

IT 11-03

Tax Type: Income Tax

Issue: Statute of Limitations Application

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS

THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS

v.

JOHN DOE AND JANE DOE,

Taxpayer

No.
Account ID
Letter ID
Tax Year

Ted Sherrod
Administrative Law Judge

RECOMMENDATION FOR DISPOSITION

Appearances: Special Assistant Attorney General Ralph Bassett on behalf of the Illinois Department of Revenue; John Doe, *pro se*.

Synopsis:

This cause arose from a protest filed by John Doe (“John Doe”) and Jane Doe (“taxpayers”) contesting a Notice of Deficiency (“NOD”) issued by the Department on February 1, 2010. This NOD was issued pursuant to the provisions of the Illinois Income Tax Act (“IITA”), 35 ILCS 5/101 *et seq.* It arose from the Department’s adjustment of the taxpayers’ Illinois net income to conform to net income reported on the taxpayers’ federal individual income tax return. The issue in this case is whether the taxpayers were permitted by the IITA to amend their return for 2007 to file as “married filing separately” for that tax year ended 12/31/07 after filing their original return as “married filing jointly” and, thereafter, amending their original return after the extended due date for filing their original return for 2007 had passed.

During the hearing, the Department introduced documents supporting its determination and John Doe, one of the taxpayers, testified and introduced several documents into the record. I have reviewed the evidence, and am including in this recommendation findings of fact and conclusions of law. I recommend that the NOD at issue in this case be finalized as issued.

Findings of Fact:

1. The Department's *prima facie* case, inclusive of all jurisdictional elements, is established by the Department's Notice of Deficiency Letter ID number XXXXXXXX dated February 1, 2010, which proposed a deficiency in the amount of \$3,058 for tax year 2007. Department Exhibit ("Ex.") 1.
2. The Department's Notice of Deficiency is based upon its determination that the taxpayer failed to include in its Illinois taxable income all of its income included in its federal return. *Id.*
3. Throughout the tax year 2007, Jane Doe was a resident of Illinois residing in Bensenville, Illinois. Department Ex. 3 (2007 Schedule NR).
4. The taxpayers timely filed their U.S. 1040 Individual Income Tax Return for the tax year 2007 with the filing status of "married filing jointly." Department Ex. No. 2, 3.
5. The taxpayers timely filed their IL-1040 Individual Income Tax Return for the tax year 2007 with the filing status of "married filing jointly." Department Ex. 3. The taxpayers attached to this return a 2007 Schedule NR on which they excluded \$88,461 of federally reported income (\$184,135) as income earned by a non-resident or part-year resident of Illinois based upon John Doe's purported status as a Nevada resident employed in that state during 2007. *Id.* (2007 Schedule NR). The taxpayers subsequently filed an

amended return in Illinois due to an adjustment by the Internal Revenue Service which increased the taxpayers' 2007 taxable income. Transcript of Hearing ("Tr.") pp. 6, 10. On this return, the taxpayers also reported their filing status as "married filing jointly." Tr. p. 6.

6. On February 8, 2010, the taxpayers filed a second amended return on form IL-1040-X, Amended Individual Income Tax Return for the tax year 2007, stating that: "I would like to amend my Illinois State Tax return to exclude the Nevada income earned by my spouse, John Doe, who has moved to Nevada in April of 2007 ... [.]"¹ Department Ex. 2. This IL-1040-X amended return excluded John Doe's income earned in Nevada during the 2007 year. *Id.*

Conclusions of Law:

For 2007, the taxpayers, John Doe and Jane Doe, filed their federal 1040 Individual Income Tax Return as "married filing jointly." Department Ex. 2, 3. The taxpayers also filed their Illinois IL-1040 Individual Income Tax Return as "married filing jointly" for the 2007 tax year. The issue presented in this case is whether, by electing to file "married filing jointly" on their original return, the taxpayers forfeited their right to file separate individual income tax returns in Illinois for 2007.²

¹ The Department is not contesting the taxpayers' claim that John Doe, one of the taxpayers, was a part-year resident of Nevada during the 2007 tax year.

² The taxpayers also filed a Schedule NR with their 2007 original return on which John Doe claimed to be a part-year resident of Illinois during that year. However, the instructions to Schedule NR plainly indicate that a claim of non-resident status through the submission of this schedule is not permitted where taxpayers are filing a joint return and one of the spouses was an Illinois resident during the tax year. Since Jane Doe was a resident of Illinois in 2007, the taxpayers could not properly file a Schedule NR for the 2007 tax year. See Department Ex. 2 (2007 Schedule NR, Step 1, item 3).

