State & Local Tax Alert

Illinois enacts major tax reform legislation

During June 2019, Illinois Gov. J.B. Pritzker signed a series of bills providing significant tax reform for many Illinois taxes.[1] Specifically, S.B. 689 provides a corporate income tax addback for foreign-derived intangible income (FDII), gradually repeals the franchise tax, imposes a use tax collection requirement on marketplace facilitators, expands the manufacturing sales tax exemption, enacts various credits and incentives, and provides tax amnesty programs.[2] S.B. 687 will increase the corporate income tax rate and enact graduated personal income tax rates if voters approve an amendment to the Illinois Constitution.[3] Also, S.B. 690 makes amendments that include changing the tax collection obligation for remote retailers from use tax to state and local retailers' occupation tax, providing incentives for data centers, limiting the sales tax trade-in credit, and increasing cigarette taxes.[4] S.B. 1939 makes changes related to transportation funding such as increasing motor fuel taxes.[5] Finally, the governor is expected to sign legislation that will change the estimated tax requirements[6] and taxation of nonresidents working in the state.[7]

Corporate income tax

Beginning Jan. 1, 2021, S.B. 687 will increase the Illinois corporate income tax rate from 7% to 7.99% if voters approve a constitutional amendment at the November 2020 general election to allow the imposition of graduated income tax rates.[8] Combined with the 2.5% replacement tax, the new corporate rate would be 10.49%. For tax years beginning after

[1] The Illinois General Assembly has passed substantial tax legislation. This SALT Alert focuses on the most significant changes.
[2] P.A. 101-0009 (S.B. 689), Laws 2019, enacted on June 5, 2019.
[3] P.A. 101-0008 (S.B. 687), Laws 2019, enacted on June 5, 2019.
[4] P.A. 101-0031 (S.B. 690), Laws 2019, enacted on June 28, 2019.
[5] P.A. 101-0032 (S.B. 1939), Laws 2019, enacted on June 28, 2019.
[6] S.B. 1800, sent to governor on June 21, 2019.
[7] S.B. 1515, sent to governor on June 28, 2019.
[8] 35 Ill. Comp. Stat. 5/201(b)(14), (15). If approved by voters, Senate Joint Resolution Constitutional Amendment (SJRCA) No. 1 would amend Ill. Const. art. IX, § 3(a) to delete the provision prohibiting a graduated income tax. The legislature would be authorized to provide income tax rate or rates. The highest rate of corporate income tax could not exceed the highest rate imposed on individuals by more than a ratio of 8-to-5.

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December 31, 2018, S.B. 689 requires taxpayers to add back the amount deducted under IRC Sec. 250(a)(1)(A) (FDII).[9]

Franchise Tax

For tax years beginning on or after Jan. 1, 2020, S.B. 689 is phasing out the franchise tax.[10] Under existing law, Illinois imposes a franchise tax on paid-in capital. The tax is phased out as follows:

- On or after Jan. 1, 2020, and prior to Jan. 1, 2021, the first $30 in liability is exempt;
- On or after Jan. 1, 2021, and prior to Jan. 1, 2022, the first $1,000 in liability is exempt;
- On or after Jan. 1, 2021, and prior to Jan. 1, 2023, the first $10,000 in liability is exempt; and
- On or after Jan. 1, 2023, and prior to Jan. 1, 2024, the first $100,000 in liability is exempt.

For tax years beginning on or after Jan. 1, 2024, the franchise tax will no longer be imposed.

Personal income tax

Graduated tax rates

Effective Jan. 1, 2021, S.B. 687 will change the current flat personal income tax rate to a graduated rate structure if voters approve the constitutional amendment to permit a graduated income tax.[11] The personal income tax currently is imposed at a flat rate of 4.95%.[12] Under S.B. 687, the graduated rates would range from 4.75% to 7.99%.[13] For high-income individuals ($750,000 for single filers and $1 million for joint filers), the 7.99% rate would apply to all of the individual's income.

