



# Publication 129

December 2006

## *Pass-through Entity Income*

The information in this publication is current as of the date of the publication. Please visit our web site at [tax.illinois.gov](http://tax.illinois.gov) to verify you have the most current revision.

This publication is written in the plain English style so the tax information is easier to understand. As a result, we do not directly quote Illinois statutes or the Illinois Administrative Code. The contents of this publication are informational only and do not take the place of statutes, rules, and court decisions. For many topics covered in this publication, we have provided a reference to the applicable section or part of the Illinois Administrative Code for further clarification or more detail. All of the sections and parts referenced can be found in Title 86 of the Code.

### ***About this publication***

Publication 129, Pass-through Entity Income, is provided to explain the many tax obligations involved in dealing with distributions from partnerships and subchapter S corporations to partners and shareholders. This publication specifically provides assistance to the partnerships and S corporations that distribute the income, as well as, the tax professionals who assist taxpayers in completing their tax returns, and the partners and shareholders who receive distributions.

Publication 129 is divided into three main sections — *Information for Partnerships and Subchapter S Corporations*, *Information for Tax Professionals*, and *Information for Partners and Shareholders*. A final section deals with the special nonfiler program started by the department to identify taxpayers who are not filing tax returns or paying the appropriate tax on income received from partnerships and S corporations.

If you need more technical or statutory information, please visit our web site at [tax.illinois.gov](http://tax.illinois.gov) and review the Illinois Administrative Code, Title 86, Part 100, Income Tax.

### ***Taxpayer Bill of Rights***

You have the right to call the Department of Revenue for help in resolving tax problems.

You have the right to privacy and confidentiality under most tax laws.

You have the right to respond, within specified time periods, to department notices by asking questions, paying the amount due, or providing proof to refute the department's findings.

You have the right to appeal department decisions, in many instances, within specified time periods, by asking for department review or by taking the issue to court.

If you have overpaid your taxes, you have the right, within specified time periods, to a credit (or, in some cases, a refund) of that overpayment.

For more information about these rights and other department procedures, you may write us at the following address:

Problems Resolution Office  
Illinois Department of Revenue  
PO Box 19014  
Springfield, IL 62794-9014

**Get forms and other information faster and easier at [tax.illinois.gov](http://tax.illinois.gov)**

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## General Information

This section defines terms and explains Illinois filing obligations

### **What is a “pass-through entity?”**

A pass-through entity is any entity treated as a partnership or subchapter S corporation for federal income tax purposes.

### **What is “pass-through entity income?”**

Pass-through entity income is the income that any partnership or subchapter S corporation passes through to its partners or shareholders.

### **What is an “investment partnership?”**

A partnership is classified as an investment partnership if at least 90 percent of its assets are investments in stocks, bonds, options, and similar intangible assets, and at least 90 percent of its income is derived from that kind of assets. For tax years ending on or after December 31, 2004, an investment partnership is not subject to replacement tax, and a nonresident partner is not subject to Illinois tax on the income passed through from the investment partnership, unless the partner's investment in the partnership was made in connection with a business the partner is conducting at least partially within Illinois. For prior years, an investment partnership and its partners are subject to the same rules as other partnerships and partners. See IITA Section 100.1501(a)(11.5) for more information.

### **What is Schedule K-1-P?**

Similar to the federal Schedule K-1, the purpose of Schedule K-1-P, Partner's or Shareholder's Share of Income, Deductions, Credits, and Recapture, is for partnerships and S corporations to supply each individual or entity who was a partner or shareholder at any time during the tax year with the information needed by the individual or entity to properly report the pass-through income on its Illinois Income Tax return.

### **What is the Personal Property Tax Replacement Income Tax (replacement tax)?**

Replacement taxes are revenues received from businesses and public utilities, collected by the state of Illinois and paid to local governments.

Prior to 1979, business entities were required to pay personal property taxes. Legislation then abolished the personal property taxes. To replace the money lost by units of local government and school districts, a new law was enacted that established replacement taxes, a flat rate that is assessed based on the income of the business.

