

IT 95-85

Tax Type: INCOME TAX

Issue: Federal Change (Corporation)  
1005 Penalty (Reasonable Cause Issue)

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

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DEPARTMENT OF REVENUE      )
STATE OF ILLINOIS         )
                           )   Docket:
      v.                   )
                           )
XXXXXX                    )
                           )   Wendy S. Paul
                           )   Admin. Law Judge
      Taxpayer(s)         )
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RECOMMENDATION FOR DISPOSITION

SYNOPSIS: This matter comes on for hearing pursuant to taxpayer's timely protest of a Notice of Deficiency issued by the Department on January 30, 1995. The Notice asserted tax deficiencies based upon a final federal change which increased taxpayer's federal taxable income for taxable year ending December 31, 1989. In its Protest, taxpayer did not contest its increase in federal taxable income and submitted payment in the amount of \$1,882, which was the amount of deficiency it contended was due, as a result of its increased federal taxable income. It asserted, however, that the computations contained in the Department's Notice of Deficiency were incomplete because the Department should have applied a net operating loss carryforward from tax year ended 10/31/87 and a net operating loss carryback from tax year ended 12/31/90.

At issue are the questions 1) whether taxpayer is timebarred from reducing its increased income by a net operating loss carryforward from taxable year ended 10/31/87 and a net operating loss carryback from taxable year ended 12/31/90, or any other tax years, without having filed claims to do so; and 2) whether penalties pursuant to 35 ILCS 5/1005 should be

assessed.

A hearing was held on June 22, 1995. Following the submission of all evidence and a review of the record, it is recommended that this matter be resolved in favor of the Department.

FINDINGS OF FACT:

1. Taxpayer is engaged in the practice of certified public accountancy. (Dept. Ex. No. 4; Taxpayer Ex. No. 1)

2. XXXXX is the president of taxpayer and is a sole practitioner. (Dept. Ex. No. 4; Taxpayer Ex. No. 2; Tr. p. 3)

3. For tax year ended 12/31/89, taxpayer's federal taxable income (Line 1) was increased as a result of a federal change which was finalized on June 11, 1992. (Dept. Ex. No. 3, 4)

4. The federal change arose out of a federal audit which culminated in a closing agreement with the Internal Revenue Service and which was executed on behalf of taxpayer by XXXXX, president, on June 11, 1992. (Dept. Ex. No. 4)

5. The Department's Notice of Deficiency asserts an increased tax liability for taxable year ended 12/31/89 based upon the final federal change. (Dept. Ex. No. 3)

6. In its Protest, filed on February 10, 1995, taxpayer did not contest the increase to Line 1 and submitted payment in the amount of \$1,882, which the Department applied to taxpayer's 1989 tax deficiency. (Dept. Ex. No. 4, 6)

7. Taxpayer has never filed a Form IL-1120-X or any other form to notify the Department of the federal change, as required by Section 506 of the Illinois Income Tax Act (35 ILCS 5/506(b)).

8. Taxpayer has never filed Forms IL-1120-X or other forms to notify the Department of its intention to carry net operating losses from taxable year ended 10/31/87 or 10/31/90 to the taxable year here at issue (tax year

ended 12/31/89). (Dept. Ex. No. 4; Taxpayer Ex. No. 1; Tr. p. 11)

9. There was no evidence that net operating losses for taxable years ended 10/31/87 or 10/31/90 were available for carryforward or carryback purposes.

10. In the Protest, XXXXX requested an abatement of penalties proposed pursuant to 35 ILCS 5/1005, and stated that there was no intention to avoid payment of taxes. He stated that the tax obligation "fell between the cracks" as a result of extreme time pressures in his business as a sole practitioner during the federal audit through the end of 1994. He also stated that his time was further consumed by the care of his elderly mother who died on December 29, 1994. (Dept. Ex. No. 4)

CONCLUSIONS OF LAW: The tax deficiency asserted in the Notice of Deficiency is based upon a final federal change which increased taxpayer's federal taxable income (Line 1), which accordingly increased its base income and its state income tax liability.

Taxpayer is not disputing the federal change which increased its federal taxable income, but contends that the Department should have reduced its base income by applying a net operating loss carryforward from tax year ended 10/31/87 and a net operating loss carryback from tax year ended 12/31/90. The Department contends that the statute of limitations (35 ILCS 5/911(b)) precluded taxpayer from filing amended returns to apply these losses to the tax year at issue and that, without such returns or other official notification from taxpayer, the Department could not have applied the losses on its own to the tax year at issue.