Estimated taxes

If S.B. 1800 is enacted, individuals would be required to pay estimated tax if the amount payable is estimated to exceed $1,000 for taxable years ending on or after Dec. 31, 2019. Under current law, individuals are required to pay estimated tax if the amount payable is estimated to exceed $500.[14]

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[9] 35 ILL. COMP. STAT. 5/203(b)(2)(E-18).
[10] 805 ILL. COMP. STAT. 5/15.35, 5/15.65.
[11] See the corporate income tax rate discussion above for information on the proposed amendment to the Illinois Constitution.
[12] 35 ILL. COMP. STAT. 5/201(b)(5.4).
[13] 35 ILL. COMP. STAT. 5/201(b)(5.5), 5/201.1.
[14] 35 ILL. COMP. STAT. 5/803(a).

Nonresidents working in Illinois

For tax years ending on or Dec. 31, 2020, S.B. 1515 would change the taxation of nonresidents working in the state if enacted. Compensation would be deemed to be paid in Illinois and subject to the state's personal income tax if: (i) some of the individual's service is performed within the state; (ii) the service performed within the state is nonincidental to the services performed outside the state; and (iii) the individual's service is performed within Illinois for more than 30 working days during the tax year. Under existing law, compensation is deemed to be paid in Illinois if some of the service is performed in Illinois and the base of operations of the nonresident's service is located in Illinois.[15] It should be noted that once the 30-day threshold is exceeded, any nonresident withholding must be calculated back to day one.

Sales and use tax

Remote retailers and marketplace Facilitators

In 2018, Illinois enacted legislation in response to *South Dakota v. Wayfair, Inc.*[16] that imposes use tax collection requirements on out-of-state retailers and service providers.[17] Effective Oct. 1, 2018, out-of-state retailers and service providers are required to collect and remit use tax and service use tax if one of two economic thresholds is met for a 12-month period: (i) the sales of tangible personal property or services to customers in Illinois are $100,000 or more; ***or*** (ii) the retailer or service provider enters into 200 or more separate transactions for sales of tangible personal property or services to Illinois customers.[18] Beginning Jan. 1, 2020, S.B. 689 requires marketplace facilitators to collect and remit use tax and service use tax if the marketplace facilitator and marketplace seller cumulatively meet either of these economic nexus thresholds.[19] The sales that a retailer makes through a marketplace facilitator are

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[15] 35 ILL. COMP. STAT. 5/304(a)(1)(B).

[16] 138 S. Ct. 2080 (2018). For a discussion of this case, see GT SALT Alert: *Wayfair* Ruling Overturns *Quill* Physical Presence Requirement.

[17] P.A. 100-0587 (H.B. 3342), Laws 2018. Illinois has a unique sales and use tax system comprised of four different taxes: (i) retailers' occupation tax; (ii) service occupation tax; (iii) service use tax; and (iv) use tax. Occupation taxes are imposed on sellers' receipts and use taxes are imposed on amounts paid by purchasers. Generally, if an out-of-state business does not charge Illinois sales tax, the purchaser must pay use tax to the Illinois Department of Revenue. Under the legislation, out-of-state sellers or service providers meeting certain sales thresholds are required to collect use tax from the purchaser and remit it to the state. For further discussion of this legislation, see GT SALT Alert: Illinois Enacts Use Tax Collection Requirements for Remote Retailers and Service Providers.

[18] 35 ILL. COMP. STAT. 105/2, 110/2.

