

General Information Letter: Acceptance without adjustment by the IRS of items on a taxpayer's federal return is not binding on the Department.

April 6, 2009

Dear:

This is in response to your letter dated December 23, 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 at www.revenue.state.il.us.

Your letter states as follows:

We are writing to request a General Information Letter under 2 Ill. Adm. Code 1200.120 to confirm our understanding of adjustments that may be made by the Department of Revenue to a corporate taxpayer's Illinois income tax liability for prior tax years after a federal income tax audit and formal closing agreement under IRC 7121.

Facts:

Assume the following facts:

1. Corporation A, which has been an Illinois income taxpayer for many years on a separate company non-unitary basis, was audited for federal income tax purposes for 2003, 2004, 2005, and 2006.
2. Corporation A entered into a comprehensive settlement of the issues with IRS and this comprehensive settlement was embodied in a closing agreement under IRC 7121. Some of the issues that had been raised by IRS on audit were completely conceded by Corporation A, some were completely conceded by IRS, and others were divided in various ways depending upon the issue.
3. At the time of the closing agreement, the period of limitations for the Illinois Department of Revenue to issue a notice of deficiency had expired under IITA 905 for 2003 and 2004.
4. The original federal income tax returns filed by Corporation A for 2003 and for 2006 showed federal taxable income, and the original federal income tax return filed for 2004 and 2005 showed a net operating loss. The closing agreement increased the taxable income in 2003 and 2006 and decreased the net operating loss in 2004 and 2005.
5. Corporation A's Illinois income tax returns for each year were filed on or about the fully extended due date of October 15 of the year following. Corporation A has not signed any extensions of the limitations periods under IITA 905(f). Therefore, the years 2003 and 2004 were closed under Illinois' standard three year statute of limitations at the time the closing agreement was signed.

Issue 1

Would the various adjustments against Corporation A that are embodied in the closing

agreement all be required to be reported and tax paid by Corporation A?

Conclusion 1

Yes, because of the federal changes being finalized, Corporation A would be required to file amended Illinois income tax returns and pay whatever Illinois income tax might result for 2003, 2004, 2005, and 2006 from the changes mutually agreed to by Corporation A and the IRS in the closing agreement. This notification through amended return and tax payment would be required to be made within 120 days of the closing agreement. In addition, Corporation A would also be required, again within 120 days of the closing agreement, to file amended returns and pay whatever Illinois income tax might result for any other year besides the four mentioned above which would be affected by a change in the Illinois net loss deduction on either a carry back or carry forward basis as a result of the change in federal taxable income or net operating loss for 2003, 2004, 2005, and 2006.

Authority for Conclusion 1

The authority for the conclusions stated above is found in IITA Section 506(b).

Issue 2

If the Illinois Department of Revenue were to conclude that, unlike the IRS, it would have chosen not to concede a particular issue that had been raised by the IRS audit team for 2003 or 2004, would the Department be able to issue a notice of deficiency to Corporation A for 2003 or 2004 for any Illinois income tax related to that issue in 2003 or 2004? Consider this situation as potentially arising because Illinois Department of Revenue has a somewhat different opinion than IRS audit had concerning the relative strength of this particular issue in the context of all of the issues that were under consideration. Also consider this issue as potentially arising not only with an issue that was conceded by IRS but also with respect to an issue which was divided in the closing agreement between IRS and Corporation A.

Conclusion 2

Even though the Department might want to pursue an adjustment that the IRS had conceded in 2003 and 2004, it would not be able to issue a notice of deficiency for either of those years based on such an adjustment.

Authority for Conclusion 2

The authority for the conclusion stated immediately above is found in IITA Section 905(a) and IITA Section 905(e)(2).

Issue 3

Issue 3 concerns the same adjustment discussed in Issue 2 and only those adjustments. These are adjustments in 2003 or 2004 that had been conceded by the IRS audit team, but which were nevertheless of interest to Illinois Department of Revenue. Would the Department issue a notice of deficiency for a later year that was open under IITA Section 905(a) to reduce

a net loss carry forward deduction to the extent of the 2003 or 2004 adjustment that IRS had conceded on audit?