All business entities, including corporations, subchapter S corporations, partnerships, and estates pay replacement tax on their annual tax return. Replacement taxes are different from the standard Illinois Income Tax, which is paid only by individuals, trusts, estates, and corporations (not including subchapter S corporations).

## Information for partnerships and subchapter S corporations

### **What are my filing obligations in Illinois, as a partnership or subchapter S corporation?**

Partnerships or subchapter S corporations that have income that is taxable in Illinois must file an annual tax return with the Illinois Department of Revenue. Partnerships and subchapter S corporations do not pay Illinois Income Tax, but are subject to the Replacement Tax at a rate of 1.5 percent on income taxable to Illinois.

### **What forms must I file?**

Partnerships file Form IL-1065, Partnership Replacement Tax Return, and subchapter S corporations file Form IL-1120-ST, Small Business Corporation Replacement Tax Return. Partnerships and subchapter S corporations must file any required Illinois schedules.

### **What if I am an “investment partnership?”**

For tax years ending before December 31, 2004, an investment partnership and its partners are treated the same as all other partnerships and their partners. For tax years ending on or after December 31, 2004, investment partnerships are not subject to replacement tax and are not required to file Illinois returns or to issue Schedules K-1-P to their partners. Also, a nonresident partner is not subject to Illinois tax on the income it receives from you unless the investment in the investment partnership was made in connection with a business that the partner is conducting within Illinois. In that case, the partner would include the income from you with the other income of the business as if it had received the income directly, rather than through you.

### **What is Schedule B?**

Schedule B, Partners' or Shareholders' Identification, is the required schedule for listing the entity's partners' and shareholders' information. If you pass any income to a partner or shareholder, you must provide the Illinois Department of Revenue with all of the required information on a department-approved form. Schedule B is included with Form IL-1065 and Form IL-1120-ST, but can also be obtained as a stand-alone form from our web site.

### **What do I do with Schedule K-1-P?**

For Illinois Income Tax purposes, you **must** give a completed Schedule K-1-P **and** a copy of the Schedule K-1-P(2), Partner's and Shareholder's Instructions, to each partner or shareholder. This must be done by the due date, including any extended due date, of your Form IL-1065 or Form IL-1120-ST.

### **Should I attach copies of all the Schedule K-1-Ps I issued to partners or shareholders?**

No. Do not attach copies of Schedule K-1-P that you issued to your partners or shareholders. However, you must maintain copies in your files in the event of an audit or review by Illinois Department of Revenue personnel.

**Note** → If you are a partner or shareholder in a partnership or subchapter S corporation, that entity is required to send you a Schedule K-1-P. You must include this pass-through income when completing your Illinois tax return and attach a copy of any Schedule K-1-P that was issued to you.

### **I filed the required tax return for my partnership or S corporation (Form IL-1065 or IL-1120-ST). Doesn't that take care of the tax liability for the partners and shareholders?**

No. The partnership or S corporation only pays replacement tax on the income taxable to Illinois. Additionally, Illinois law provides that you, as the distributing entity, may subtract any amount distributable to a partner or shareholder that is also subject to replacement tax, to avoid double taxation of the income.

Since the partnership or S corporation does not pay Illinois Income Tax on any of the income, and in some cases does not pay replacement tax on the income, the partner or shareholder that receives the pass-through income must report and pay the appropriate tax(es) on the income.

### **Can I file an Illinois tax return on behalf of my partners and shareholders?**

If you have individual partners and shareholders that are nonresidents of Illinois, we encourage you to file Form IL-1023-C, Composite Income and Replacement Tax Return, on their behalf. Generally, Illinois residents may not be included on the composite return, unless you submit a written request to the department and receive approval in advance. For more information regarding the petition process, see Form IL-1023-C Instructions.

### **What is Schedule BC?**

Schedule BC, Composite Return Membership, is the 2nd page of Form IL-1023-C for tax years ending on or after December 31, 2006. You are required to complete this schedule and provide the department with the requested information regarding all of the members you have included in the composite return. You must use the department-approved form. A print out is not acceptable.

