

IT 26-0009-GIL 08/05/2026 COMPENSATION PAID IN ILLINOIS

Disability payments will be considered compensation paid in Illinois if subject to the presumption that they were earned ratably over the employee's last 5 years of service with the employer. (This is a GIL).

August 5, 2026

NAME
COMPANY
ADDRESS
EMAIL

Re: Form W-2 Reporting of Disability Income

Dear NAME:

This letter is in response to your letter dated October 18, 2024, in which you requested information. 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. Adm. 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. Adm. Code 1200.120. 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.

INQUIRY:

Dear Sir:

I was contacted by an individual ("Taxpayer"), a STATE resident, who asked whether disability payments to him by a third-party insurance company ("Insurance Company"), which is also not located in Illinois are required to be reported on Form W-2 to the Illinois Department of Revenue.

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I asked the Illinois Department of Revenue whether such payments are required to be reported to that department. The Revenue Tax Specialist, in his or her response to the inquiry, said he or she was unable to find an answer to this question and suggested it be referred to your office. This letter, based on the Tax Specialist's recommendation, it [sic] being sent to your office for that reason.

My reading of the Illinois revenue statutes is that there should be no Form W-2 reporting to the Illinois Department of Revenue of these payments. The factual background and the statutory basis for this conclusion are as follows:

1. The Taxpayer was injured in 2007 while working in Illinois for an Illinois employer. He was found to be permanently disabled because of the injury.
2. In 2011, the Taxpayer became a resident of STATE and has continued to reside in that state.
3. In 2008, the Taxpayer started receiving disability benefits under the employer's long-term disability plan and has continued to be paid these benefits. The disability benefits are paid by the Insurance Company which issued a disability policy funding the employer's long-term disability plan. When the Taxpayer moved to STATE in 2011, he made an election with the Insurance Company to withhold STATE income tax on his disability benefits. This withholding has continued to date and the Taxpayer has filed STATE income tax returns since 2011 to date.
4. To date, the Insurance Company paying the benefits has not reported the payments on Form W-2 to the Illinois Department of Revenue.
5. The Insurance Company recently informed the Taxpayer that, starting for 2024, it is going to report the disability benefits on Form W-2 to the Illinois Department of Revenue.
6. The Taxpayer has not tried to contact his former employer regarding this matter. Instead, he has communicated with the Insurance Company, the third-party payer of his disability benefits. Our understanding is that the former employer is no longer involved with this matter and it is now the responsibility of the Insurance Company.

For the following reasons, the disability benefits are not Illinois base income and should not be reported to the Illinois Department of Revenue on Form W-2:

1. Under 35 ILCS Sec. 5/1501(a)(3), the disability benefits constitute "compensation".

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2. Under 35 ILCS Sec. 5/302, all compensation paid in Illinois is allocated to that state. Whether “compensation paid in this “state” is determined under 35 ILCS Sec. 5/304(a)(2)(B).
3. Section 35 ILCS Sec. 5/302(a)(2)(B) provides the amount of compensation paid in the state is the portion of the individual’s total compensation for services performed on behalf of his employer during the tax year in which the number of working days spent in Illinois during the tax year bears to the total number of working days spent working both within and without Illinois during the tax year. Under 35 ILCS Sec. 5/304(a)(2)(B)(iii)(a), a working day is a day in which the individual performs duties on behalf of his employer.

Copies of the statutes cited above are attached to this message.

Because the Taxpayer will have no working days either within or without Illinois as described in Section 35 ILCS Sec. 304(a)(2)(B)(iii)(a) in 2024, none of the disability benefits, under the ratio described above, constitute compensation paid in Illinois and should not be reported to Illinois on Form W-2 for 2024.

If the income is reported to Illinois, the income tax impact on the individual will be minimal because any Illinois income taxes attributable to the disability benefits would be a credit against his STATE income tax liability. Also, the benefits may have been paid pursuant to a government plan in which case they would also not be taxed to Illinois. The problem is that the Taxpayer is totally disabled, cannot work and has minimal income. If the income is reported to Illinois, he will have to engage an income tax professional to prepare an Illinois income tax return for him. The Taxpayer cannot afford the expense of having an Illinois income tax return prepared for him.

We will explain to the Insurance company, for the reasons described above, why it should not report the disability benefits to Illinois. Before doing that, however, I would like to know whether you agree with my conclusions regarding this matter as described above.

Please contact me with any questions or comments you have regarding this matter.

Thank you for your consideration.

DEPARTMENT’S RESPONSE:

Illinois personal income tax is imposed on a person's net income, which is their federal adjusted gross income that is allocated to Illinois in accordance with the provisions of Illinois law. If the taxpayer is not an Illinois resident, the income item must be allocated to Illinois to be subject to Illinois taxation. If a payment is considered compensation for federal purposes, that payment will be considered compensation for Illinois purposes. If the payment is subject to withholding as reported on a W-2, reported as wages on a W-2, it is treated as wages. Allocation of compensation for nonresidents is discussed in 86 Ill. Admin. Code 100.3120.

