

Illinois – Composite returns eliminated, non-resident withholding required, alternative apportionment updated

August 21, 2013

In brief

On August 16, 2013, Illinois Governor Pat Quinn signed [H.B. 3157](#), which, effective for tax years ending on or after December 31, 2014, (1) eliminates composite returns and (2) requires partnerships, S-corporations, and trusts to withhold tax on nonbusiness income distributable to their respective non-resident partners, shareholders, and beneficiaries. Additionally, Illinois' alternative apportionment provision is updated to reflect market-based sourcing language. Illinois pass-through entities should be aware of the significant compliance changes that will be in effect for the 2014 tax year.

In detail – Composite return authority repealed, non-resident nonbusiness income withholding required

Under current law, the Department generally permits partnerships, S-corporations, and limited liability companies (taxed as partnerships) to file composite returns on behalf of their respective non-resident partners, shareholders, and members. The composite return (Form 1023-C) reflects the income and payment of personal income tax for such individuals.

H.B. 3157 ends the Department's authority to

permit composite returns effective for taxable years ending on or after December 31, 2014.

Under current law, partnerships, S-corporations, and trusts must withhold tax on business income and certain credits distributable to their respective non-resident partners, shareholders, and beneficiaries. Effective for taxable years ending on or after December 31, 2014, partnerships, S-corporations, and trusts must *also withhold tax on nonbusiness income* and certain credits distributable to their respective non-resident partners, shareholders, and beneficiaries.

The takeaway

Under current compliance requirements, the reporting and tracking of non-residents has been a confusing and cumbersome process. Non-residents may be included in a Form 1023-C composite return or in a Form IL-1000, which reports the business income of non-residents not included in a composite return. Additionally, non-residents can be included in an IL-1040 (schedule NR), IL-1065 (partnership return), or IL-1041 (fiduciary income tax return).

Following enactment of H.B. 3157, it is expected that the Department will make non-resident pass-through

withholding payments a part of the IL-1120, IL-1065, and IL-1041 returns and will eliminate the IL-1023-C and the IL-1000. We understand that the Department intends to allow a pass-through entity to make a single extension payment without designating the non-resident withholding amount. When the pass-through entity files its return, it will then determine how much should be allocated between the non-resident and the entity's personal property replacement tax obligations. We expect the Department to issue formal guidelines in this area.

In detail – Alternative apportionment updated

Under prior law, for tax years ending before December 31, 2008, a taxpayer may petition for, or the Department may require, an alternative apportionment methodology if the general apportionment formula did not “fairly represent the extent of a person’s business activity” in Illinois.

H.B. 3157 provides that, for tax years ending on or after December 31, 2008, the alternative apportionment provision applies when the general apportionment formula does not “fairly represent the market for the

person’s goods, services, or other sources of business income.”

The takeaway

The change appears to align alternative apportionment language with Illinois’ market-based approach for sourcing sales other than sales of tangible personal property, which was introduced for the 2008 taxable year. It is unknown whether this change will have any practical impact on the Department’s scope of power to impose alternative apportionment against taxpayers or to approve taxpayer requests for alternative apportionment.

Let’s talk

For more information on H.B. 3157, please contact:

State and Local Tax Services

Kevin Merckell
Partner, *Chicago*
+1 (312) 298-5686
kevin.merkell@us.pwc.com

Christopher Tobin
Partner, *Chicago*
+1 (312) 298-2139
christopher.tobin@us.pwc.com

Michael Lovett
Director, *Chicago*
+1 (312) 298-5912
michael.a.lovett@us.pwc.com