[19] 35 ILL. COMP. STAT. 105/2d, 110/2d. For purposes of use tax, a "marketplace facilitator" is a person who, pursuant to an agreement with a marketplace seller, facilitates sales of tangible personal property by that marketplace seller. A person facilitates a sale by, directly or indirectly through one or more affiliates, doing both of the following: (i) listing or otherwise making available for sale the tangible personal property of the marketplace seller through a marketplace owned or operated by the marketplace facilitator; and (ii) processing sales or payments for marketplace sellers. A "marketplace seller" is a person that sells or offers to sell tangible personal property through

not included in determining whether the retailer meets the economic thresholds provided the retailer has received a certification from the marketplace facilitator.[20] Marketplace sellers are responsible for furnishing information that is necessary for marketplace facilitators to correctly collect and remit taxes, such as whether the item is taxable, not taxable, or taxable at a specified rate.[21] The out-of-state sellers and marketplace facilitators collect and remit use tax or service use tax at the rate of 6.25%.[22]

Beginning July 1, 2020, S.B. 690 changes the out-of-state retailer collection and remittance obligation from use tax to state and local retailers' occupation tax (ROT).[23] Specifically, the use tax collection and remittance requirement for out-of-state retailers is limited to October 1, 2018 through June 30, 2020.[24] Beginning July 1, 2020, an ROT collection and remittance requirement for remote retailers[25] exceeding the $100,000 or 200 separate transactions thresholds is enacted.[26] Beginning July 1, 2020, for purposes of determining the correct local ROT rate, ***destination sourcing will be used for remote retailers that meet the economic nexus thresholds***.[27]

Leveling the Playing Field for Illinois Retail Act

S.B. 690 also enacts the Leveling the Playing Field for Illinois Retail Act, designed to assist remote retailers with their state and local tax compliance by providing certified service providers[28] and certified automated systems[29] without charge.[30] The legislation clarifies that ***origin sourcing is retained for all transactions by retailers maintaining a physical presence in Illinois.***[31] By July 1, 2020, the

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a marketplace. A "marketplace" is a physical or electronic place, forum, platform, application or other method by which a marketplace seller sells or offers to sell items.

[20] 35 ILL. COMP. STAT. 105/2, 110/2.

[21] 35 ILL. COMP. STAT. 105/2d(f).

[22] 35 ILL. COMP. STAT. 105/3-10, 110/3-102.

[23] 35 ILL. COMP. STAT. 105/2, 120/2(b).

[24] 35 ILL. COMP. STAT. 105/2. The click-through nexus and affiliate nexus provisions are repealed.

[25] A "remote retailer" is a retailer located outside Illinois that does not maintain within the state, directly or by a subsidiary, an office, distribution house, sales house, warehouse or other place of business, or any agent or other representative operating within Illinois under the authority of the retailer or its subsidiary, irrespective of whether the place of business or agent is located in Illinois permanently or temporarily or whether the retailer or subsidiary is licensed to do business in the state. 35 ILL. COMP. STAT. 120/1.

[26] 35 ILL. COMP. STAT. 120/2.

[27] 35 ILL. COMP. STAT. 120/2-12(6).

[28] A "certified service provider" is an agent certified by the Department to perform the remote retailer's use and occupation tax function, as outlined in the contract between the state and the certified service provider. S.B. 690, § 5-10. The Leveling the Playing Field for Illinois Retail Act will be codified at 35 ILL. COMP. STAT. 185.

[29] A "certified automated system" is a system that is certified by the state as meeting all performance and tax calculation standards required by Department rules. *Id.*

[30] S.B. 690, § 5-5.

[31] *Id.*

Department must provide an electronic database of product categories and local ROT rates.[32] Also, the Department is directed to provide minimum certification standards and enter into contracts with companies that qualify as certified service providers or that will be using a certified automated system.[33] The contract must provide for compensation equal to 1.75% of the tax dollars collected and remitted on behalf of the remote retailers. Beginning Jan. 1, 2020, remote retailers using a certified service provider or automated system will be relieved from liability to the state for having charged and collected the incorrect amount of tax because they were relying on erroneous data provided by the state.[34]

Manufacturing exemption

S.B. 689 amends the sales and use tax statutes to expand the manufacturing machinery and equipment exemption to include production-related tangible personal property purchased on or after July 1, 2019.[35] This is now a full sales tax exemption that replaces the former manufacturers' purchase credit (MPC).