"Compensation" is defined in the IITA 35 ILCS 5/1501(a)(3) as "...wages, salaries commissions and any other form of remuneration paid to employees for personal services." 86 Ill. Admin. Code Section 100.3100 elaborates:

a) General Definition

Compensation is defined in IITA Section 1501(a)(3) to mean wages, salaries, commissions and any other form of remuneration paid to employees for person services. The term is thus comparable to the term 'wages' as used in IRC Section 3401(a), except that the exceptions set forth in the Code section are inapplicable for purposes of Article 3 of the Act. (See Section 100.7000 for definition of compensation subject to withholding.)

35 ILCS 5/302(a) adds, "[a]ll items of compensation paid in this State (as determined under section 304(a)(2)(B)) to an individual who is a nonresident at the time of such payment and all items of deduction directly allocatable thereto, shall be allocated to this State."

Section 701 of the Illinois Income Tax Act (IITA) requires tax to be withheld upon payment of compensation in Illinois. 86 Ill. Adm. Code 100.3120(a) provides as follows:

In order for items of compensation paid to an individual who is a nonresident of Illinois at the time of payment to be allocated in Illinois, the compensation must constitute 'compensation paid in this State.' If the test is met, then all items of the compensation, and all items of deduction directly allocable thereto, are allocated to Illinois under IITA Section 302(a) (except items allocated under IITA Section 301(c)(2), as to which see subsection (d)). Compensation paid to a nonresident, which is allocated to Illinois enters into the computation of the individual's net income under IITA Section 202 and is generally subject to withholding under IITA Section 701 (see Section 100.7000, 100.7010 and 100.7020). The test for determining whether compensation is paid in Illinois appears in IITA Section 304(a)(2)(B)....

The next question is whether or not the money was “paid in Illinois.” 86 Ill. Admin. Code 100.3120(c) goes on to state:

...For the purpose of determining whether and to what extent compensation paid for past service is ‘paid in’ Illinois and is allocated to Illinois under IITA Section 302(a), that compensation is presumed to have been earned ratably over the employee’s last 5 years of service with the employer (or any predecessor or successor of the employer or a parent or subsidiary corporation of the employer), in the absence of clear and convincing evidence that the compensation is properly attributable to a different period of employment or that it was not earned ratably over the appropriate period of employment. Compensation earned in each past year will be deemed compensation paid in Illinois if the individual’s service in that year met the tests set forth in subsection (a) applicable to that year. Compensation paid for past service includes amounts paid under deferred compensation agreements where the amount of compensation is unrelated to the amount of service being currently rendered....

If the money is “compensation,” and if it is paid in Illinois, then the five-year lookback comes into play. Where compensation is paid to a nonresident for past service, such compensation will, for the purpose of determining whether and to what extent such compensation is “paid in” Illinois and is allocated to Illinois under IITA Section 302(a), be presumed to have been earned ratably over the employee’s last 5 years of service with the employer (or any predecessor or successor of the employer or a parent or subsidiary corporation of the employer), in the absence of clear and convincing evidence that such compensation is properly attributable to a different period of employment or that it was not earned ratably over the appropriate period of employment. Compensation earned in each past year will be deemed compensation paid in Illinois if the individual’s service in such year met the tests set forth in subsection (a) above.

In the current situation, the taxpayer was formerly employed in Illinois. He suffered an injury and became disabled, ultimately receiving disability payments from his employer. He at some point left the state and moved to STATE. The disability insurance that he was able to claim against was attached to his employment, and his subsequent receipt of those disability benefits were based upon his employment and arose out of that employment relationship. It is not required that he be currently an Illinois resident, and it is not required that he currently perform services for his employer for these payments to be considered “wages.” The payments are therefore allocable to Illinois under Section 304(a)(2)(B), and is subject to Illinois income tax regardless of current residence at time of payment.

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Under the facts presented, the employee was injured in 2007 and began receiving disability payments in 2008. The employee moved to STATE in 2011. He has not worked in Illinois since 2007, and has had STATE tax removed from the disability payments since 2011. The insurance company has been reporting the payments on W-2s since 2024. If taxes are paid in Illinois there could be an offset for any taxes due in STATE for those payments. In this case, it is reasonable to withhold Illinois tax from disability payments that arose from employment in Illinois and are “compensation” for both federal and state purposes.

I hope this information is helpful. If you require additional information, please visit our website at <https://tax.illinois.gov/> or contact the Department’s Taxpayer Information Division at 800-732-8866.

Very truly yours,

Javonna Ackerman
Associate Counsel

JA:sc