Where, as here, a taxpayer's federal taxable income is altered or redetermined federally, and such change affects the computation of Illinois base income, the taxpayer is required to notify the Department by amended return or such other form as the Department may by regulations prescribe, not later than 120 days after the federal change has been finalized. 35

ILCS 5/506(b). Here, under this statute, notification of taxpayer's final federal change was due on or before October 9, 1992 (not later than 120 days after June 11, 1992). Taxpayer, however, did not provide such notification.

The applicable statute of limitations ((35 ILCS 5/911(b)) provides, in pertinent part, as follows:

Federal changes. (1) In general. In any case where notification of an alteration is required by Section 506(b), a claim for refund may be filed within 2 years after the date on which such notification was due (regardless of whether such notice was given). . .

Under the above statute, taxpayer should have filed a claim by October 9, 1994 in order to apply any net operating losses from the other tax years to the tax year at issue. Having failed to do so, it is now barred.

The Department was not obligated to, and should not have, applied the losses on its own without notification from the taxpayer. Assuming that there were net operating losses from tax years ended 10/31/87 and 10/31/90, taxpayer would have had the option of utilizing such losses as either carryover or carryback deductions in the manner allowed under Section 172 of the Internal Revenue Code. 35 ILCS 5/207. Without a claim or other notification filed by taxpayer, there was no way for the Department to determine how the loss deductions, if available, were to have been applied.

Taxpayer contended that the statute of limitations (35 ILCS 5/911) is inapplicable as it was not making a claim for refund in seeking to have the losses from other years applied to the year at issue. This contention is without merit. By seeking to apply the losses from other years to the year at issue, taxpayer is actually seeking a credit against the tax deficiency. The statute of limitations governing claims for refund (35 ILCS 5/911) is also applicable to claims for credit. For example, Section 911(a) sets out a 3 year limitation period for a "claim for refund". Section 911(b) then states:

No credit or refund shall be allowed or made with respect to the year for which the claim was filed unless such claim was filed unless such claim is filed within such period. [emphasis added]

Accordingly, this issue should be resolved in favor of the Department.

Taxpayer also contended that reasonable cause existed for abatement of penalties under 35 ILCS 5/1005. The existence of reasonable cause justifying abatement of a penalty is a factual determination that can only be decided on a case by case basis (Rorabaugh v. United States, 611 F. 2d 211 (7th Cir.,1979)) and has generally been interpreted to mean the exercise of ordinary business care and prudence (Dumont Ventilation Company v. Department of Revenue, 99 Ill.App.3d 263 (3rd Dist. 1981)). The burden of proof is upon the taxpayer to show by a preponderance of the evidence that it acted in good faith and exercised ordinary business care and prudence in providing for the timely payment of its tax liability.

As grounds for abatement of the penalties pursuant to 35 ILCS 5/1005, taxpayer relied upon personal and business time pressures. I do not find, however, that taxpayer presented sufficient evidence to support a finding of reasonable cause sufficient to abate the penalties.

On a personal level, taxpayer cited and relied upon the sickness and eventual death of XXXXX's mother during 1993 and 1994 and upon problems relating to the alcoholism of his 28-year-old daughter beginning at the end of 1993 and continuing into 1994. (Taxpayer Ex. No. 2; Tr. p. 16) These problems, however, occurred well after the lapse of the statutory 120 day period (35 ILCS 5/506(b)). Certainly the exercise of ordinary business care and prudence by a tax practitioner engaged in certified public accountancy in Illinois would at a minimum have included compliance with the statutory filing deadline.

At the business level, taxpayer cited what it characterized as a heavy workload by a sole practitioner during 1991 through 1994, which was summarized in a schedule (Taxpayer Ex. No. 2). I do not find that any of

the scheduled items, either alone or together, constitute a sufficient basis for abatement of the Section 1005 penalties. While some matters were possibly atypical, there were none so extraordinary as to excuse the timely filing and/or payment of income tax, especially by a tax practitioner well aware of its state tax obligations.

In conclusion, the tax deficiencies and penalties as proposed in the Notice of Deficiency should be upheld in their entirety.

Wendy S. Paul  
Administrative Law Judge

Date