Trade-In credit

Under present law, the entire value of traded-in tangible personal property may be subtracted from the taxable "selling price" of the property.[36] Beginning Jan. 1, 2020, S.B. 690 limits the value of a traded-in car or light truck that may be subtracted from the taxable selling price to $10,000.

Credits and incentives

Construction jobs credits

Effective January 1, 2021, S.B 689 enacts the Blue Collar Jobs Act that provides four new credits related to construction: (i) High Impact Business construction jobs credit;[37] (ii) Enterprise Zone construction jobs

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[32] S.B. 690, § 5-20. The Department must: (i) provide and maintain an electronic, downloadable database of defined product categories that identifies the taxability of each category; (ii) provide and maintain an electronic, downloadable database of all local ROT rates; and (iii) provide and maintain an electronic, downloadable database that assigns delivery addresses in the state to applicable taxing jurisdictions.

[33] S.B. 690, § 5-25.

[34] S.B. 690, § 5-30.

[35] 35 Ill. Comp. Stat. 105/305(18), 105/3-50, 110/2, 115/2, 120/2-45; *Informational Bulletin FY 2019-28*, Illinois Department of Revenue, June 2019. The definition of "production related tangible personal property" is expanded to encompass supplies and consumables used in a manufacturing facility including fuels, coolants, solvents, oils, lubricants, and adhesives, hand tools, protective apparel, and fire and safety equipment used or consumed within a manufacturing facility.

[36] 35 Ill. Comp. Stat. 105/2, 120/1. Note that the item that is traded-in must be of like kind and character as that which is being sold.

[37] 20 Ill. Comp. Stat. 655/5.5(b-7), (i); 35 Ill. Comp. Stat. 5/201(h-5).

credit;[38] (iii) New Construction EDGE credit;[39] and (iv) River Edge construction jobs credit.[40] The credits equal 50% of incremental income tax[41] attributable to eligible jobs (75% if located in underserved areas) and unused credits may be carried forward five years.[42] A $10 million minimum investment is required to receive the Enterprise Zone construction jobs credit or the New Construction EDGE credit.[43] The River Edge construction jobs credit requires a $1 million minimum investment and only is available for tax years ending before January 1, 2022.[44] The credits flow through to the owners of pass-through entities.[45] The total aggregate amount of credits awarded under the Blue Collar Jobs Act may not exceed $20 million in any state fiscal year.[46]

Data center incentives

A new statute enacted by S.B. 690 that is effective immediately provides data center investment incentives.[47] The Department of Commerce and Economic Opportunity (DCEO) is authorized to issue certificates of exemption from use taxes, the service occupation tax, state and local ROTs, and the Chicago non-titled use tax and electricity excise tax to qualifying Illinois data centers.[48] Also, the DCEO may grant credit certificates against the Illinois income tax. To qualify, the data center must make a capital investment of at least $250 million and create at least 20 jobs over a five-year period.[49] The