Within the Illinois Income Tax Act (“IITA”), the Illinois legislature has provided, generally, that an Illinois taxpayer must report items on his Illinois return in the John Doe manner as such items are reported on his federal return. 35 ILCS 5/401-5/403. However, there are exceptions to this general rule, and the Illinois legislature has expressed certain specific exceptions within the IITA itself. One of the instances in which the legislature has made an express exception to the general rule is within IITA section 502, which sets forth, among other things, which persons must file Illinois income tax returns. Subsection (c) (1) of section 502 provides the general rule and subsection (c) (3) provides the express exception:

Section 502. Returns and Notices...(c) Joint returns by husband and wife.

(1) Except as provided in paragraph (3), if a husband and wife file a joint federal income tax return for a taxable year they shall file a joint return under this Act for such taxable year and their liabilities shall be joint and several, but if the federal income tax liability of either spouse is determined on a separate federal income tax return, they shall file separate returns under this Act. ...

x x x

(3) If either husband or wife is a resident and the other is a non- resident, they shall file separate returns in this state on such forms as may be required by the Department in which event their tax liability shall be separate; but they may elect to determine their joint net income and file a joint return as if both were residents and in such case, their liability shall be joint and several. 35 ILCS 5/502(c).

As is evident, IITA section 502(c) (3) provides an express, limited exception to the general rule requiring married individuals who file joint federal returns to file Illinois returns in the John Doe manner. This statutory section provides the exclusive procedure the Illinois legislature has prescribed for a married person with an Illinois reporting obligation that has filed a federal joint return to have his or her Illinois income tax liability calculated separately from the potential liability of his or her spouse. In this way, the Illinois legislature has taken into account and provided for the possibility that, in a given tax year, an individual residing in Illinois might

marry another individual who is not an Illinois resident, or that one, and only one, spouse might have a different domicile or residence than the other spouse. The Illinois legislature clearly intended that married individuals be allowed to file separate Illinois returns under such circumstances, and that such persons could have their individual income tax liabilities calculated separately, if they followed the procedures set forth in section 502(c)(3).

However, the record in this case clearly shows that the taxpayers did not file separate IL-1040 Individual Income Tax Returns in Illinois and, therefore, did not follow the procedures prescribed for filing separate returns in Illinois provided for in section 502(c) (3). Because the taxpayers filed their federal returns as married filing jointly, the only statutorily allowed manner in which the taxpayers could have had their Illinois income tax liabilities calculated separately would have been by filing separate Illinois individual income tax returns as “married, filing separately”. 35 ILCS 5/502(c) (3). They did not do so on their original Illinois income tax return. Department Ex. 3. Therefore, they failed to meet the requirements of section 502(c) (3).

Since 502(c)(3) is the only statutorily prescribed procedure for filing separate returns where a federal joint return has been filed, there is no statutory basis for the taxpayers’ claim that they must be allowed to file separate returns for the tax year at issue.

The taxpayers have admitted that they filed their original returns “married filing jointly.” Tr. p. 9. However, the taxpayers contend that this filing was erroneous and that they corrected this “error” by filing an amended return after their original return was due, but within the statutory period for filing amended returns prescribed by the Instructions to Form IL-1040-X. Tr. p. 27. (“This error was corrected later on by filing ...[an]...1040-X, which is corrected within the three years as permitted by the instructions of the 1040-X.”). The Department contends that the taxpayers waived their right to report, or to have any of their individual

incomes realized during 2007 computed, as though one of the taxpayers, John Doe, was a part-year resident of Illinois, by failing to file their original return electing the status “married filing separately.” Tr. p. 32. A logical corollary of the Department’s contention is that, because the taxpayers filed their 2007 income tax return jointly, they were not allowed to file an amended return after their original return was due reducing their tax for the 2007 tax year as if they had originally each filed separate returns. Consequently, the fact that they nevertheless filed such an amended return purporting to reduce their liability within 3 years of filing their original return provides no basis for the relief the taxpayers seek.

As noted above, the correctness of the Department’s claim that the taxpayers could not have their individual tax liabilities calculated separately based on their amended return because they filed their original return “married filing jointly” is plainly evident from the language contained in section 502(c)(3). Consequently, Illinois law clearly supports the Department’s determination that the taxpayers could not treat their original filing as erroneous and subsequently file an amended return after their original return was due excluding non-resident income based upon an alleged “error” contained in their original return.