### **If I choose to file form IL-1023-C on behalf of my partners and shareholders, do I have any other responsibilities?**

Yes. Illinois law states that estimated payments must be made by the partnership or S corporation acting as an authorized agent on behalf of the partners and shareholders on Form IL-1023-CES, Composite Estimated Tax Payments for Partners and Shareholders. For more information on making quarterly estimated payments see Form IL-1023-CES and instructions. You are also responsible for sending a copy of Form IL-1023-C to each partner or shareholder included on the composite return.

### **How can I best help my partners and shareholders comply with Illinois filing requirements?**

- ◆ File a composite return for your nonresident individual partners or shareholders.
- ◆ Complete an Illinois Schedule K-1-P for each partner or shareholder that is not included in a composite return.
- ◆ Mail the completed Schedule K-1-P in a timely manner. Be sure to include a copy of Schedule K-1-P(2).
- ◆ You may wish to include a letter from the partnership informing them that income shown on Schedule K-1-P indicates that they must file an Illinois Income Tax return.
- ◆ If your partners or shareholders contact you with questions that you cannot answer, refer them to the Illinois Department of Revenue or their tax professional. All tax forms are available on our web site at [tax.illinois.gov](http://tax.illinois.gov).

## Information for Tax Professionals

### ***I have clients that live in a reciprocal state. Do they need to file an Illinois tax return?***

If your clients live in a state with whom Illinois has a reciprocal agreement (Wisconsin, Iowa, Michigan, and Kentucky), and they receive pass-through income from a partnership or subchapter S corporation, your clients still have an Illinois Income Tax obligation and must file an Illinois income tax return showing the pass-through income as taxable to Illinois. The reciprocal agreement between Illinois and other states is only applicable to employment wages.

### ***What if my clients have not filed a tax return?***

If your clients have not filed an Illinois Income Tax return and should have, you should encourage your clients to file the necessary tax return and schedules as soon as possible. If any tax is owed to Illinois, penalty and interest may be assessed.

There is no statute of limitations for us to assess tax on someone who has not filed a return. However, if a nonfiler participates in our voluntary disclosure program, we will only collect taxes for the last four years. See Form BOA-2, Application for Voluntary Disclosure, for more information.

### ***How can I best help my clients comply with Illinois filing requirements?***

- ◆ Explain to your client that any Illinois-sourced income is taxable in Illinois.
- ◆ If your client receives one or more Schedules K-1-P, they have an Illinois filing requirement. Help them obtain and complete the appropriate tax forms.
- ◆ If your client received a Schedule K-1-P, but did not receive the instructions to help them complete an Illinois tax return, refer your client to the department's web site. Copies of all forms and instructions can be obtained from [tax.illinois.gov](http://tax.illinois.gov). You or your client may also call our Forms Order Line at 1 800 356-6302 to have forms mailed via the U.S. Postal Service.
- ◆ If your client receives a Nonfiler Notice or a Notice of Proposed Tax Due from the Illinois Department of Revenue, encourage your client to respond within the timeframe provided on the notice. If the client is present or has given you a Power of Attorney for tax purposes, you may respond to the department on their behalf.
- ◆ If your client claims to not have received a Schedule K-1-P from the partnership or S corporation, help them to contact the entity directly.

### ***What forms does my client need?***

If your client is a(n)	your client should file Form
Individual (married or single)	IL-1040, Individual Income Tax Return.  Illinois nonresidents must also file Schedule NR, Nonresident and Part-Year Resident Computation of Illinois Tax.
Trust or Estate	IL-1041, Fiduciary Income and Replacement Tax Return.  Illinois nonresidents must also file IL-1041 Schedule NR, Nonresident Computation of Fiduciary Income.
Corporation	IL-1120, Corporation Income and Replacement Tax Return.  Unitary Groups must also file Schedule UB, Combined Apportionment for Unitary Business Group.
Subchapter S corporation	IL-1120-ST, Small Business Corporation Replacement Tax Return, including Schedule B and Form IL-2569, Personal Property Replacement Tax (Partners' or Shareholders' annual certification).
Partnership	IL-1065, Partnership Replacement Tax Return, including Schedule B and Form IL-2569, Personal Property Replacement Tax (Partners' or Shareholders' annual certification).
Additional schedules and information may be required. For more information, see the instructions for the specific tax form you are filing.	