[38] 20 Ill. Comp. Stat. 655/13; 35 Ill. Comp. Stat. 5/201(f)(8).
[39] 35 Ill. Comp. Stat. 10/5-5, 10/5-51. Economic Development for a Growing Economy is commonly abbreviated as EDGE.
[40] 35 Ill. Comp. Stat. 5/221(a-2); 65 Ill. Comp. Stat. 115/10-10.3.
[41] "Incremental income tax" means the total amount withheld during the tax year from the compensation of the construction job employees.
[42] 20 Ill. Comp. Stat. 655/5.5(i), 655/13(a); 35 Ill. Comp. Stat. 5/201(f)(8), (h-5), 5/221(a-2), 10/5-5; 65 Ill. Comp. Stat. 115/10-10.3(a). For the EDGE credit, the five-year carryforward is provided under existing law. 35 Ill. Comp. Stat. 5/211.
[43] 20 Ill. Comp. Stat. 655/13(a); 35 Ill. Comp. Stat. 10/5-51(a).
[44] 35 Ill. Comp. Stat. 5/221(a-2).
[45] 35 Ill. Comp. Stat. 5/201(f)(8), (h-5), 5/221(a-2). For the EDGE credit, the pass-through treatment is provided under existing law. 35 Ill. Comp. Stat. 10/5-60.
[46] 20 Ill. Comp. Stat. 655/5.5(b-7); 35 Ill. Comp. Stat. 5/201(f)(8), (h-5), 5/221(a-2), 10/5-51(e); 65 Ill. Comp. Stat. 115/10-10.3(g).
[47] 20 Ill. Comp. Stat. 605/605-1025. A "data center" is a facility: (i) whose primary services are the storage, management, and processing of digital data; and (ii) that is used to house (a) computer and network systems, including associated components such as servers, network equipment and appliances, telecommunications, and data storage systems, (b) systems for monitoring and managing infrastructure performance, (c) Internet-related equipment and services, (d) data communications connections, (e) environmental controls, (f) fire protection systems, and (g) security systems and services. 20 Ill. Comp. Stat. 605/605-1025(c).
[48] 20 Ill. Comp. Stat. 605/605-1025(a).
[49] 20 Ill. Comp. Stat. 605/605-1025(c).

duration of the certificate of exemption may not exceed 20 years.[50] The sales and use tax statutes are amended to provide new exemptions for qualified tangible personal property used in the construction or operations of a data center that has been granted an exemption certificate by the DCEO.[51]

S.B. 690 enacts a new statute that provides a data center construction employment income tax credit that is effective immediately.[52] The credit is available to data centers that have been awarded a credit by the DCEO and equals 20% of the wages paid to construction workers who construct a data center in a distressed area. Unused credits may be carried forward five years. Also, the credit flows through to owners of pass-through entities.

Tax amnesty

S.B. 689 enacts two tax amnesty programs that will be held from Oct. 1 through Nov. 15, 2019. The general tax amnesty program covers all taxes collected by the Department and applies to taxes due for any tax period ending after June 30, 2011, and before July 1, 2018.[53] The program waives penalties and interest if the full tax owed is paid. Unlike prior amnesty programs, the Department will not charge double penalties and interest for failing to come forward. The second amnesty program is administered by the Secretary of State and covers franchise tax and license fees imposed under the Business Corporation Act (BCA).[54] The second amnesty program applies to taxes due for any tax period ending after March 15, 2008, and on or before June 30, 2019. The program waives interest and penalties, but the penalties and interest under the BCA are much more significant than the penalties and interest imposed by the Department.

Other taxes

S.B. 690 also creates or increases various other taxes. Beginning Jan. 1, 2020, a parking excise tax is imposed for using a parking space.[55] The tax is imposed at a rate of 6% of the purchase price for a parking space paid on an hourly, daily or weekly basis and 9% of the purchase price paid on a monthly or annual basis. This tax also is imposed on valet services. Beginning July 1, 2019, the cigarette tax is increased from 99 mills ($1.98 per pack) to 149 mills ($2.98 per pack).[56] A tax is imposed on electronic cigarettes by expanding the definition of tobacco products beginning July 1, 2019.[57] The tax rate is 15% of the wholesale price.[58]

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[50] 20 Ill. Comp. Stat. 605/605-1025(d). The DCEO may not issue any new certificates after July 1, 2029, but this not affect any existing certificates. 20 Ill. Comp. Stat. 605/605-1025(i).
[51] 35 Ill. Comp. Stat. 105/3-5(40), 110/3-5(31), 115/3-5(32), 120/2-5(44).
[52] 35 Ill. Comp. Stat. 5/229.
[53] 35 Ill. Comp. Stat. 745/10.
[54] 805 Ill. Comp. Stat. 8/5-10.
[55] S.B. 690, Art. 10. The Parking Excise Tax Act will be codified at 35 Ill. Comp. Stat. 525.
[56] 35 Ill. Comp. Stat. 130/2(a), 135/2.
[57] 35 Ill. Comp. Stat. 143/10-5.
[58] 35 Ill. Comp. Stat. 143/10-10(a).