As noted by the Department (tr. p. 8), the IITA provides that “[T]he term regulations includes rules promulgated and forms prescribed by the Department.” 35 ILCS 5/1501(a) (19). Moreover, the Department’s regulations (including instructions to Department forms) have the force and effect of law. Craftmasters, Inc. v. Department of Revenue, 269 Ill. App. 3d 934 (4th Dist. 1995). Since the filing instructions to form IL-1040-X address the timeliness of an amended return changing a taxpayer’s filing status, they provide an additional source of legal authority regarding the issue presented in this case.

The Department's instructions for filing an IL-1040-X state that "you must file your Illinois return using the John Doe filing status as your federal return". They further provide that: "There is one exception to this rule. If one spouse is an Illinois resident and the other is a non-resident, taxpayers can file 'married filing separately' unless they elect to file a joint return. If taxpayers elect to file a joint return, they can revoke the election at any time prior to the extended due date of the return by filing form IL-1040-X." (emphasis added) See Taxpayers' Ex. No. 6 (Form IL-1040-X Instructions). The extended due date for the taxpayers' 2007 return was October 15, 2008. 35 ILCS 5/505(a)(2).

In the instant the case, the taxpayers filed their federal form 1040 for 2007 as "married filing jointly." The taxpayers then filed their IL-1040 as "married filing jointly." After filing in Illinois as "married filing jointly" the taxpayers apparently wished to revoke this election. Department Ex. No. 2. As noted above, while the instructions for filing a 2007 IL-1040-X state that this election can be revoked, they expressly indicate that it must be revoked prior to October 15, 2008, the extended due date for the 2007 return. The taxpayer did not seek to revoke this election until after this limitations period had expired.

Taxpayers wishing to exclude income earned as a nonresident must file a Schedule NR with their Illinois returns. However, the instructions to the Schedule NR plainly state that this form cannot be filed, if a joint return is being filed. See 2007 Schedule NR (IL-1040) Instructions – Nonresident and Part-Year Resident Computation of Tax. The taxpayers contend that the inclusion of a Schedule NR with their original Illinois IL-1040 excluding John Doe's income earned in Nevada from the taxpayers' original Illinois joint return, proves that the taxpayers never intended to elect to file "married filing jointly" and that doing so was an obvious error.

Given the fact that the taxpayers filed their return as a joint return and that John Doe never filed a separate return reporting his Nevada income, the inclusion of the Schedule NR with the taxpayers' original return was, at best, ambiguous. See footnote 2. Moreover, even if the taxpayers' Illinois individual income tax return contained an obvious error the Illinois law offers no provision requiring the Department to correct such an error in the absence of the timely filing of an amended return by the taxpayer. Indeed, the Illinois courts have admonished against fashioning ad hoc remedies to provide equitable relief after a statute of limitations for correcting an error in a taxpayer's return has run, by barring the making of exceptions to a statute of limitations which toll the statute's limitations period or enlarge its scope. Dow Chemical Co. v. Department of Revenue, 224 Ill. App. 3d 263, 268-69 (1st Dist. 1991). Consequently, the Department cannot now fashion relief that ignores the bar presented by the limitations period for amending the taxpayers' filing status based upon the purported obvious error in the taxpayers' original return that the taxpayer allege they have identified.

The taxpayers filed their Illinois amended return seeking to amend their election of their filing status to "married filing separately" from "married filing jointly" for tax year 2007 on February 8, 2010. Department Ex. No. 2. The instructions to the form IL-1040-X the taxpayers filed make it clear that this filing is beyond the extended due date for a 2007 amended return that seeks to amend the taxpayers' filing status. Taxpayers have not suggested, and my research does not indicate, any Illinois case law or other authority where an extended due date has been further extended to allow taxpayers who have filed a joint return to revoke their election and file as "married filing separately." Accordingly, Illinois law does not permit any discretion in this matter and requires that the extended due date be strictly adhered to as the deadline for amending

a return to change a taxpayer's Illinois filing status from "married filing jointly" to "married filing separately" where a federal joint return has been filed.

In sum, it is undisputed that the taxpayers elected to file their 2007 Illinois return as married filing jointly in the John Doe manner as their federal return, and did not timely amend this election in accordance with the instructions to form IL-1040-X. As a consequence, the taxpayers waived the right to report, or have any of their individual incomes realized during 2007, treated as though either of them was a part-year resident or non-resident of Illinois. Form IL-1040-X Instructions. See also Dow Chemical Co., *supra*.

WHEREFORE, for the aforementioned reasons, I recommend that the Director finalized the Notice of Deficiency at issue in this case, with interest to accrue pursuant to statute.

Ted Sherrod
Administrative Law Judge

Date: May 10, 2011