

IT 97-17
Tax Type: INCOME TAX
Issue: Exemption (Federal) On Government Securities
Reasonable Cause Asserted on Application of Penalties

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

THE DEPARTMENT OF REVENUE)	
OF THE STATE OF ILLINOIS,)	
Petitioner)	No.
)	
v.)	FEIN:
)	
TAXPAYER)	Linda K. Cliffler,
)	Admin. Law Judge
Taxpayer)	
)	

RECOMMENDATION FOR DISPOSITION

APPEARANCES: Jill A. Dougherty of Kelly, Olson, Michod & Siepker, for TAXPAYER; Robert C. Asbille, Special Assistant Attorney General, for the Illinois Department of Revenue.

SYNOPSIS:

The instant case arose as a result of an audit conducted by the Illinois Department of Revenue (hereinafter referred to as the "Department") of TAXPAYER and TAXPAYER, Inc. (hereinafter referred to collectively as "TAXPAYER" or "Taxpayers") for the years ended 12/31/89, 12/31/90 and 12/31/91.

Notices of Deficiency were issued to TAXPAYER Savings & Loan and TAXPAYER on July 13, 1993 in the amounts of \$975,154 and \$411, respectively, inclusive of interest and penalties. A timely protest was filed by taxpayer on September 10, 1993.

The primary issue in this case, whether the interest earned by TAXPAYER ("TAXPAYER" or "taxpayer") on its daily investment deposit ("DID") account with the Federal Home Loan Bank of Chicago ("FHLB") is exempt from state taxation under section 13 of the Federal Home Loan Bank Act, 12 U.S.C. §1433, was resolved in favor of the Department upon cross-motions for summary judgment. The order of partial summary judgment is incorporated in this recommendation.

The only remaining issue at hearing was whether the Section 1005 penalties should be abated for reasonable cause.

FINDINGS OF FACT:

1. KPMG Peat Marwick ("Peat Marwick") acted as TAXPAYER's accountants and prepared their federal and state tax returns during the years at issue. (Tr. p. 7)
2. TAXPAYER had no tax department of its own for the relevant period. (Tr. p. 7)
3. Vincent Lanuza was the head of Peat Marwick's thrift tax practice for the 1989 through 1991 period. (Tr. p. 7)
4. Mr. Lanuza testified that he, TAXPAYER WITNESS, the tax partner for TAXPAYER, and others in the state and local tax group jointly made the decision to deduct the DID account interest as a subtraction modification on the Illinois income tax returns for the taxpayers. (Tr. pp. 7-8)
5. Mr. Lanuza testified he based his advice on his analysis of the Illinois statute, the federal statute which defined interest on notes, securities and other obligations, and court decisions. (Tr. pp. 8-12)

CONCLUSIONS OF LAW:

Section 1005 of the Illinois Income Tax Act provides that:

...If any amount of tax required to be shown on a return prescribed by this Act is not paid on or before the date required for filing such return (determined without regard to any extension of time to file), a penalty shall be imposed at the rate of 6% per annum upon the tax underpayment unless it is shown that such failure is due to reasonable cause. This penalty shall be in addition to any other penalty determined under this Act...

Federal case law interprets "reasonable cause" for purposes of I.R.C. Section 6664(c) relating to the waiver of penalties. Following the advice of a tax professional may constitute reasonable cause if it was reasonable for the taxpayer to rely on professional advice under the circumstances, and the taxpayer did so in good faith. Vorsheck v. Commissioner, 933 F.2d 757 (9th Cir. 1991); Heasley v. Commissioner, 902 F.2d 38 (5th Cir. 1990).

In this case, taxpayers employed a major accounting firm, KPMG Peat Marwick, to prepare their tax returns. Its expert in the area of taxation of thrift institutions, Vincent Lanuda, testified that he, and others at Peat Marwick, made the determination that DID account interest was properly deductible as a subtraction modification under Illinois law based on his review of the statute, and relevant federal authority. Mr. Lanuda also testified that at the time the tax returns were filed he was unaware of any cases either in Illinois or elsewhere which were contrary to the position taken. (Tr. p. 11) In fact, it has only been with a recent Illinois Appellate Court decision involving the same taxpayer that this issue has been resolved. See TAXPAYER v. Wagner, 286 Ill. App. 3d 521 (1st Dist. 1996).

Taxpayers had no tax department of their own and Peat Marwick was their accountant and tax preparer. Mr. Lanuda testified he discussed this position with TAXPAYER WITNESS , the executive vice president of TAXPAYER Savings and Loan, and TAXPAYER followed his advice. I find that taxpayers' reliance on Mr. Lanuda's opinion of the meaning of the term "other obligations" was clearly reasonable in light of his expertise and the extent of his analysis. Taxpayers have shown reasonable cause for their filing position and therefore, the Section 1005 penalties are abated.

WHEREFORE, for the reasons stated above, it is my recommendation that the Notice of Deficiency should be affirmed in accord with the Order of Partial Summary Judgment, but that the Section 1005 penalties be abated for reasonable cause.

Date:

Linda K. Cliffler
Administrative Law Judge