S.B. 1939, enacted on June 28, 2019, increases various taxes related to transportation funding.[59] Beginning July 1, 2019, the motor fuel tax is increased from 19 cents to 38 cents per gallon and will be adjusted for inflation.[60] The additional tax on diesel is raised from 2.5 cents to 7.5 cents per gallon.[61] Beginning with the 2021 registration year, the passenger car registration fee is raised from $98 to $148.[62]

Commentary

Illinois has been facing a fiscal crisis with large state budget deficits and unpaid bills. In February 2019, Illinois Gov. J.B. Pritzker released a comprehensive budget plan to address the fiscal situation. His budget plan included a proposed graduated personal income tax and an increase in tax revenue by enacting new taxes and increasing certain existing taxes. During the first weekend of June 2019, the Illinois General Assembly passed a very large amount of legislation during a short period of time to implement the governor's plan and make sweeping changes. One of the key components for increasing state revenue is the proposed adoption of a graduated personal income tax rate structure. Because this requires approval by Illinois voters, the question of whether Illinois will impose a graduated personal income tax will not be answered until the November 2020 election. The future of a graduated income tax may not be certain, but the gradual repeal of the unpopular franchise tax will be appreciated by many businesses.

S.B. 689 and S.B. 690 both made major changes to the sales and use tax collection and remittance requirements for remote retailers. Some of the changes made by S.B. 690 seem to be inconsistent with some of the provisions in S.B. 689. As discussed above, S.B. 689 imposes use tax collection and remittance requirements on marketplace facilitators. The legislation requires remote retailers to inform the marketplace facilitator if the items sold are exempt from tax or should be taxed at a reduced rate. A marketplace seller will be held harmless for liability for tax if the marketplace facilitator fails to correctly collect and remit tax after having been provided with this information. However, it is not clear whether the marketplace facilitator is liable if the information provided is incorrect. S.B. 690 changes the existing use tax obligation for out-of-state retailers to a state and local ROT obligation for newly defined "remote retailers." The new ROT economic nexus thresholds expressly apply to remote retailers but do not address marketplace facilitators. There appears to be a disparity between the treatment of marketplace facilitators and remote retailers, but an argument could be made that the broad new definition of "remote retailer" could include a marketplace facilitator. However, this would contradict the application of the 6.25% use tax on marketplace facilitators in S.B. 689. Also, destination-based sourcing will apply to remote retailers but origin-based sourcing applies

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[59] P.A. 101-0032 (S.B. 1939), Laws 2019.
[60] 35 Ill. Comp. Stat. 505/2(a).
[61] 35 Ill. Comp. Stat. 505/2(b).
[62] 625 Ill. Comp. Stat. 5/3-806.

to Illinois retailers. The disparate treatment of remote retailers and in-state retailers may raise constitutional concerns. Some of these issues may be addressed by future legislation.

The expansion of the manufacturing and machinery sales tax exemption to include production related tangible personal property should be welcome by many taxpayers. This exemption includes items that were previously eligible for the MPC. Fortunately, this change eliminates the burdensome compliance associated with documenting and utilizing the former credit.

As discussed above, the legislation limits the existing unlimited sales tax trade-in credit provision to periods prior to 2020. However, the new provision beginning January 1, 2020 that limits the trade-in credit to $10,000 only applies to certain motor vehicles. As a result, it appears that the trade-in credit for items other than motor vehicles has been eliminated.

The legislation includes significant credit and incentive provisions designed to attract business and investment to Illinois. Notably, Illinois joins the approximately 30 other states that provide incentives to data centers. Businesses should evaluate and consider the expansive new credits and incentives. Also, taxpayers should consider participation in the new tax amnesty programs. This is the first time that Illinois has offered tax amnesty since 2010.

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such changes. All references to "Section," "Sec.," or "§" refer to the Internal Revenue Code of 1986, as amended.