

IT 13-03

Tax Type: Income Tax

Tax Issue: Reasonable Cause On Application of Penalties

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

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

v.

JANE DOE

Taxpayer

**Docket # XXXX
Letter ID: XXXX
Letter ID: XXXX
Reporting Period: 12/05**

RECOMMENDATION FOR DISPOSITION

Appearances: Jennifer Kieffer, Special Assistant Attorney General, for the Department of Revenue of the State of Illinois; Jane Doe, *pro se*

Synopsis:

The Department of Revenue (“Department”) issued two Notices of Deficiency (“NODs”) to Jane Doe (“taxpayer”) alleging that the taxpayer owes income tax, plus penalties and interest, for the tax year ending December 31, 2005.¹ The taxpayer timely protested the NOD², and an evidentiary hearing was held during which the parties agreed that after taking into account the taxpayer’s exemptions, credits, and tax withheld by her employer, the taxpayer is entitled to a refund of \$XXX before any penalties are imposed. The only remaining penalty is a late filing penalty in the amount of \$XXX. The taxpayer has requested that the penalty be abated due to

¹ The two NODs are identical except for the Letter ID numbers and the addresses for the taxpayer (*i.e.*, each NOD was sent to a different address). (Dept. Ex. #1, #9)

² The taxpayer filed a timely protest in response to the one NOD that was sent to her mother’s address. (Dept. Ex. #9; Tr. pp. 7-8)

reasonable cause. After reviewing the record, it is recommended that this matter be resolved in favor of the taxpayer.

FINDINGS OF FACT:

1. The taxpayer's adjusted gross income for the tax year ending December 31, 2005 was \$XXXX. (Stipulation, tr. pp. 4-5)
2. For the tax year ending December 31, 2005, the taxpayer was entitled to three exemptions, an education expense credit in the amount of \$XXX, and an earned income credit in the amount of \$XXX. The taxpayer also had Illinois income tax withheld by her employer in the amount of \$XXX. After taking all of these into account, the taxpayer is entitled to a refund of \$XXX before any penalties are imposed. (Stipulation, tr. pp. 4-6)
3. On March 18, 2010, the Department received an amended return, Form IL-1040-X, for the taxpayer for the tax year ending December 31, 2005. (Dept. Ex. #1, p. 3; Dept. Ex. #9, p. 3)
4. The taxpayer's amended return for 2005 indicates that the taxpayer's address is Anywhere A. Line 34 of the amended return states "Explain, in detail, the reason(s) for filing this amended return." The typed response was "ADDRESS HAS ERRORS."³ (Dept. Ex. #2, pp. 1-2)
5. On September 13, 2010, the Department issued a Taxpayer Notification Response ("Notification") to the taxpayer at the following address: Anywhere B. The Notification

³ The other information on the amended return also indicates that the only reason for filing the amended return was to report an address change. The return shows the same information to which the parties have agreed in Findings of Fact numbers 1 and 2. In other words, it indicates that the taxpayer's adjusted gross income for the year was \$XXXX, and the taxpayer was entitled to three exemptions, an education expense credit in the amount of \$XXX, and an earned income credit in the amount of \$XXX. In addition, the amended return indicates the taxpayer had Illinois income tax withheld by her employer in the amount of \$XXX. Furthermore, the amended return shows, on line 15, that the total of all "previous overpayments, refunds, or credit carryforward" was \$XXX (*i.e.*, the same refund amount to which the parties agree the taxpayer is entitled). Finally, lines 26 and 27 of the amended return, which show whether the taxpayer is due a refund or owes additional taxes as a result of the amended return, both show "0". (Dept. Ex. #2, pp. 1-2)

indicates that it is regarding the taxpayer's 2005 amended tax return and that the Department did not receive the taxpayer's 2005 original return. The Notification asks the taxpayer for additional documents and for a response within 30 days. (Dept. Ex. #8, p. 3)

6. The taxpayer did not respond to the Notification within 30 days. (Dept. Ex. #1, p. 3; Dept. Ex. #9, p. 3)
7. On May 12, 2011, the Department issued a Notice of Deficiency, Letter ID: XXXX, to the taxpayer at the following address: Anywhere C. The NOD alleges that the taxpayer owes \$XXXX, including interest and penalties, for the year ending December 31, 2005. The NOD was admitted into evidence under the certificate of the Director. (Dept. Ex. #9, pp. 1-5)
8. On May 12, 2011, the Department issued another Notice of Deficiency, Letter ID: XXXX, to the taxpayer at the following address: Anywhere D, Illinois. The NOD alleges that the taxpayer owes \$XXXX, including interest and penalties, for the year ending December 31, 2005. The NOD was admitted into evidence under the certificate of the Director. (Dept. Ex. #1, pp. 1-5)
9. The late filing penalty in the amount of \$XXX is the only remaining amount at issue in this matter. (Tr. p. 6)

CONCLUSIONS OF LAW:

The Department imposed the late filing penalty pursuant to section 3-3 of the Uniform Penalty and Interest Act ("UPIA") (35 ILCS 735/3-1 *et seq.*) Subsection (a-10) of section 3-3 provides, in relevant part, as follows:

This subsection (a-10) is applicable to returns due on and after January 1, 2001. A penalty equal to 2% of the tax required to be shown due on a return, up to a maximum amount of \$250, reduced by any tax that is paid on time or by any credit that was properly allowable on the date the return was required to be filed, shall be imposed for failure to file the tax return on or before the

due date prescribed for filing determined with regard for any extension of time for filing. However, if any return is not filed within 30 days after notice of nonfiling mailed by the Department to the last known address of the taxpayer contained in Department records, an additional penalty amount shall be imposed equal to the greater of \$250 or 2% of the tax shown on the return. However, the additional penalty amount may not exceed \$5,000 and is determined without regard to any part of the tax that is paid on time or by any credit that was properly allowable on the date the return was required to be filed (penalty for late filing or nonfiling). ... 35 ILCS 735/3-3(a-10).

The Department's regulations and notices refer to the two different late filing penalties in section 3-3(a-10) as first tier and second tier penalties (*i.e.*, Tier 1 and Tier 2 penalties). See 86 Ill. Admin. Code §700.300(c); §700.400(e)(12)(A). The NODs that were issued to the taxpayer explain the penalties as follows:

We are imposing a late-filing or nonfiling penalty because you did not file a processable return by the due date (including any extended due date). This penalty is figured using a two-tier formula. The first tier is equal to the lesser of \$XXX or 2 percent of the tax required to be shown due on your return, with regard to any payments and credits. This tier is imposed the day after the original due date of your return, including any extended due date. The second tier is equal to the greater of \$XXX or 2 percent of the tax shown on the return, determined with regard to any payments and credits, and may be imposed up to a maximum of \$5,000. *This tier may be imposed only if you did not timely respond to our original notification that your return cannot be processed or that your return has not been filed.* This tier is imposed in addition to the first tier. Emphasis added; Dept. Ex. #1, p. 3; Dept. Ex. #9, p. 3.

In the present case, the Department did not assess the Tier 1 penalty. The first tier penalty is equal to the lesser of \$XXX or 2 percent of the tax required to be shown due on the return, reduced by any tax that is paid on time or by any credit that was properly allowable on the date the return was required to be filed. Because the parties agreed that after considering the credits and withholding taxes the taxpayer is entitled to a refund of \$XXX, this penalty is zero. The taxpayer, therefore, does not owe the Tier 1 penalty.

The Department did, however, assess the Tier 2 penalty. This penalty of \$XXX was assessed because the taxpayer did not timely respond to the Taxpayer Notification Response that

was sent on September 13, 2010. As the following discussion indicates, the taxpayer has established reasonable cause for abating this penalty.

Section 3-8 of the UPIA provides a basis for abating penalties and states, in relevant part, as follows:

The penalties imposed under the provisions of Sections 3-3, 3-4, and 3-5 of this Act shall not apply if the taxpayer shows that his failure to file a return or pay tax at the required time was due to reasonable cause. Reasonable cause shall be determined in each situation in accordance with the rules and regulations promulgated by the Department. 35 ILCS 735/3-8.

The Department's regulation concerning reasonable cause provides, in part, as follows:

e) Examples of Reasonable Cause. The following non-exclusive list of situations will constitute reasonable cause for purposes of the abatement of penalties:

...

12) The following occurrences are situations involving reasonable cause with respect to the imposition of the Tier 2 late filing penalty:

A) Taxpayer demonstrates that he or she did not receive the penalty notice. If the taxpayer can show that he or she filed a change of address card, tax return, payment or letter with the Department and the Department still sent the notice to the wrong address, penalty abatement may be warranted. ... 86 Ill. Admin. Code §700.400(e)(12)(A).

The taxpayer has established reasonable cause under this provision because the Department sent the Notification to the wrong address after the taxpayer filed her amended return. The Department provided a copy of the amended return that the taxpayer filed on March 18, 2010. (Dept. Ex. #2, pp. 1-2) The taxpayer's address on the amended return was Anywhere A, and the sole reason for filing the amended return was stated on Line 34 as "ADDRESS HAS ERRORS." In response to the amended return, the Department sent the Notification concerning the failure to file the original return to a different address: Anywhere B. The taxpayer testified

that she did not remember receiving the Notification because she was not living at that address at the time it was issued. (Tr. pp. 12-13)

The only reason for imposing the \$XXX Tier 2 penalty was because the taxpayer did not respond to the Notification within 30 days. The Department, however, did not send the Notification to the last known address of the taxpayer that was contained in Department records (*i.e.*, the address on the amended return). Instead, the Department sent the Notification to a different address. These facts are the same as those in the example of reasonable cause found in section 700.400(e)(12)(A) of the Department's regulation, and these facts warrant abating the penalty.

Recommendation:

For the foregoing reasons, it is recommended that the late filing penalty of \$XXX be abated. In addition, based on the stipulation of the parties, the NOD should be dismissed.

Linda Olivero
Administrative Law Judge

Enter: May 16, 2013