Tax Return*.

If the estate has an Illinois filing requirement but is not required to file a federal estate tax return, the Illinois return should contain the same information required by the federal return, including all schedules, appraisals, wills, trusts, and attachments.[55]

The Illinois estate tax is due nine months after the decedent's death. The Illinois Form 700 can be extended six months if a federal Form 4768 is filed.

ESTATE TAX RATES

The reinstatement of the Illinois estate tax is based on the "state death tax credit" calculated under IRC §2011, as it would have been computed on December 31, 2001.

The following table shows federal and Illinois estate taxes at various taxable estates for a decedent dying in 2011 or 2012.

Taxable Estate	Federal Estate Tax	Illinois Estate Tax	Total
$2 million	$ 0	$ 0	$ 0
3 million	0	167,279	167,279
4 million	0	253,986	253,986
5 million	0	352,158	352,158
6 million	190,375	456,071	646,446

54. Illinois Public Act 96-1496, enacted Jan. 13, 2011.

55. Information obtained from the Illinois Attorney General's website. [www.illinoisattorneygeneral.gov] Accessed on Jul. 26, 2011.

QTIP ELECTION

An Illinois qualified terminal interest property (QTIP) marital trust election is still available and can be made separate and apart from a federal QTIP election. Making the Illinois QTIP election allows the estate to maximize the $5 million federal estate tax exclusion without incurring Illinois estate tax on the additional $3 million until the surviving spouse's death.

Illinois' legislation did not provide for any portability of the decedent's state estate tax exclusion, as is allowed under the new federal estate tax law.

Illinois also reinstated a special election related to QTIP marital trusts effective January 1, 2011. This is particularly important for married couples who own more than $2 million of property (including life insurance).

If the tax-free amount for federal estate tax purposes exceeds the $2 million Illinois tax-free amount, some Illinois estate tax may become due upon the death of the first spouse to die in certain situations. A surviving spouse who uses the special QTIP election can defer up to $352,158 in Illinois estate taxes that would otherwise be due upon the death of the first spouse, should he or she die in 2011 or 2012.

Illinois couples who have a will or revocable trust with a marital trust allocation formula may find that the new Illinois estate tax law unfavorably affects the allocation formula. Married Illinois residents should have their trusts reviewed by qualified counsel so that these recent changes in the Illinois law can be fully considered.

The Illinois estate tax is administered by the Illinois Attorney General, not the Department of Revenue. Questions regarding Illinois estate tax issues should be directed to:

Estate Tax Section
100 West Randolph Street, 13th Floor
Chicago, Illinois 60601
Telephone: (312) 814-2491

Estate Tax Section
500 South Second Street
Springfield, Illinois 62706
Telephone: (217) 524-5095