

IT 14-05

Tax Type: Income Tax

Tax Issue: Properly Determined AGI For Individual Taxpayers

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

**THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS**

v.

**JOHN DOE,
TAXPAYER**

**No. XXXX
Account ID XXXX
Letter ID XXXX
XXXX
XXXX
XXXX
Tax Years.: 2002-2005**

DIRECTOR'S DECISION

I have determined that the Administrative Law Judge's Order finding in favor of the Taxpayer is based on an erroneous interpretation of the Department's Statute, 35 ILCS 5/203. Therefore, pursuant to 86 Ill. Admin. Code, § 200.165, I reject that decision and issue the following decision.

Synopsis:

This matter involves protests filed by the taxpayer, JOHN DOE ("taxpayer"), contesting Notices of Deficiency the Illinois Department of Revenue ("Department") issued to him assessing tax deficiencies for the calendar tax years 2002 through 2005. The Notice of Deficiency for 2002 assessed tax, penalties and interest for the taxpayer's failure to file an Illinois Individual Income Tax Return for that year. By agreement of the parties reached at the commencement of the

hearing in this case, the Department has agreed to withdraw this Notice of Deficiency based upon the taxpayer's agreement to submit the missing return and related schedules.

The Department's assessments for calendar tax years 2003, 2004 and 2005 assess tax, penalty and interest based upon the taxpayer's underreporting of federal Adjusted Gross Income and the resulting underreporting of Illinois base income and net income for each of those years. A hearing in this matter was held at the Department's offices in Chicago, Illinois on April 13, 2012, during which the taxpayer offered testimony. Following a review of this testimony, and documents of record, I have determined that the Notices of Deficiency should be upheld. In support of this recommendation, the following "findings of fact" and "conclusions of law" are made.

Findings of Fact

1. The Department's *prima facie* case, inclusive of all jurisdictional elements, is established by the admission into evidence of the Department's Notices of Deficiency issued on September 21, 2010 assessing the taxpayer tax, penalty and interest for the tax years ended December 31, 2002 through December 31, 2005. Department Ex. 1A - ID.
2. For the calendar tax years 2003 through 2005, taxpayer, an Illinois resident, timely filed U.S. Individual Income Tax Form 1040 returns and Illinois Form IL-1040. Department Ex. 2 (Auditor's Comments), 4-9. In connection with the filing of his federal returns for each of the calendar tax years 2003 and 2004, the taxpayer included a federal Schedule C "Profit or Loss From Business" with his U.S. Individual Income Tax Form 1040, reporting business expenses exceeding business income. Department Ex. 7, 8. In connection with the filing of his federal return for calendar tax year 2005, the taxpayer

included a federal Schedule E "Supplemental Income and Loss" with his U.S. Individual Income Tax Form 1040, reporting expenses from rental of real estate exceeding business income from this activity. Department Ex. 9. These deductions were claimed for expenses relating to the taxpayer's operation of an investment consulting business in the calendar tax years 2003 and 2004, and for expenses related to the taxpayer's rental of real estate during calendar tax year 2005. Department Ex. 7-9. The deductions in excess of income offset gross income from other sources, reducing the taxpayer's Adjusted Gross Income reported for federal income tax purposes for each of those years. *Id.*

3. In computing his Illinois state income tax liability for each of the tax years at issue, the taxpayer included his Adjusted Gross Income reported on his U.S. Individual Income Tax Form 1040 returns on line 1 of his Illinois IL-1040. Department Ex. 2 (Auditor's Comments), 4, 5, 8, 9.
4. The Department conducted an audit of the taxpayer's IL-1040 returns for each of the calendar tax years 2003 through 2005. Department Ex. 2 (Auditor's Comments). At the conclusion of this audit, the Department determined that the taxpayer should not have taken business expense deductions and deductions related to the rental of real property in the amounts reported on the taxpayer's Federal U.S. Individual Income Tax Form 1040 returns for each of those years. *Id.* It determined that the amounts shown as losses on the taxpayer's Schedule C filed with its federal income tax returns for each of the calendar taxable years 2003 and 2004 were overstated. *Id.* It also determined that the taxpayer overstated the amount of his loss from rental of real property on his Schedule E filed with his federal income tax return for 2005. *Id.* 5.
5. The adjustments to the taxpayer's federal income tax returns determined by the Department

had the effect of increasing the taxpayer's federal Adjusted Gross Income for each of the tax years in question and therefore increased the taxpayer's Illinois net income, resulting in deficiencies in taxes for each taxable year, which the Department assessed by issuing Notices of Deficiency on September 21, 2010. Department Ex. 1A through ID.

6. The taxpayer presented no evidence that the Department's determination of his Adjusted Gross Income for any of the taxable years in question was erroneous.
7. The record in this case contains no evidence that the IRS reviewed the taxpayer's federal income tax returns or asserted any adjustment should be made to the Adjusted Gross Income reported on those returns for any of the taxable years at issue.

Conclusions of Law

Section 201(a) and (b) of the Illinois Income Tax Act (35 ILCS 5/201) imposes the tax on the "net income" of the taxpayer for a taxable year. Section 202 of the Illinois Income Tax Act (35 ILCS 5/202) provides:

For purposes of this Act, a taxpayer's net income for a taxable year shall be that portion of his base income for such year which is allocable to this State under the provisions of Article 3, less the standard exemption allowed by Section 204 and the deduction allowed by Section 207.

Section 203(a)(1) of the Illinois Income Tax Act (35 ILCS 5/203) provides:

In the case of an individual, base income means an amount equal to the taxpayer's adjusted gross income for the taxable year as modified by paragraph (2).

Section 203(e)(1) of the Illinois Income Tax Act provides, in part:

[F]or purposes of this Section and Section 803(e), a taxpayer's gross income, adjusted gross income, or taxable income for the taxable year shall mean the amount of gross income, adjusted gross income or taxable income properly reportable for federal income tax purposes for the taxable year under the provisions of the Internal Revenue Code. (emphasis added)

Section 403(b) of the Illinois Income Tax Act (35 ILCS 5/403) provides:

A final determination pursuant to the Internal Revenue Code adjusting any item or items of income, deduction or exclusion for any taxable year shall be correct for purposes of this Act to the extent such item or items enter into the determination of base income.

The Department determined that the amount of adjusted gross income reported by the taxpayer on each of his Illinois income tax returns for the tax years in question was less than the amount “properly reportable” on his federal income tax returns for each year. The taxpayer presented no evidence challenging this determination, but instead argued that the Department must accept the amounts he reported on his federal income tax returns for the year. However, Section 403(b) of the Illinois Income Tax Act, by deeming a final determination under the Internal Revenue Code making an adjustment to an item of a taxpayer’s income to be correct for purposes of the Illinois Income Tax Act necessarily implies that, when no adjustment has been made to an item, the Department may review the item and adjust it if necessary to cause the taxpayer’s adjusted gross income to be the amount “properly reportable.” In this case, there is no evidence that any review or final determination was made of any of the taxpayer’s federal income tax returns for the tax years in question.

The Department therefore has the authority to make adjustments to the taxpayer’s adjusted gross income amounts for each of the years in question, and the taxpayer has presented no evidence that the Department’s adjustments were incorrect. Accordingly, the Department’s determination must be upheld.

Because the decision rendered by the Administrative Law Judge is based upon an erroneous interpretation of the Department's statute, pursuant to 86 Ill. Admin. Code, § 200.165, I reject that decision.

Respectfully submitted,

Brian Hamer
Director of Revenue