

Nexus issues are not generally suitable for resolution by letter ruling. (This is a GIL.)

August 15, 2025

NAME
COMPANY
ADDRESS
EMAIL

Re: Illinois Income Tax – Nexus

Dear NAME:

This letter is in response to your email dated July 28, 2025, in which you requested information regarding income tax nexus under Illinois law for the licensing of proprietary software and providing equipment to an Illinois-based customer. The Department issues two types of letter rulings. Private Letter Rulings (“PLRs”) are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department’s regulations at 2 Ill. Admin. Code 1200.110. The purpose of a General Information Letter (“GIL”) is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Admin. Code 1200.120(b) and (c). You may access our website at <https://tax.illinois.gov/> to review regulations, letter rulings, and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

We are writing to request a formal opinion from the Illinois Department of Revenue regarding the income tax treatment of the following scenario:

My client is a STATE-based company with no physical presence in Illinois—no offices, property, or employees are located in the state. My client has entered into a contract with an Illinois-based customer to license proprietary software. As part of the agreement, my client also provides certain equipment to the customer. Importantly, my client retains ownership of both the software and the equipment, and both are returned at the conclusion of the contract.

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All services, including training and support, are performed remotely from STATE. No employees or agents of my client perform work within the state of Illinois.

The software being licensed is highly specialized and tailored to the specific needs of the Illinois customer. It is not off-the-shelf software and could not be repurposed or resold to another client.

We seek clarification on whether the revenue generated under this contract would be considered Illinois-source income for corporate income tax purposes.

We appreciate your guidance on this matter.

DEPARTMENT'S RESPONSE

The determination as to whether a taxpayer has nexus with Illinois is extremely fact specific. Therefore, the Department does not issue rulings regarding whether a taxpayer has nexus with the State. Such a determination can only be made in the context of an audit where a Department auditor has access to all relevant facts and information. For information regarding nexus, see 86 Ill. Admin. Code 100.9720 (accessible from the Department's website). In addition, the following general information regarding income tax nexus with the State may be provided.

The United States Constitution limits the power of states to subject foreign corporations and other nonresidents to income tax. The Due Process Clause requires that there exists some minimum connection between a state and the person, property, or transaction the state seeks to tax. (*Quill Corp. v. N. Dakota*, 504 U.S. 298 (1992)) Similarly, the Commerce Clause requires that a state's tax be applied only to activities with a substantial nexus to the taxing state. (*Id.*) In addition, in the case of foreign corporations, Illinois may not assert jurisdiction to tax where a corporation falls under the protection provided by Public Law 86-272 (15 U.S.C. § 381). Public Law 86-272 precludes any state from subjecting a nondomiciliary corporation to a net income tax where such corporation's only activities within the state for the taxable year consist of solicitation activities for sales of tangible personal property.

A nonresident is liable for Illinois income tax under Section 201 of the Illinois Income Tax Act ("IITA"; 35 ILCS 5/101 et seq.) if it computes "net income" defined under IITA Section 202 as that portion of the taxpayer's "base income" which is allocated or apportioned to Illinois under the provisions of Article 3 of the IITA, less certain deductions. Under IITA Section 203, base income is generally determined by starting with the taxpayer's federal taxable income (adjusted gross income in the case of an individual) and adjusting that

amount by certain statutorily prescribed addition and subtraction modifications. Base income must then be classified as between nonbusiness income and business income, and allocated or apportioned to Illinois, respectively, according to the rules set forth in Article 3 of the IITA.

IITA Section 304 contains apportionment rules that determine the amount of business income of a nonresident that is taxable in Illinois where the income is derived from Illinois and one or more other states. Under IITA Sections 304(a) and (h), the general apportionment rule requires a taxpayer to multiply its business income for the taxable year by its sales factor. IITA Section 304(a)(3)(A) defines the “sales factor” as the fraction consisting of the taxpayer’s total sales in Illinois during the taxable year over its total sales everywhere during the taxable year. IITA Section 1501(a)(21) defines the term “sales” to mean all gross receipts of the taxpayer that are part of the taxpayer’s business income.