Conclusion 3

The Department would not issue a notice of deficiency in a later open year on such an adjustment from 2003 or 2004, because the Department would accept federal taxable income as finally determined by IRS as the starting point for computation of Corporation A's Illinois income tax liability. For the Department to assert this adjustment to Illinois net loss carry forward deductions from 2003 or 2004 that Corporation A might have claimed in 2005, 2006 or 2007 or might yet claim in later years' Illinois returns would constitute looking behind the final determination of federal taxable income by IRS in 2003 and 2004 as embodied in the closing agreement.

Authority for Conclusion 3

The authority for the conclusion stated immediately above is 86 Ill. Adm. Code 100.9200(a)(4).

Issue 4

If the Illinois Department of Revenue were able to conclude that, unlike the IRS, it would not have chosen to concede a particular issue that had been raised by the IRS audit team for 2005 or 2006, would the Department issue a notice of deficiency to Corporation A for 2005 or 2006 for any Illinois income tax related to that issue in 2005 or 2006? As with Issue 2, consider this situation as potentially arising because Illinois Department of Revenue has a somewhat different opinion than IRS audit has concerning the relative strength of this particular issue in the context of all of the issues that were under consideration. Also consider this issue as potentially arising not only with an issue that was conceded by IRS but also with respect to an issue which was divided in the closing agreement between IRS and Corporation A.

Conclusion 4

Even though the Department might want to pursue an adjustment that the IRS had conceded in 2005 and 2006, it would not issue a notice of deficiency for either of those years based on such an adjustment. This is because the Department would accept federal taxable income as finally determined by IRS and embodied in the closing agreement as the starting point for computation of Corporation A's Illinois income tax liability. For the Department to assert one of these adjustments in 2005 or 2006 that the IRS had conceded or split in entering into the closing agreement would constitute looking behind the final determination of federal taxable income by IRS in those years.

Authority for Conclusion 4

The authority for the conclusion stated immediately above is 86 Ill. Adm. Code 100.9200(a)(4).

RULING

IITA Section 506(b) states in pertinent part:

A person shall notify the Department if ... the taxable income, any item of income or deduction, the income tax liability, or any tax credit reported in a federal income tax return of that person for any year is altered by amendment of such return or as a result of any other recomputation or redetermination of federal taxable income or loss, and such alteration reflects a change or settlement with respect to any item or items, affecting the computation of such person's net income, net loss, or of any credit provided by Article 2 of this Act for any year under this Act.

...

Such notification shall be in the form of an amended return or such other form as the Department may by regulations prescribe, shall contain the person's name and address and such other information as the Department may by regulations prescribe, shall be signed by such person or his duly authorized representative, and shall be filed not later than 120 days after such alteration has been agreed to or finally determined for federal income tax purposes or any federal income tax deficiency or refund, tentative carryback adjustment, abatement or credit resulting therefrom has been assessed or paid, whichever shall first occur.

Regarding Issue 1, Corporation A would be required to file the notification required under IITA Section 506(b) for its 2003, 2004, 2005, and 2006 taxable years. In addition, notification would be required with respect to other taxable years in which Corporation A's Illinois net income or Article 2 credits are affected as a result of the federal changes made to the 2003 through 2006 taxable years. For example, a change in the Illinois net operating loss for 2003 that results from adjustments to federal taxable income may necessitate notification with respect to the 2007 taxable year to report a change in the net operating loss deduction.

IITA Section 905(a) states:

Except as otherwise provided in this Act:

- (1) A notice of deficiency shall be issued not later than 3 years after the date the return was filed, and
- (2) No deficiency shall be assessed or collected with respect to the year for which the return was filed unless such notice is issued within such period.

