

# Tax Bulletin

September 2007

## New Law: Illinois Requires Partnerships, S corporations and Trusts to Withhold Income Tax on Nonresidents That Are Not Included on a Composite Income Tax Return

Beginning with the 2008 tax year, a provision of SB 1544 (Public Act 095-0233), approved by Governor Blagojevich on August 16, 2007, requires partnerships (including limited liability companies that are treated as partnerships for federal income tax purposes), S corporations and trusts (“Pass-Thru Entities”) to withhold Illinois income tax with respect to each nonresident partner, shareholder or beneficiary, unless such partner, shareholder or beneficiary was included on a composite income tax return filed by the partnership or S corporation (trusts are excluded from filing composite returns for their beneficiaries).

The amount of Illinois income tax withheld is equal to the rates imposed under subsections (a) through (d) of section 201 of the Illinois Income Tax Act (“IITA”), multiplied by the nonresident’s distributable share (whether or not distributed) of the business income of the Pass-Thru Entity that is apportionable to Illinois. Nonbusiness income of the Pass-Thru Entity is allocated as if paid directly to the nonresident partner, shareholder or beneficiary in his or her separate capacity pursuant to the rules set forth in IITA sections 303 and 305(b) and is, therefore, not subject to the withholding tax.

Based on the current tax rates imposed under IITA section 201(a) through (d), the new withholding tax will be imposed at a 3 percent rate for nonresident individuals and estates; a 7.3 percent rate for nonresident corporations (4.8 percent income tax and 2.5 percent personal property tax replacement income tax (“replacement tax”)); a 4.5 percent rate for trusts (3 percent income tax and 1.5 percent replacement tax); and at the rate of 1.5 percent for partnerships and S corporations. There are currently no exemptions from withholding for nonresident partners, shareholders or beneficiaries, including any partners, shareholders or beneficiaries that are themselves Pass-Thru Entities.

The Pass-Thru Entity must report and pay over to the Illinois Department of Revenue (“Department”) the amounts withheld for each nonresident partner, shareholder or beneficiary no later than the due date (without extensions) of the income tax return of the Pass-Thru Entity for the taxable year. Any amounts withheld can be claimed as an estimated tax payment by the nonresident partner, shareholder or beneficiary and shall be deemed a payment of Illinois estimated tax on the last day of the taxable year for which the income from the withholding is computed. The Pass-Thru Entity must provide each nonresident partner, shareholder or beneficiary with a statement of the amounts withheld on or before January 31 of the succeeding calendar year.

A Pass-Thru Entity is liable for the income taxes it withholds or is required to withhold for its nonresident partners, shareholders or beneficiaries, including any penalties or interest that may be imposed or due thereon. Even if the nonresident partner, shareholder or beneficiary files an Illinois income tax return and pays his or her Illinois income tax liability, the Pass-Thru Entity may still be liable for any penalties or interest that may be due if the Pass-Thru Entity did not withhold or timely remit the required withholding tax to the Department.

If you have any questions about this new law, please contact one of the attorneys in the Vedder Price Tax Group.

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Due to the complexity and constantly changing nature of the federal, state and local tax laws, the tax aspects of almost every type of business and personal transaction require scrutiny by a tax attorney. At Vedder, Price, Kaufman & Kammholz, P.C., this experience is provided by the members of the tax group, each of whom has had substantial formal tax education, including in some cases advanced degrees in taxation, as well as practical experience in resolving tax problems.

In addition to advising the firm's business clients with respect to the tax issues involved in the everyday operation of a corporation, limited liability company, partnership or sole proprietorship, Vedder Price's tax attorneys plan for and provide advice on the tax aspects of taxable and nontaxable acquisitions of business entities, mergers, recapitalizations, the organization and liquidation of entities, taxable and nontaxable sales and exchanges of assets, foreign operations, redemptions, distributions, and the public and private offering of securities.

Besides representing corporations, limited liability companies, partnerships and sole proprietorships, members of Vedder Price's tax group have substantial experience with respect to a wide variety of other entities, including S corporations, professional service corporations, regulated investment companies, real estate investment trusts and unit investment trusts, and provide advice regarding the desirability of using these entities and the special tax issues encountered by each of them.

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