IITA Section 304(a)(3) provides various rules for determining whether sales are sourced to Illinois for sales factor purposes. IITA Section 304(a)(3)(B-1) provides that the gross receipts from the licensing, sale, or other disposition of a patent, copyright, trademark or similar item of intangible personal property are sourced to Illinois to the extent the item is utilized in this State during the year the gross receipts are included in gross income. IITA Section 304(a)(3)(C-5)(ii) provides that sales from the lease or rental of tangible personal property are sourced to Illinois if the property is located in Illinois during the rental period. IITA Section 304(a)(3)(C-5)(iii) provides that income from intangible personal property (other than patents, copyrights, trademarks, and similar items) is sourced to Illinois where, (i) if the taxpayer is a dealer with respect to the item of intangible personal property, the income is received from a customer in Illinois, or (ii) if the taxpayer is not a dealer, the income producing activity of the taxpayer is performed in Illinois, or if the income-producing activity of the taxpayer is performed both within and without Illinois, if a greater proportion of the income-producing activity of the taxpayer is performed within Illinois than in any other state, based on performance costs. IITA Section 304(a)(3)(C-5)(iv) provides that sales of services are sourced to Illinois if the services are received in Illinois:

Sales of services are in this State if the services are received in this State. For the purposes of this section, gross receipts from the performance of services provided to a corporation, partnership, or trust may only be attributed to a state where that corporation, partnership, or trust has a fixed place of business. If the state where the services are received is not readily determinable or is a state where the corporation, partnership, or trust receiving the service does not have a fixed place of business, the services shall be deemed to be received at the office of the customer from which the services were ordered in the regular course of the customer’s trade or business. If the ordering office cannot be determined, the services shall be deemed to be received at the office of the customer to which the services are

billed. If the taxpayer is not taxable in the state in which the services are received, the sale must be excluded from both the numerator and denominator of the sales factor. The Department shall adopt rules prescribing where specific types of service are received, including, but not limited to publishing, and utility service.

86 Ill. Admin. Code 100.3370 provides rules for determining “sales” in various situations, except for when an alternative method of determining the sales factor is prescribed in Section 100.3380. Section 100.3370(c)(8)(C)(ii) defines “intangible personal property” for purposes of that subsection (in the case of interest, net gains (but not less than zero) and other items of income from intangible personal property) as only an item that can ordinarily be resold or otherwise reconveyed by the person acquiring the item from the taxpayer, and does not include any obligation of the taxpayer to make any payment, perform any act, or otherwise provide anything of value to another person. Example 2 in that subsection illustrates the definition:

EXAMPLE 2: A taxpayer selling canned computer software is selling intangible personal property. (First National Bank of Springfield v. Dept. of Revenue, 85 Ill.2d 84 (1981)) If the taxpayer sells software to customers in the ordinary course of its business, it is a dealer with respect to those sales. In contrast, a taxpayer providing programming or maintenance services to its customers is selling services rather than intangible personal property.

Section 100.3370(c)(8)(D) provides further guidance on whether the activities of your client would be characterized as a sale of service or a lease of property:

D. Sales of services are in this State if the services are received in this State.
(IITA Section 304(a)(3)(C-5)(iv))

- i. General Rule. Gross receipts from services are assigned to the numerator of the sales factor to the extent that the receipts may be attributed to services received in Illinois.
- ii. A contract that involves the provision of a service by the taxpayer and the use of property of the taxpayer by the service recipient shall be treated as a sale of service unless the contract is properly treated as a lease of property under IRC section 7701(e)(1), taking into account all relevant factors, including whether:
 - the service recipient is in physical possession of the property;
 - the service recipient controls the property;

- the service recipient has a significant economic or possessory interest in the property;
- the service provider does not bear any risk of substantially diminished receipts or substantially increased expenditures if there is nonperformance under the contract;
- the service provider does not use the property concurrently to provide significant services to entities unrelated to the service recipient; and
- the total contract price does not substantially exceed the rental value of the property for the contract period.

EXAMPLE: A taxpayer selling access to an online database or applications software, and who is required to perform regular update services to the database or software, retains control over the contents of the database or software, and provides access to the same database or software to multiple customers is not selling or licensing an item of intangible personal property to its customers, but rather is providing a service.

As stated above, this is a General Information Letter. A General Information Letter does not constitute a statement of Department policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you require additional information, please visit the Department's website at <https://tax.illinois.gov/> or contact the Department's Taxpayer Assistance Division at 800-732-8866.

Sincerely,

Jennifer Uhles
Associate Counsel (Income Tax)

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