## Information for Partners and Shareholders

### ***I am a nonresident of Illinois and received income from an Illinois partnership or S corporation. Do I need to file an Illinois tax return?***

Yes. Any Illinois-sourced income that you receive is taxable by the state of Illinois. If you complete your tax return correctly, you should only be taxed on the Illinois-sourced income. You may be able to take a credit for taxes paid to Illinois on your home state's tax return.

### ***I live in a reciprocal state. Do I still have to file an Illinois tax return?***

Yes. If you live in a state with whom Illinois has a reciprocal agreement (Wisconsin, Iowa, Michigan, and Kentucky), and you receive pass-through income from a partnership or subchapter S corporation, you have an Illinois Income Tax obligation and must file an Illinois income tax return showing the pass-through income as taxable to Illinois. The reciprocal agreements between Illinois and other states are only applicable to employee wages.

### ***The partnership or S corporation said they filed their annual tax return. Doesn't this take care of my filing obligation?***

No. Partnerships and S corporations pay only replacement tax on Illinois-sourced income. (See Page 3, General Information, for more information on replacement taxes.) The income distributable to you is also taxable by Illinois for income tax purposes. Therefore, you must file a tax return and pay any income tax due on the income distributed to you.

**Note** → Business entities that receive income from a pass-through entity are also responsible for paying replacement tax on the income because partnerships and S corporations are allowed a deduction equal to the amount distributed to other entities that are also subject to replacement tax.

### ***How do I know how much income I received from partnerships and S corporations?***

Each partnership and S corporation that distributes income to you is also responsible for letting you know how much income you must claim on your tax return. For Illinois purposes, the partnership or S corporation should issue you a Schedule K-1-P and Schedule K-1-P(2), showing how much you must claim on the Illinois tax return and where the information is reported on the return.

### ***What if I do not receive a Schedule K-1-P?***

If you do not receive a Schedule K-1-P, you should contact the partnership or S corporation and ask them to send you the information. You may wish to keep documentation of all attempts you make to obtain your K-1-P information.

If you do not receive the information by the original due date of your tax return, you may wish to take advantage of six month automatic filing extension (seven months for corporations). However, if you will owe tax, you must file Form IL-505-I, Automatic Extension Payment for Individuals, or Form IL-505-B, Automatic Extension Payment (for businesses) and make any tax payment by the original due date of the tax return.

If you receive Schedule K-1-P information after you have filed an original tax return, you must file an amended return to include the pass-through income or loss.

### ***Can the partnership or S corporation file on my behalf?***

If you are a nonresident individual and have no other Illinois income, the partnership or S corporation may include your income and pay your tax liability on Form IL-1023-C, Composite Income and Replacement Tax Return. Contact the partnership or S corporation to find out if the entity provides this service and if you are included or eligible to be included.

If you are a partner or shareholder in more than one pass-through entity with Illinois income, you must join in a composite return for every one of them or none of them, except in the case where a pass-through entity has received prior written permission from us to include you on its composite return, even though you are filing your own return to report your other Illinois income

If you are an Illinois resident individual, you are generally not eligible to be included in a composite filing. You must file the appropriate tax return and include any distributions listed on the Schedule K-1-P. In rare circumstances, the partnership or S corporation may petition the department to allow an Illinois resident individual to be included in on the composite return. However, the petition must be submitted and approved prior to the filing of the tax return.

### **What if I received income from an “investment partnership?”**

For tax years ending before December 31, 2004, an investment partnership and its partners are treated the same as all other partnerships and their partners. For those years, any income passed through to you from an investment partnership is taxable to Illinois as indicated by the partnership on the K-1-P that it issued to you.