IITA Section 905(e)(2) states:

On and after August 13, 1999, in any case where notification of an alteration is given as required by Section 506(b), a notice of deficiency may be issued at any time within 2 years after the date such notification is given for the taxable year for which the notification is given or for any taxable year to which the taxpayer may carry an Article 2 credit, or a Section 207 loss, earned, incurred, or used in the year for which the notification is given, provided, however, that the amount of any proposed assessment set forth in such notice shall be limited to the amount of any deficiency resulting under this Act from recomputation of the taxpayer's net income, Article 2 credits, or Section 207 loss earned, incurred or used in the taxable year for which the notification is given after giving effect to the item or items reflected in the reported alteration.

IITA Section 903(a)(3) states:

If an amended return or report is filed with the Department pursuant to section 506(b), any deficiency in tax under this Act resulting therefrom shall be deemed to be assessed on the date of filing such report or amended return and such assessment shall be timely notwithstanding any other provisions of this Act.

Although the IITA does not define the term “deficiency,” Section 904(a) states:

If the Department finds that the amount of tax shown on the return is less than the correct amount, it shall issue a notice of deficiency to the taxpayer which shall set forth the amount of tax and penalties proposed to be assessed.

Accordingly, a deficiency of Illinois income tax is generally equal to the amount by which the correct tax imposed under the IITA exceeds the tax shown by the taxpayer on the return. Where the limitations period for issuing a notice of deficiency is closed under IITA Section 905(a), Section 905(e)(2) provides an additional 2 years for issuing a notice of deficiency in the case where proper notification of a federal change is given. The section limits the amount of deficiency that may be assessed in this situation to the amount that results from recomputing the taxpayer’s net income by giving effect to the items reflected in the federal change notification. In other words, in determining the correct tax only the items reflected in the federal change notification may be considered. Sections 905(e)(2) and 903(a)(3) provide for notice of deficiency and assessment for the amount of additional tax that results from such recomputation.

Regarding Issue 2, assuming that the limitations period for issuing a notice of deficiency is otherwise closed under IITA Section 905 with respect to Corporation A’s 2003 and 2004 taxable years, Section 905(e)(2) does not extend that period for any deficiency that may otherwise be computed by taking into account items not reflected in the federal change notification.

Regarding Issue 3, the general rule is that the Department may determine the correct Illinois net income or loss with respect to a taxable year for which the limitations period for issuing a notice of deficiency is closed for the purpose of determining the correct Illinois net loss deduction for a taxable year for which the limitations period is open. See Hill v. Commissioner, 95 T.C. 437 (1990) and Calumet Indus., Inc. v. Commissioner, 95 T.C. 257, 276-277 (1990). The determination of correct Illinois net income or loss for a closed year may include adjustments to one or more items included in a taxpayer’s federal taxable income. Under IITA Section 203(e), the starting point in computing the base income of a corporation is the amount of taxable income properly reportable for federal income tax purposes under the Internal Revenue Code. Regarding this section, Department Regulations Section 100.9200(a)(4) states in pertinent part:

[I]t shall be the Department’s position and practice to rely upon and accept the federal Internal Revenue Service determination as to the amount of a taxpayer’s adjusted gross or taxable income and the number of exemptions to which he is entitled for federal income tax purposes. Adherence to that position shall be subject to exception only in rare circumstances such as where the Internal Revenue Service for some reason (e.g. where no change in federal tax liability would result) might fail or decline to act, or where the 18-month statutory period of limitations for prosecution would expire before action by IRS.

Based on the facts you have presented, there is not sufficient information to determine whether rare circumstances exist with respect to Corporation A’s 2003 or 2004 taxable years that may cause the

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Department to depart from its general practice of adherence to an IRS determination of a taxpayer's federal taxable income.

Similarly regarding your Issue 4, the facts you have presented are not sufficient to determine whether rare circumstances exist with respect to Corporation A's 2005 or 2006 taxable years that may cause the Department to depart from its general practice of adherence to an IRS determination of a taxpayer's federal taxable income.

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 further questions regarding this GIL, please call (217) 782-7055. If you have additional questions regarding Illinois income tax laws, please visit the Department's website at www.Iltax.com.

Sincerely,

Brian L. Stocker
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