

General Information Letter: Reduction in tax liability payable to another state, resulting in a decrease in the credit allowed for taxes paid to other states, does not open a new limitations period in the manner of a federal change.

July 8, 2008

Dear:

This is in response to your letter dated May 5, 2008, in which you request a General Information Letter (GIL). A GIL is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), which may be accessed from the Department's web site at www.ILtax.com.

Your letter states as follows:

Mr. X is an individual and an Illinois resident for income tax purposes for all relevant tax years. In 2002, Mr. X also paid income tax to a foreign state ("State Y"). Mr. X timely filed his 2002 Illinois resident income tax return (Form IL-1040), and properly took a foreign tax credit, pursuant to Illinois Income Tax Act Section 601(b)(3), for the amount of income tax paid to State Y. During the first half of 2005, State Y audited Mr. X, and assessed additional income tax, which he paid at that time. Later in 2005, Mr. X amended his 2002 Illinois Form IL-1040 to reflect the additional tax he paid to State Y by increasing the amount of his foreign tax credit. Based on the amended Illinois return, Mr. X received a refund from Illinois.

Due to a 2007 State Y ruling clarifying a law that affected Mr. X's 2002 State Y tax liability, Mr. X timely applied for a refund of the full amount of taxes paid to State Y for 2002 (both the taxes paid with the original nonresident return and the taxes paid on the 2005 State Y audit). In 2008, State Y partially granted Mr. X's request for refund of taxes paid to State Y for the 2002 tax year.

The question I would like you to answer is whether Mr. X must now amend his 2002 Illinois resident income tax return to reflect the reduction in the foreign tax credit for taxes paid to State Y. We believe that since the three-year statute of limitations for assessment of additional Illinois tax for 2002 has run, Mr. X is not required to amend his 2002 Illinois return. This contention is also based on our belief that the filing of the Illinois amended return in 2005 did not restart or extend the statute of limitations on assessment of additional tax for the 2002 year.

Although we have not been able to find any cases or rulings addressing this question specifically, there are Illinois rulings dealing with the opposite situation, i.e. where a taxpayer requested an Illinois refund after the expiration of the Illinois three-year statute of limitations for taxes paid to a foreign state. And in those rulings, it was held that the taxpayer's refund claims were time-barred. For example, in one ruling, the Illinois resident taxpayers received a notice of deficiency from North Dakota regarding income with respect to which the taxpayers already paid Illinois income tax. The Illinois Department of Revenue ("DOR") indicated that the Illinois foreign tax credit was available to ameliorate double taxation, but that the taxpayer could only claim a refund from Illinois for taxes already paid to Illinois if the three-year statute of limitations for doing so was still open.

Thus, if the taxpayers cannot obtain a refund for foreign taxes paid following the expiration of

the statute of limitations, we would also assume that they are not required to pay additional taxes as a result of a foreign tax refund if the three-year period for filing an Illinois amended return has expired. Here, therefore, we believe that even though State Y refunded the amount of tax that Mr. X paid to State Y for the 2002 tax year, Mr. X is not required to file an amended Illinois return for the 2002 tax year. We are asking you to confirm this conclusion in a General Information Letter.

RULING

Section 601(b)(3) of the Illinois Income Tax Act ("IITA"; 35 ILCS 5/601(b)(3)), allows Illinois residents a credit equal to the aggregate amount of tax which is imposed upon or measured by income and which is paid by a resident for a taxable year to another state or states on income which is also subject to tax under the IITA. Department Regulations Section 100.2197(c)(3) (86 Ill. Adm. Code 100.2197(c)(3)) states that because the Section 601(b)(3) credit is allowed for taxes paid for the taxable year, rather than for taxes paid in or during the taxable year:

Any increase or decrease in the amount of tax paid to another state for a taxable year, as the result of an audit, claim for refund, or other change, shall increase or decrease the amount of credit for that taxable year, not for the taxable year in which the increase or decrease is paid or credited.

In addition, Regulations Section 100.2197(g)(1) states:

Any person claiming the credit under IITA Section 601(b)(3) shall attach a statement in support thereof and shall notify the Director of any refund or reductions in the amount of tax claimed as a credit under IITA Section 601(b)(3) all in such manner and at such time as the Department shall by regulations prescribe. No credit shall be allowed under this Section for any tax paid to another state nor shall any item of income be included in base income subject to tax in that state except to the extent the amount of such tax and income is evidenced by the following documentation attached to the taxpayer's return (or, in the case of an electronically filed return, to the taxpayer's Form IL-8453, Illinois Individual Income Tax Electronic Filing Declaration), amended return or claim for refund:

- (1) Unless otherwise provided in this subsection (g), a taxpayer claiming the credit must attach a copy of the tax return filed for taxes paid to the other state or states to the taxpayer's Illinois income tax return, Form IL-8453, amended return or claim for refund.

Under this provision, taxpayers who claimed a credit under IITA Section 601(b)(3) for taxes paid to another state must file an amended return where all or part of the creditable tax paid to the other state or states is refunded in order to report the accompanying reduction to the allowable credit.

IITA Section 905(a) states, in general, that a notice of deficiency shall be issued no later than 3 years after the date the return was filed, and that no deficiency may be assessed or collected with respect to the year for which the return was filed unless such notice is issued within that 3-year period. For purposes of this rule, Department Regulations Section 100.9320(h) provides that a return filed before the last day prescribed by law for filing (including any extensions of time for filing) shall be deemed filed on such last day. The last day prescribed by law for filing returns shall take into account any

automatic extensions of time for filing.

IITA Section 905(g) states that in the case of an erroneous refund of tax, a notice of deficiency may be issued at any time within 2 years from the making of such refund, or within 5 years if any part of the refund was induced by fraud or material misrepresentation. The amount of any proposed assessment set forth in a notice issued under IITA Section 905(g) is limited to the amount of the erroneous refund.

In this case, although Mr. X is required under Regulations Section 100.2197(g) to file an amended return reducing the amount of the claimed Section 601(b)(3) credit, the Department is precluded under IITA Section 905 from issuing a notice of deficiency for either the increased 2002 tax resulting from the credit reduction or the 2005 erroneous refund.

As stated above, this is a GIL. A GIL does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you have questions regarding this GIL you may contact Legal Services at (217) 782-7055. If you have further questions related to Illinois income tax laws, visit our website at www.revenue.state.il.us or contact the Department's Taxpayer Information Division at (217) 782-3336.

Sincerely,

Brian L. Stocker
Staff Attorney (Income Tax)