For tax years ending on or after December 31, 2004, if you are a nonresident and have invested in an investment partnership, you are not subject to Illinois tax on your income from the partnership unless you are conducting a business within Illinois and invested in the partnership in connection with that business. In that case, you would include your income from the partnership in your business income and apportion it to Illinois in the same manner as any other business income.

### **What if I have not filed a tax return?**

If you have not filed an Illinois income tax return and should have, you should file the necessary tax return and schedules as soon as possible. If any tax is owed to Illinois, penalty and interest may be assessed.

There is no statute of limitations for us to assess tax on someone who has not filed a return. However, if a nonfiler participates in our voluntary disclosure program, we will only collect taxes for the last four years. See Form BOA-2, Application for Voluntary Disclosure, for more information.

### **What tax return must I file?**

If you are a(n)	you should file Form
Individual (married or single)	IL-1040, Individual Income Tax Return.  Illinois nonresidents must also file Schedule NR.
Trust or Estate	IL-1041, Fiduciary Income and Replacement Tax Return.  Illinois nonresidents must also file IL-1041 Schedule NR.
Corporation	IL-1120, Corporation Income and Replacement Tax Return.  Unitary Groups must also file Schedule UB, Combined Apportionment for Unitary Business Group.
Subchapter S corporation	IL-1120-ST, Small Business Corporation Replacement Tax Return, including Schedule B and Form IL-2569.
Partnership	IL-1065, Partnership Replacement Tax Return, including Schedule B and Form IL-2569.

Additional schedules and information may be required. For more information, see the instructions for the specific tax form you are filing.

## **Special Programs**

### **Does Illinois have a nonfiler program, specifically for pass-through entity income?**

Yes. The Illinois Department of Revenue uses the partner and shareholder information obtained from the Schedule B and Schedule BC to ensure that taxpayers who have received income from Illinois sources have filed the appropriate tax return and paid any required tax liability. Taxpayers who have not filed an Illinois tax return and should have, may receive a Nonfiler Notice or a Notice of Proposed Tax Due. Penalties and interest may be assessed according to Illinois law. If taxpayers do not respond to these notices, the tax, penalty, and interest will be deemed assessed, and the taxpayer will be referred for collection activity. Collection activity can result in property liens, frozen assets and accounts, and wage garnishments.

### **I received a Nonfiler Notice or Notice of Proposed Tax Due and believe that the partnership or S corp included me on a composite return. What should I do?**

If the partnership or S corporation included you in a composite return, they should have sent you a copy of the Form IL-1023-C they filed with the department for your records. Send us a copy of that Form IL-1023-C showing that you were included.

**Office locations**

Maine North Regional Building  
 9511 Harrison Street FA 203  
 Des Plaines, Illinois 60016-1563  
 847 294-4200

200 South Wyman Street  
 Rockford, Illinois 61101-1237  
 815 987-5210

James R. Thompson Center  
 Concourse Level  
 100 West Randolph Street  
 Chicago, Illinois 60601-3274  
 312 814-5232

Willard Ice Building  
 101 West Jefferson  
 Springfield, Illinois 62702  
 800 732-8866  
 217 782-3336

15 Executive Drive  
 Business Center One, Suite 2  
 Fairview Heights, Illinois 62208-1331  
 618 624-6773


2309 W. Main  
 Suite 114  
 Marion, Illinois 62959-1196  
 618 993-7650

**Out-of-state office location**

Century Plaza  
 45 Eisenhower Drive  
 Suite 2  
 Paramus, New Jersey 07352-1416  
 201 845-0255

**For information or forms**

Visit our web site at [tax.illinois.gov](http://tax.illinois.gov).  
 Call us at **1 800 732-8866** or **217 782-3336**.  
 Call our TDD (telecommunications device for the deaf) at **1 800 544-5304**.  
 Write us at Illinois Department of Revenue, P.O. Box 19044, Springfield, IL 62794-9044.  
 Call our 24-hour Forms Order Line at **1 800 356-6302**.

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